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UNITED STATES – SUBSIDIES ON UPLAND COTTON

Recourse to Article 21.5 of the DSU by Brazil

Report of the Panel

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Brazil – Aircraft (Article 21.5 – Canada)	Appellate Body Report, *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/AB/RW, adopted 4 August 2000, DSR 2000:VIII, 4067
Brazil – Aircraft (Article 21.5 – Canada)	Panel Report, *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW, adopted 4 August 2000, as modified by Appellate Body Report, WT/DS46/AB/RW, DSR 2000:IX, 4093
Canada – Aircraft (Article 21.5 – Brazil)	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/AB/RW, adopted 4 August 2000, DSR 2000:IX, 4299
Canada – Aircraft (Article 21.5 – Brazil)	Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/RW, adopted 4 August 2000, as modified by Appellate Body Report, WT/DS70/AB/RW, DSR 2000:IX, 4315
Canada – Dairy	Panel Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, WT/DS103/R, WT/DS113/R, adopted 27 October 1999, as modified by Appellate Body Report, WT/DS103/AB/R, WT/DS113/AB/R, DSR 1999:VI, 2097
Canada – Dairy (Article 21.5 – New Zealand and US)	Panel Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Recourse to Article 21.5 of the DSU by New Zealand and the United States*, WT/DS103/RW, WT/DS113/RW, adopted 18 December 2001, as reversed by Appellate Body Report, WT/DS103/AB/RW, WT/DS113/AB/RW, DSR 2001:XIII, 6865
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EC – Bed Linen (Article 21.5 – India)	Appellate Body Report, *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by India*, WT/DS141/AB/RW, adopted 24 April 2003, DSR 2003:III, 965
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US – FSC (Article 21.5 – EC II)	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Second Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW2, adopted 14 March 2006
US – FSC (Article 21.5 – EC II)	Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Second Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/RW2, adopted 14 March 2006, upheld by Appellate Body Report, WT/DS108/AB/RW2
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US – Oil Country Tubular Goods Sunset Reviews (Article 21.5 – Argentina)	Appellate Body Report, *United States – Sunset Reviews of Anti-Dumping Measures on Oil Country Tubular Goods from Argentina – Recourse to Article 21.5 of the DSU by Argentina*, WT/DS268/AB/RW, adopted 11 May 2007
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US – Softwood Lumber IV (Article 21.5 – Canada)	Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada – Recourse by Canada to Article 21.5 of the DSU*, WT/DS257/AB/RW, adopted 20 December 2005
US – Softwood Lumber VI (Article 21.5 – Canada)	Appellate Body Report, *United States – Investigation of the International Trade Commission in Softwood Lumber from Canada – Recourse to Article 21.5 of the DSU by Canada*, WT/DS277/AB/RW, adopted 9 May 2006
US – Upland Cotton	Appellate Body Report, *United States – Subsidies on Upland Cotton*, WT/DS267/AB/R, adopted 21 March 2005
US – Upland Cotton	Panel Report, *United States – Subsidies on Upland Cotton*, WT/DS267/R, and Corr.1, adopted 21 March 2005, as modified by Appellate Body Report, WT/DS267/AB/R

Short Title	Full Case Title and Citation
US – Wool Shirts and Blouses	Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R and Corr.1, adopted 23 May 1997, DSR 1997:I, 323

I. INTRODUCTION

1.1 On 18 August 2006, Brazil requested the establishment of a panel pursuant to Article 21.5 of the Dispute Settlement Understanding ("DSU") concerning the alleged failure of the United States to implement the recommendations and rulings of the Dispute Settlement Body ("DSB") in *US – Upland Cotton*.[1]

1.2 At its meeting of 28 September 2006 the DSB decided, in accordance with Article 21.5 of the DSU, to refer this matter, if possible, to the original panel.

1.3 The terms of reference of the Panel are the following:

> "To examine, in the light of the relevant provisions of the covered agreements cited by Brazil in document WT/DS267/30, the matter referred to the DSB by Brazil in that document, and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."

1.4 On 18 and 20 October 2006, Brazil and the United States respectively requested the Director-General to determine the composition of the Panel in accordance with Article 8.7 of the DSU. Article 8.7 of the DSU provides:

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

1.5 On 25 October 2006, the Director-General determined the composition of the Panel as follows:

Chairman: Mr. Eduardo Pérez Motta

Members: Mr. Mario Matus
Mr. Ho-Young Ahn.[2]

1.6 Argentina, Australia, Canada, Chad, China, the European Communities, India, Japan, New Zealand, and Thailand reserved their rights to participate in the Panel proceedings as third parties.

1.7 The Panel met with the parties to the dispute on 27-28 February 2007. The Panel met with the third parties on 28 February 2007.

1.8 The Panel submitted its interim report to the parties on 27 July 2007 and submitted its final report to the parties on 15 October 2007.

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[1] WT/DS267/30.
[2] WT/DS267/31.

II. BACKGROUND

2.1 This dispute concerns the disagreement between Brazil and the United States, within the meaning of Article 21.5 of the DSU, as to "the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings" of the DSB in *US – Upland Cotton*.[3]

2.2 The report of the original panel in *US – Upland Cotton* was circulated to Members on 8 September 2004.

2.3 The original panel found that certain measures of the United States were inconsistent with the *Agreement on Agriculture* and/or the Agreement on Subsidies and Countervailing Measures ("*SCM Agreement*").

2.4 *First*, the original panel found that export credit guarantees under the GSM 102, GSM 103 and SCGP export credit guarantee programmes[4] were inconsistent with Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement* in respect of exports of upland cotton and other unscheduled agricultural products supported under these programmes and in respect of one scheduled product (rice).[5] The original panel also found that in respect of exports of unscheduled agricultural products not supported under the programmes and other scheduled agricultural products, export credit guarantees under the GSM 102, GSM 103 and SCGP export credit guarantee programmes were not inconsistent with Articles 10.1 and 8 of the *Agreement on Agriculture*.[6]

2.5 *Second*, the original panel found that section 1207(a) of the Farm Security and Rural Investment Act of 2002 ("FSRI Act of 2002") providing for user marketing (Step 2) payments to exporters of upland cotton was inconsistent with Articles 3.3 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*[7] and that section 1207 (a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users of upland cotton was inconsistent with Articles 3.1(b) and 3.2 of the *SCM Agreement*.[8]

2.6 *Third*, the original panel found that the effect of certain mandatory, price-contingent subsidy measures of the United States[9] was significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement* in the same world market constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*.[10]

[3] As discussed below, the United States considers that certain claims of Brazil are not properly within the scope of this proceeding because they do not pertain to a disagreement regarding "the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings". *Infra*, Section IX.B.

[4] See *infra*, paras. 3.13-3.16.

[5] Panel Report, *US – Upland Cotton*, paras. 7.875, 7.881 and 8.1(d)(i).

[6] Panel Report, *US – Upland Cotton*, paras. 7.896 and. 8.1(d)(ii). Thus the Panel concluded that these export credit guarantees were exempt from actions based on Article XVI of the GATT 1994 and Article 3 of the *SCM Agreement*.

[7] Panel Report, *US – Upland Cotton*, paras. 7.749, 7.760-7.761 and 8.1(e).

[8] Panel Report, *US – Upland Cotton*, paras. 7.1097-7.1098 and 8.1(f).

[9] Marketing loan programme payments, user marketing (Step 2) payments, market loss assistance payments and counter-cyclical payments. See *infra*, paras. 3.7-3.11.

[10] Panel Report, *US – Upland Cotton*, paras. 7.1416 and 8.1(g)(i).

2.7 In respect of the measures found to be inconsistent with the *Agreement on Agriculture*, the original panel recommended pursuant to Article 19.1 of the DSU that the United States bring its measures into conformity with the *Agreement on Agriculture*.[11]

2.8 In respect of the measures found to be subsidies prohibited under Articles 3.1(a) and 3.2 and 3.1(b) and 3.2 of the *SCM Agreement*, the original panel recommended pursuant to Article 4.7 of the *SCM Agreement* that the United States withdraw the prohibited subsidy without delay, i.e. at the latest within six months of the date of adoption of the panel report by the DSB or 1 July 2005, whichever was earlier.[12]

2.9 In respect of the measures subject to the finding of significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement* constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*, the original panel stated the following:

> "[W]e recall that, in respect of the subsidies subject to our conclusion in paragraph 8.1(g)(i) above, pursuant to Article 7.8 of the *SCM Agreement*:
>
>> '7.8 Where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member within the meaning of Article 5, the Member granting or maintaining such subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy.'
>
> Accordingly, upon adoption of this report, the United States is under an obligation to 'take appropriate steps to remove the adverse effects or ... withdraw the subsidy'."[13]

2.10 The Appellate Body report in the original proceeding in this dispute was circulated to Members on 3 March 2005.

2.11 The Appellate Body upheld the finding in paragraph 7.869 of the original panel report that the export credit guarantee programmes at issue constituted a *per se* export subsidy within the meaning of item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* and the finding in paragraphs 7.947 and 7.948 of the original panel report that these export credit guarantee programmes were inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*.[14] The Appellate Body reversed the finding in paragraph 7.881 of the original panel report that Brazil had not established that the application of export credit guarantees had resulted in actual circumvention of export subsidy commitments for pig meat and poultry meat. The Appellate Body considered that there were insufficient facts in the record to enable it to complete the legal analysis to determine whether the export credit guarantees had been applied in a manner that resulted in actual circumvention of the export subsidy commitments of the United States.[15]

2.12 The Appellate Body upheld the findings in paragraphs 7.1088, 7.1097-7.1098 and 8.1(f) of the original panel report that Step 2 payments to domestic users of upland cotton under section 1207(a) of the FSRI Act of 2002 were inconsistent with Articles 3.1(b) and 3.2 of the *SCM Agreement* and the findings in paragraphs 7.748-7.749, 7.760-7.761 and 8.1(e) of the original panel

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[11] Panel Report, *US – Upland Cotton*, para. 8.3(a).
[12] Panel Report, *US – Upland Cotton*, paras. 8.3(b) and (c).
[13] Panel Report, *US – Upland Cotton*, para. 8.3(d).
[14] Appellate Body Report, *US – Upland Cotton*, paras. 674 and 763(e)(iv).
[15] Appellate Body Report, *US – Upland Cotton*, paras. 693-694 and 763(f)(i).

report that Step 2 payments to exporters of US upland cotton under section 1207(a) of the FSRI Act of 2002 were inconsistent with Articles 3.3 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*.[16]

2.13 The Appellate Body upheld the finding in paragraphs 7.1416 and 8.1(g)(i) of the original panel report that the effect of certain price contingent subsidies was significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*.[17]

2.14 On 21 March 2005, the DSB adopted the report of the Appellate Body in *US – Upland Cotton* and the report of the original panel, as modified by the Appellate Body report.

III. FACTUAL ASPECTS

A. PRODUCTS AT ISSUE

3.1 The original panel described the products at issue as follows:

> "This dispute principally concerns alleged United States subsidies in respect of 'upland cotton' (*Gossypium hirsutum*). This is defined in relevant United States legislation as:
>
> > 'Planted and stub cotton that is produced from other than pure strain varieties of the Barbadense species, any hybrid thereof, or any other variety of cotton in which one or more of these varieties predominate.'
>
> In relation to Brazil's claims that United States export credit guarantee measures constitute export subsidies under the *Agreement on Agriculture* and the *SCM Agreement*, the dispute concerns upland cotton and other eligible agricultural products as well."[18] (footnotes omitted)

3.2 In this compliance dispute, there is no disagreement between the parties on the description of upland cotton, and thus, the Panel considers that the above description of upland cotton remains accurate.

3.3 The original panel explained that "[u]pland cotton harvested from a field has cotton lint and cottonseed", that "[g]inning involves separating cotton lint from cottonseed", and that "[u]nless otherwise indicated, references in this report to upland cotton ordinarily refer to upland cotton lint."[19] In this proceeding, there is no disagreement between the parties that the term "upland cotton" refers to upland cotton lint.

3.4 While the product at issue in Brazil's claims of serious prejudice is upland cotton, with respect to Brazil's claims under the *Agreement on Agriculture* and the *SCM Agreement* relating to export credit guarantees, this compliance dispute concerns upland cotton and the following products: (i) three agricultural products for which the United States has entered export subsidy reduction

[16] Appellate Body Report, *US – Upland Cotton*, paras. 552, 583-584 and 763(d).
[17] Appellate Body Report, *US – Upland Cotton*, paras. 496 and 763(c).
[18] Panel Report, *US – Upland Cotton*, paras. 7.197-7.198.
[19] Panel Report, *US – Upland Cotton*, footnote 258.

commitments ("scheduled products") – rice, poultry meat and pig meat[20] – and (ii) "unscheduled products" for which export credit guarantees were provided after 1 July 2005.[21]

3.5 The products described in (i) and (ii) in the preceding paragraph as well as upland cotton, all fall within the product coverage of the *Agreement on Agriculture*.[22]

3.6 In addition, three other products (lysine, lyocell and wood products) are the subject of claims by Brazil that the United States provided export subsidies in the form of export credit guarantees, inconsistently with its obligations under the *SCM Agreement*.[23]

B. DEVELOPMENTS CONCERNING THE MEASURES FOUND TO BE WTO-INCONSISTENT BY THE ORIGINAL PANEL[24]

1. User marketing (Step 2) payments, marketing loan payments, market loss assistance payments and counter-cyclical payments

(a) User marketing (Step 2) payments

3.7 The term "user marketing (Step 2) payments" as used in the original panel report refers to payments made under the upland cotton user marketing certificate or "Step 2" programme, a special marketing loan provision for upland cotton in section 1207(a) of the FSRI Act of 2002. This programme provided for marketing certificates or cash payments to eligible domestic users and exporters of eligible upland cotton when certain market conditions existed such that US cotton pricing benchmarks were exceeded.[25] On 1 February 2006, the Congress of the United States adopted legislation repealing the Step 2 subsidy programme for upland cotton effective as of 1 August 2006.[26]

(b) Marketing loan payments

3.8 Marketing loan payments are provided for in sections 1201-1205 of the FSRI Act of 2002. The original panel described these measures as follows:

> "Marketing loan programme payments for upland cotton began in 1986 and have continued under successive legislation, including the Federal Agriculture

[20] The United States requests that the Panel rule that Brazil's claims concerning poultry meat and pig meat are outside the scope of this proceeding. US First Written Submission, paras. 24-30. The Panel addresses this request of the United States below in Section IX.B.2.

[21] Brazil has identified the following products as having benefited from GSM 102 export credit guarantees since 1 July 2005: cotton, oilseeds (including soybeans and soybean meal), protein meals, fresh vegetables, hides/skins, tallow, corn products. Brazil's First Written Submission, para. 450 and note 622.

[22] Article 2 and Annex 1 of the *Agreement on Agriculture*. In particular, the Panel notes that the Agreement covers products under Harmonized System Headings 52.01 to 52.03 (raw cotton, waste and cotton carded and combed).

[23] Brazil included these products in the list of unscheduled products that benefited from GSM 102 export credit guarantees. Following an argument by the United States that these products fall outside the product coverage of the *Agreement on Agriculture*, Brazil indicated that, with respect to these three products, it makes no claims under the *Agreement on Agriculture* but maintains its claims under the *SCM Agreement*. See US Rebuttal Submission, para. 83, Brazil's Response to Panel Question 50 and US Comments thereon. See *infra*, Section XIV.D for the Panel's determination that Brazil's claims concerning these products are outside the scope of these proceedings.

[24] The inclusion of a measure in this section and the terms used to describe the measure are without prejudice to the Panel's position on the preliminary objections raised by the United States with respect to whether certain measures are properly within the scope of this proceeding under Article 21.5 of the DSU.

[25] Panel Report, *US – Upland Cotton*, para. 7.209.

[26] Section 1103 of the Deficit Reduction Act of 2005, reproduced in Exhibit Bra-435.

Improvement and Reform Act of 1996 ('FAIR Act of 1996') and the FSRI Act of 2002. The marketing loan programme is intended to minimize potential loan forfeitures by providing interim financing to eligible producers on their eligible production and facilitate the orderly distribution of eligible commodities throughout the year. Accordingly, rather than selling the crop at harvest when prices tend to be at their lowest, the proceeds of the interim loan enable producers to pay off their expenses when they become due, while storing their pledged harvested crop as collateral and repaying the loan when market conditions are potentially more favourable.

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

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

The repayment rate for marketing loans is the lower of the adjusted world market price and the loan rate plus interest. When the adjusted world market price is lower than the loan rate, the producer repays at less than the loan rate and the difference is referred to as a 'marketing loan gain'. Alternatively, a producer may forego a marketing loan and receive a 'loan deficiency payment' in the amount of the difference between the lower adjusted world market price and the loan rate. Additionally, in October 1999, the FAIR Act of 1996 was amended to include provisions for the issuance of 'commodity certificates', available to producers, including upland cotton producers, to use in acquiring 1998 through 2002 crop collateral pledged to CCC for a commodity loan. Marketing loan gains, loan deficiency payments and commodity certificate exchange gains are collectively referred to below as 'marketing loan programme payments'.

When loans are repaid, the CCC charges interest at a rate 1 per cent higher than the rate it pays the Treasury. The CCC forgives interest and pays storage charges for the loan period when upland cotton under loan is forfeited, and also on redemption of upland cotton under loan where the repayment amount is too low to satisfy the loan amount and those charges."[27] (footnotes omitted)

[27] Panel Report, *US – Upland Cotton*, paras. 7.204-7.208.

3.9 It is not in dispute that the United States continues to provide marketing loan payments to US producers of upland cotton and that the legislative and regulatory provisions governing these marketing loan payments have not been changed.

(c) Market loss assistance payments

3.10 Market loss assistance payments were provided for in four separate pieces of legislation.[28] The original panel described these measures as follows:

> "Market loss assistance ('MLA') payments were made under four separate pieces of legislation, one each for the years 1998 through 2001. They were *ad hoc* emergency and supplementary assistance provided to producers in order to make up for losses sustained as a result of recent low commodity prices.
>
> The 1998 MLA payments were intended essentially as a 50 per cent additional [production flexibility contract] payment. The 1998, 1999 and 2001 Acts each appropriated a dollar amount to assistance which was divided among PFC payment recipients proportionately to their respective previous PFC payment. The 2000 Act provided for payments at the same contract payment rates as the 1999 Act. MLA payments were only made to recipients enrolled in the PFC programmes."[29] (footnotes omitted)

(d) Counter-cyclical payments

3.11 Counter-cyclical payments are provided for in sections 1101-1108 of the FSRI Act of 2002. The original panel described these measures as follows:

> "The counter-cyclical payments ('CCP') programme was also established by the FSRI Act of 2002. It provides support to producers (as defined) based on historical acreage and yields for the same commodities as [direct payments], including upland cotton.
>
> An eligible producer must enter into an annual agreement in order to receive payments for a crop year. The eligibility requirements and planting flexibility requirements are the same as for the DP programme. CCP payments, like DP payments, are made to producers on farms for which payment yields and base acres are established for each of the 2002 through 2007 crop years of each covered commodity.
>
> CCP payments depend on the current prices of commodities. They are provided to producers with base acres and yields for a covered commodity for each of the 2002 through 2007 crop years whenever the effective price falls below the target price, which is fixed by the Act at 72.4 cents per pound for upland cotton. The effective price for a commodity is the sum of the DP payment rate [...], plus the higher of the national average farm price for the marketing year or the loan rate [...]. The difference between the effective price and the target price is the CCP payment rate. Consequently, the CCP payment rate, DP payment rate and, where applicable, the

[28] Market loss assistance payments were provided pursuant to the following Acts: the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriation Act of 1999 for the 1998 crop; the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriation Act of 2000 for the 1999 crop; the Agriculture Risk Protection Act of 2000 for the 2000 crop; and the Crop Year 2001 Agriculture Economic Assistance Act for the 2001 crop.

[29] Panel Report, *US – Upland Cotton*, paras. 7.216-7.217.

loan rate, are equal to the difference between the market price and 72.4 cents per pound.

CCP payments are made on 85 per cent of the base acreage for each commodity multiplied by the corresponding payment rate multiplied by the applicable payment yield. An owner who elected to have his or her base acreage calculated on the basis of the four-year average of planted acreage during the 1998 through 2001 crops, had a one-time opportunity partially to 'update' CCP payment *yields* for CCP payments for all covered commodities, using one of two methods which both included the farm's average yields for the 1998 through 2001 crop years."[30] (emphasis original, footnotes omitted)

3.12 It is not in dispute that the United States continues to provide counter-cyclical payments to US producers of upland cotton and that the legislative and regulatory provisions governing these counter-cyclical payments have not been changed.

2. Export credit guarantees

3.13 The original panel examined three export credit guarantee programmes administered by the United States Department of Agriculture (USDA) through the Commodity Credit Corporation (CCC):[31] the General Sales Manager 102 ("GSM 102") programme, the General Sales Manager 103 ("GSM 103") programme and the Supplier Credit Guarantee Programme ("SCGP"). Brazil challenged the programmes "as such" and "as applied"[32] to exports of upland cotton and other eligible agricultural commodities.[33] All three programmes were used to guarantee the repayment of credit made available to finance commercial export sales of US agricultural commodities.

3.14 The original panel described the three programmes as follows:

"*General Sales Manager 102 ('GSM 102')*

Under the GSM 102 export credit guarantee programme, the CCC is authorized to guarantee the repayment of credit made available to finance commercial export sales of agricultural commodities from privately owned stocks on credit terms between 90 days and three years. The CCC generally covers 98 per cent of the principal and a portion of the interest. The CCC selects agricultural commodities and products according to market potential. The CCC does not provide financing, but rather guarantees payments due from foreign banks. To secure such a payment guarantee, once a firm export sale exists, the United States exporter must apply prior to the date of exportation. The exporter pays a fee calculated on the dollar amount guaranteed, based on a schedule of rates applicable to different credit periods. There is a statutory cap on the fee charged of 1 per cent of the guaranteed dollar value of the transaction. In terms of financing, the CCC-approved foreign bank issues an irrevocable letter of credit in favour of the United States exporter, ordinarily advised or confirmed by the financial institution in the United States which agrees to extend credit to the foreign

[30] Panel Report, *US – Upland Cotton*, paras. 7.223-7.226.

[31] The CCC is a wholly-owned government corporation within the USDA; it has no employees and carries out the majority of its programmes through the personnel and facilities of the Farm Service Agency. See Panel Report, *US – Upland Cotton*, footnote 346.

[32] Because the original panel adopted a "programme-wide" analytical approach under item (j) of the Illustrative List of Export Subsidies in Annex I to the *SCM Agreement*, it did not view the distinction between Brazil's "as such" and "as applied" claims as a determinative one. Panel Report, *US – Upland Cotton*, para. 7.763.

[33] Panel Report, *US – Upland Cotton*, para. 7.69.

bank. If the foreign bank fails to make any payment as agreed, the exporter is required to submit a notice of default to the CCC. The CCC pays a valid claim for loss.

General Sales Manager 103 ('GSM 103')

The GSM 103 programme operates in a similar fashion to GSM 102. The main differences between the two programmes include: export credit guarantees under GSM 103 are "intermediate term credit guarantees" issued for terms from three to 10 years; there are additional statutory required determinations to be made when the CCC issues guarantees; and there is no statutory cap on the origination fees that may be charged by the CCC in connection with an export credit guarantee transaction.

Supplier Credit Guarantee Programme ('SCGP')

Under the SCGP, the CCC is authorized to issue guarantees for the repayment of credit made available for a period not exceeding 180 days by a United States exporter to a purchaser of United States agricultural commodities in a foreign country. These direct credits must be secured by promissory notes signed by the importers. The CCC does not provide financing, but rather guarantees payment due from the importer. Typically, the CCC guarantees a portion (65 per cent) of the value of the exports (principal only; the guarantee does not cover interest). The exporter negotiates terms of export credit sales with the importer. Once a firm export sale exists, the United States exporter must apply for a payment guarantee prior to the date of exportation. The exporter pays a fee for the guarantee calculated on the guaranteed portion of the value of the export sales. There is a statutory cap on the fee charged of 1 per cent of the guaranteed dollar value of the transaction. The importer must issue a dollar-denominated promissory note in favour of the United States exporter in the form specified in the applicable country or regional programme announcement. The United States exporter may negotiate an arrangement to be paid, in full or in part, by assigning the right to proceeds that may become payable under the CCC's guarantee to a United States financial institution. If the foreign bank fails to make any payment, the exporter or assignee is required to submit a notice of default to the CCC. The CCC pays a valid claim for loss."[34] (footnotes omitted)

3.15 Under the GSM 102 and GSM 103 export credit guarantee programmes, the fees charged by the CCC varied with the guaranteed dollar value of the transaction, the repayment period, and the principal repayment interval (annual or semi-annual).[35] Under the SCGP, fees varied with the repayment period (up to 90 days or 90 to 180 days).[36]

3.16 Following the adoption of the original panel and Appellate Body reports, the USDA announced, on 30 June 2005, that as of 1 July 2005, the CCC would no longer accept applications for payment guarantees under the GSM 103 programme.[37] It also announced that the CCC would henceforth use a new fee structure for the GSM 102 and SCGP programmes. Under the new schedule, fees were increased and fees now vary with country risk, repayment term (tenor) and repayment frequency (annual or semi-annual).[38] Countries are classified in eight risk categories (0-7);

[34] Panel Report, *US – Upland Cotton*, paras. 7.242-7.244.
[35] Panel Report, *US – Upland Cotton*, para. 7.820.
[36] Panel Report, *US – Upland Cotton*, para. 7.821 and footnote 975.
[37] Exhibits Bra-502 and Bra-503.
[38] "Fee rates will be based on the country risk that CCC is undertaking, as well as the repayment term (tenor) and repayment frequency (annual or semi-annual) under the guarantee. For the GSM-102 programme,

countries in the riskiest category (category 7) are ineligible.[39] Lastly, in October 2005, the United States ceased issuing export credit guarantees under the SCGP.[40]

IV. PARTIES' REQUESTS FOR FINDINGS AND RECOMMENDATIONS

4.1 With respect to its claims relating to adverse effects within the meaning of Article 5 of the *SCM Agreement*, **Brazil** requests the Panel to make the following findings:

(a) The United States failed to take any measures to remove the adverse effects or to withdraw the three price-contingent upland cotton subsidy programmes under the FSRI Act of 2002 between 22 September 2005 and 31 July 2006.

(b) The US measure eventually taken to comply, i.e. the amendment of the FSRI Act of 2002 to repeal Section 1207(a), providing for Step 2 payments, is insufficient to ensure compliance with the DSB recommendations and rulings, because the resulting basket of measures is inconsistent with Articles 5 and 6 of the *SCM Agreement*. In particular, Brazil requests the compliance Panel to find that the marketing loan and counter-cyclical payment programmes of the FSRI Act of 2002 cause "present" serious prejudice to the interests of Brazil in the form of (a) significant price suppression in the world market for upland cotton and (b) an increase in the US world market share of upland cotton.

(c) The US measure eventually taken to comply is insufficient to ensure compliance with the DSB recommendations and rulings, because the resulting basket of measures is inconsistent with Articles 5(c) and 6.3(c) as well as footnote 13 of the *SCM Agreement*. In particular, Brazil requests the compliance Panel to find that the marketing loan and counter-cyclical payment programmes of the FSRI Act of 2002 cause a threat of serious prejudice to the interests of Brazil in the form of a threat of significant price suppression in the world market for upland cotton. The Panel need only decide this claim if it is unable to find that there is "present" serious prejudice from marketing loan and counter-cyclical payment programmes of the FSRI Act of 2002; and

(d) The failure of the United States to take any measure to remove the adverse effects or to withdraw the three price-contingent upland cotton subsidy programmes under the FSRI Act of 2002 between 22 September 2005 and 31 July 2006 causes "present" serious prejudice to the interests of Brazil in the form of significant price suppression in the world market for upland cotton and an increase in the US world market share, in violation of Articles 5(c), 6.3(c) and (d) of the *SCM Agreement*. The Panel need only reach this claim if it is unable to make findings in favour of Brazil with respect to Brazil's claims summarized under (a)-(c) above.[41]

4.2 With regard to its claims under the *Agreement on Agriculture* and the *SCM Agreement* relating to export credit guarantees, Brazil requests the Panel to make the following findings:

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country risk will be based on the country of the foreign obligor (opening bank), as determined by the CCC. For the SCGP, country risk will be based on the country of the foreign obligor (importer), as determined by the CCC." Exhibit Bra-504. See also Exhibits Bra-502, Bra-505 and Bra-506.

[39] A number of countries that were previously eligible were reclassified into this ineligible risk category. See US First Written Submission, footnote 15 and Exhibit US-2.

[40] See US First Written Submission, para. 20 and Exhibit Bra-513. The United States indicates that "[a]t present, [it] has no plan to resume the SCGP either in the same or different form." US First Written Submission, para. 20.

[41] See Brazil's First Written Submission, para. 461.

(a) With respect to those export credit guarantees under the GSM 102, GSM 103 and SCGP programmes that were outstanding on 1 July 2005, "measures taken to comply" within the meaning of Article 21.5 of the DSU do not exist.

(b) The "measures taken to comply" by the United States with regard to the GSM 102 export credit guarantee programme are inconsistent with Articles 10.1 and 8 of the *Agreement on Agriculture*.

(c) The "measures taken to comply" by the United States with regard to the GSM 102 export credit guarantee programme are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*.[42]

4.3 Brazil requests that, on the basis of the findings requested above, the Panel make the following recommendations:

(a) The United States has failed to comply fully with its obligation, under Article 7.8 of the *SCM Agreement*, to "remove the adverse effects or … withdraw the subsidy", and the original Article 7.8 recommendation of the DSB therefore remains in effect, and applies to the full extent of the findings requested above.

(b) The United States has failed to comply fully with its obligation, under Article 4.7 of the *SCM Agreement*, to "withdraw the subsidy", and the original Article 4.7 recommendation of the DSB therefore remains in effect, and applies to the full extent of the findings requested above.

(c) The United States has failed to bring itself into conformity with its obligations under the *Agreement on Agriculture*, and the original recommendation of the DSB therefore remains in effect, and applies to the full extent of the findings requested above.[43] [44]

4.4 The **United States** requests the Panel to reject the claims of Brazil in their entirety and to find that the United States has complied with the recommendations and rulings of the DSB and, further, that the measures of the United States taken to comply are not inconsistent with the *SCM Agreement* or the *Agreement on Agriculture*.[45]

4.5 The United States requests the Panel to make preliminary rulings that certain claims of Brazil are not within the scope of this proceeding.[46]

4.6 In respect of Brazil's claims of "present" serious prejudice and threat of serious prejudice, the United States submits that: (i) Brazil fails to substantiate its arguments in support of the claim that the effects of the elimination of the Step 2 programme are modest; (ii) Brazil does not demonstrate that the marketing loan or counter-cyclical programmes mandate a breach of WTO obligations; (iii) Brazil fails to make a *prima facie* case of "present" serious prejudice within the meaning of Articles 5(c) and 6.3(c) (significant price suppression) of the *SCM Agreement;* (iv) Brazil fails to make a *prima facie* case of "present" serious prejudice under Articles 5(c) and 6.3(d) (increased market share) of the

[42] See Brazil's First Written Submission, para. 462.

[43] See Brazil's First Written Submission, para. 463.

[44] In this connection, Brazil also observes that the deadlines for implementation of the original recommendations and rulings of the DSB continue to be 1 July 2005 (for the export credit guarantee-related recommendations and rulings) and 21 September 2005 (for the adverse effects-related recommendations and rulings). Brazil's First Written Submission, para. 464.

[45] US First Written Submission, para. 344.

[46] See *infra*, para. 9.7. The Panel addresses the issue of whether, as argued by the United States, certain claims of Brazil are not properly within the scope of this proceeding in Sections IX.B.2-5 of this Report.

SCM Agreement; and (v) Brazil fails to make a *prima facie* case of threat of serious prejudice pursuant to Articles 5(c) and 6.3(c) of the *SCM Agreement*.[47]

4.7 In respect of Brazil's claims regarding export credit guarantees, the United States submits that export credit guarantees have been provided under the GSM 102 programme subsequent to 1 July 2005 consistently with WTO obligations of the United States and that the United States has taken action to withdraw the subsidy with respect to GSM 102, GSM 103 and SCGP export credit guarantees issued prior to 1 July 2005.[48]

V. ARGUMENTS OF THE PARTIES

5.1 The arguments of the parties, as submitted, or as summarized in their executive summaries as submitted to the Panel, are attached as Annexes.

5.2 The responses of the parties to questions of the Panel, their comments on each other's responses and other relevant documents submitted by the parties are also attached as Annexes.

VI. ARGUMENTS OF THE THIRD PARTIES

6.1 The arguments of the third parties are attached to this Report as Annexes.[49]

VII. INTERIM REVIEW

7.1 The Panel submitted its interim report to the parties on 27 July 2007. On 3 September 2007, the parties submitted written requests for review of precise aspects of the interim report. Neither party requested that the Panel hold an interim review meeting. On 17 September 2007, the parties submitted written comments on each other's written requests for review.

7.2 The Panel has modified aspects of the interim report in light of the parties' requests and comments where the Panel considered it appropriate. The Panel has also made technical corrections and changes of an editorial nature.

A. CHANGES REQUESTED BY THE PARTIES REGARDING THE "FACTUAL ASPECTS" SECTION OF THE INTERIM REPORT

7.3 The **United States** proposes changes to paragraphs 3.7, 3.13 and 3.16 in the "Factual Aspects" Section of the interim report (paragraphs 3.7, 3.13 and 3.16 of this Report). The **Panel** considers that these proposed changes correct certain factual errors or inaccuracies in the interim report and has therefore amended the concerned paragraphs in accordance with the request of the United States.

B. CHANGES REQUESTED BY THE PARTIES WITH RESPECT TO THE PANEL'S DESCRIPTION OF ARGUMENTS OF THE PARTIES

7.4 The Panel has made a number of amendments to the interim report pursuant to requests by one of the parties to amend certain paragraphs of the report in order to better reflect arguments made by that party in the course of the proceeding. The Panel has made such changes to paragraphs 4.5; 9.19 (footnote 101); 9.28 (footnote 111); 9.62 (footnote 163); 9.56; 10.6; 10.46 (footnote 254); 10.73; 10.118; 10.155; 10.156; 10.163 (footnote 443); 10.165; 10.200; 10.200 (footnote 481); 14.16 and

[47] US First Written Submission, paras. 149, 196, 203 and 332 and US Rebuttal Submission, para. 405.
[48] US First Written Submission, paras. 60-142 and 143-145.
[49] India and Thailand did not make written submissions.

footnote 588, and 14.122 (footnote 728) of the interim report (paragraphs 4.5; 9.19 (footnote 105); 9.29 (footnote 115); 9.64 (footnote 165); 9.58; 10.6; 10.46 (footnote 256); 10.73; 10.118; 10.155; 10.156; 10.163 (footnote 450); 10.165; 10.205; 10.205 (footnote 497); 14.16 and footnote 604, and 14.122 (footnote 747) of this Report).

7.5 The **United States** requests the Panel to add a footnote to the first sentence of paragraph 8.29 of the interim report (paragraph 8.29 of this Report) with the following text: "For purposes of this dispute, the United States did not object to Chad being considered as a least-developed country Member". The United States notes in this respect that the issue of whether Chad is a least-developed country Member was not discussed by either party and that no relevant evidence was presented to support such a finding. **Brazil** opposes the change proposed by the United States.

7.6 The **Panel** declines to make the change requested by the United States. The reference in the interim report to Chad as a least-developed country Member is consistent with the WTO practice to rely on the UN classification of least-developed countries.[50] Moreover, the United States has not stated in this proceeding that it did not object to Chad being considered a least-developed country Member for purposes this dispute. Therefore, the sentence suggested by the United States is not an accurate reflection of an argument made in this proceeding.

7.7 The **United States** notes that paragraph 9.7 of the interim report (paragraph 9.7 of this Report) appears to omit a summary of an additional argument of the United States and requests that this paragraph be revised to add the objection of the United States that Brazil's claims against the marketing loan and counter-cyclical programmes are outside the scope of this dispute because these measures were not measures taken to comply under Article 21.5 of the DSU. Brazil has not commented on this suggested change.

7.8 The **Panel** agrees with the United States that the interim report does not adequately reflect the two distinct bases of the preliminary objections of the United States to Brazil's claims regarding the marketing loan and counter-cyclical payment programmes. To address this issue, the Panel has amended the title of Section IX.A.3 and has added new paragraphs 9.28 and 9.55.

C. REQUESTS FOR CHANGES WITH RESPECT TO THE PANEL'S FACTUAL AND LEGAL ANALYSIS

7.9 The **United States** requests that the Panel delete footnote 108 to the last sentence of paragraph 9.25 of the interim report (footnote 112 to the last sentence of paragraph 9.25 of this Report) in which the Panel notes that in interpreting the concept of "measures taken to comply" in Article 21.5 of the DSU, the Appellate Body has taken into consideration the need for prompt compliance with DSB recommendations and rulings. The United States argues that the need for prompt compliance with DSB recommendations and rulings does not somehow convert a claim outside the scope of an Article 21.5 proceeding into one that is properly before the compliance panel. The United States also observes that Brazil itself has implicitly recognized that any export credit guarantees for pig meat and poultry meat are outside the scope of this proceeding by bringing a separate case in WT/DS365 challenging US export credit guarantees in respect of all scheduled and unscheduled products.

7.10 **Brazil** objects to the suggestion of the United States to delete this footnote. Brazil submits, in this respect, that the Panel's citation to the statements made by the Appellate Body regarding the promotion of prompt compliance is correct as a matter of law and that the Panel is entitled to consider that the argument of the United States that GSM 102 export credit guarantees for pig meat and poultry

[50] It should be noted that the original panel treated Benin and Chad as least-developed country Members and that there is nothing in the original panel report to indicate that the United States had expressed a view or a reservation on that issue. Panel Report, *US – Upland Cotton*, para. 7.54.

meat are outside the scope of this proceeding will not promote prompt compliance with DSB recommendations and rulings. Brazil rejects the argument of the United States that the fact that Brazil has raised the consistency of GSM 102 export credit guarantees in a consultation request in WT/DS365 constitutes an implicit recognition by Brazil that GSM102 export credit guarantees for pig meat and poultry meat are outside the scope of this proceeding.

7.11 The **Panel** declines to delete the footnote to the last sentence of paragraph 9.25 of the interim report (footnote 112 to the last sentence of paragraph 9.25 of this Report). In this footnote, the Panel refers to a statement of the Appellate Body in *US – Oil Country Tubular Goods Sunset Reviews (Article 21.5 – Argentina),* paragraph 151, which the Panel considers to provide further support for its view that Brazil's claims regarding export credit guarantees for pig meat and poultry meat are properly within the scope of this proceeding. The United States does not contest the factual accuracy of the Panel's citation to the statement of the Appellate Body. As is already clear from the fact that the Panel makes this point in a footnote, the Panel relies on this statement simply as an additional element in support of the main arguments set out in paragraphs 9.24-9.25 of the interim report (paragraphs 9.24-9.25 of this Report). The Panel remains of the view that the notion that the purpose of Article 21.5 of the DSU is to promote prompt compliance with DSB recommendations and rulings is a pertinent consideration that supports the Panel's conclusion that Brazil's claims are within the scope of this proceeding. Finally, the Panel sees no merit to the argument of the United States that the Panel should construe Brazil's request for consultations in WT/DS365 as constituting an implicit recognition by Brazil that Brazil's claims relating to GSM102 export credit guarantees for pig meat and poultry meat are not within the scope of this proceeding.

7.12 With regard to paragraph 9.78 of the interim report (paragraph 9.80 of this Report), **Brazil** suggests that the Panel may wish to provide a more detailed explanation as to why the rulings in *US – Softwood Lumber IV* support the Panel's conclusion that marketing loan and counter-cyclical payments made after 21 September 2005 are "measures taken to comply" within the meaning of Article 21.5 of the DSU. Brazil refers, in this regard, to the arguments that it has advanced on this issue in this proceeding. The **United States** disagrees with Brazil's suggestion. The United States submits that Brazil errs in suggesting that the panel and Appellate Body reports in *US – Softwood Lumber IV (Article 21.5 – Canada)* support finding that the US measures at issue are measures taken to comply.

7.13 The **Panel** agrees with Brazil that paragraph 9.78 of the interim report (paragraph 9.80 of this Report) does not sufficiently explain why the Panel considers that its reasoning is supported by the reports of the panel and the Appellate Body in previous Article 21.5 proceedings. The Panel has amended this paragraph to state more clearly why the Panel considers that its reasoning is supported by the Appellate Body's statement in *US – Softwood Lumber IV (Article 21.5 – Canada)* that "measures taken to comply" in Article 21.5 of the DSU include "measures with a particularly close relationship to the declared 'measure taken to comply', and to the recommendations and rulings of the DSB".

7.14 **Brazil** requests the Panel to amend paragraph 9.79 of the interim report (paragraph 9.81 of this Report) by deleting the words "to the extent" in the first line, the word "are" in the second line, and the comma and the word "they" after "prejudice" in the fifth line. Brazil submits that these proposed changes are consistent with its comment on paragraph 9.78 of the interim report and with the reasoning underlying the Panel's conclusion that marketing-loan and counter-cyclical payments made after 21 September 2005 are within the scope of this proceeding. The **United States** disagrees with Brazil's proposed changes. The United States considers that the wording of paragraph 9.79 makes clear that the existing marketing loan and counter-cyclical payments could be provided by the United States on different conditions that were found to be inconsistent with the provisions of the *SCM Agreement*.

7.15 The **Panel** declines to make the changes requested by Brazil to paragraph 9.79 of the interim report (paragraph 9.81 of this Report). The Panel considers that these changes are inconsistent with the text of the immediately preceding paragraphs and that Brazil has offered no convincing explanation as to why these changes are warranted.

7.16 With respect to the paragraph 10.23 of the interim report (paragraph 10.23 of this Report), the **United States** considers that it is inaccurate to state that there is "no disagreement" between the parties regarding the "general order of magnitude" of marketing loan payments made by the United States to upland cotton producers in MY 2004 and MY 2005. The United States notes that while Brazil and the United States have submitted identical figures for the amount of marketing loan payments in MY 2005, with respect to the amount of marketing loan payments in MY 2004 the figures submitted by the parties have continued to differ. The United States thus requests the Panel to delete the reference to MY 2004 in this paragraph. **Brazil** objects to the request of the United States, arguing that any difference between Brazil's and the US figures for MY 2004 is negligible.

7.17 The **Panel** has amended paragraph 10.23 of the interim report (paragraph 10.23 of this Report) by deleting the statement that "there is no disagreement" between the parties regarding the general order of magnitude of marketing loan payments in MY 2004 and MY 2005 and by adding language that makes clear that it is the Panel, rather than the parties, that considers that the figures supplied by the parties on marketing loan payments for MY 2004 and MY 2005 are of the same general order of magnitude.

7.18 The **United States** requests that the Panel revise the text of footnote 236 to paragraph 10.40 of the interim report (footnote 238 to paragraph 10.40 of this Report) to make it clear that the response of the United States to Panel question 55 does not imply agreement with the "cotton-to-cotton" methodology. Brazil opposes this request, arguing that the change requested by the United States is unnecessary as the interim report already summarizes the arguments of the United States on the "cotton-to-cotton" methodology.

7.19 The **Panel** has amended the text of footnote 236 to paragraph 10.40 of the interim report (footnote 238 to paragraph 10.40 of this Report) to clarify that in posing question 55 the Panel was not asking whether the United States agreed with "Brazil's methodology or the "cotton-to-cotton" methodology.

7.20 With respect to paragraph 10.95 of the interim report (paragraph 10.95 of this Report), the **United States** requests the Panel either (1) to add a finding that the current economic literature supports the view that counter-cyclical payments do not appear to have had more than minimal production- and trade-distorting effects, *inter alia*, because the conditions under which such payments might in theory have greater effects have not been established in fact by Brazil in this proceeding, or (2) to explain its basis for rejecting each of the studies cited by the United States drawing the conclusion that the production effects of counter-cyclical payments are minimal.

7.21 **Brazil** objects to this request of the United States. Brazil argues that both parties have submitted significant evidence and arguments regarding the effects of counter-cyclical payments and that in its interim report the Panel has analyzed the studies submitted by both parties in great detail. Since the Panel has explained its evaluation of these studies, there is no basis for the United States to request the Panel to explain its basis for rejecting the evidence and argument of the United States. Similarly, there is no basis for the Panel to conclude that the economic literature supports the US position since the Panel has found exactly the opposite.

7.22 The **Panel** considers that paragraphs 10.90-10.95 of the interim report adequately explain the conclusion drawn by the Panel from its review of the economic studies referred to by the parties. However, in light of the comments of the United States, the Panel has made certain changes to paragraphs 10.91 and 10.92 of the interim report (paragraphs 10.91 and 10.92 of this Report) to refer more specifically to certain studies cited by the United States.

7.23 The **United States** requests that the text of footnote 363 to the third sentence of paragraph 10.110 of the interim report (footnote 369 to the third sentence of paragraph 10.110 of this Report) be revised to reflect that Step 2 payments were only made to users of upland cotton rather than to producers. **Brazil** opposes the change requested by the United States on the ground that Step 2 payments were made not only to users but also to exporters of cotton.

7.24 The **Panel** considers that while the United States is correct that Step 2 payments were not made to producers, Brazil is correct that such payments were made not only to users but also to exporters. The Panel has therefore amended the text of footnote 363 to the third sentence of paragraph 10.110 of the interim report (footnote 369 to the third sentence of paragraph 10.110 of this Report), to reflect that Step 2 payments were made to users and exporters of cotton.

7.25 With respect to paragraph 10.126 of the interim report (paragraph 10.126 of this Report), the **United States** requests the Panel to revise the statement in the second sentence that "neither Brazil nor the United States appear to have access to recent data on foreign planted acreage." The United States submits that foreign planted acreage data does not exist; therefore, it is not a question of access for either party. Only the United States has a consistent public source of data on both planted and harvested acreage. The United States requests that the Panel revise the second sentence to read: "However, neither Brazil nor the United States appear to have access to recent data on foreign planted acreage; indeed such data do not appear to exist." **Brazil** objects to the request of the United States on the ground that the United States is raising a new argument that foreign planted acreage data does not exist. Brazil submits, in this regard, that it is not appropriate for a party to make new arguments at the interim review stage that were not made during the proceedings, much less to ask a panel to reflect those new arguments in its final report.

7.26 The **Panel** has decided not to make the change to paragraph 10.126 of the interim report proposed by the United States. The question of whether or not data on foreign planted acreage exists was not raised in this dispute.

7.27 **Brazil** requests the Panel to amend paragraph 10.127 of the interim report (paragraph 10.127 of this Report) because, as currently formulated, the paragraph can be construed to be in contradiction with other findings made by the Panel in its interim report. Brazil refers in particular to the statement of the Panel in paragraph 10.127 that "Brazil's claim of insulation of US producers from market price signals applies when expected prices are *below* their intervention levels" but "this insulation does not apply when expected cotton prices are above their intervention levels". Brazil considers that, taken out of context, this statement might be construed to be in contradiction with the Panel's finding in paragraph 10.81 of the interim report (paragraph 10.81 of this Report) that marketing loan payments affect the level of acreage planted to cotton even when the expected market price for upland cotton at the time of planting is higher than the marketing loan rate. Brazil requests that the Panel revise paragraph 10.127 "to eliminate any basis for concluding that paragraph 10.127 conflicts in any way with the Panel's earlier findings regarding the role of marketing loan and counter-cyclical payments in insulating US upland cotton farmers from market price signals".

7.28 The **United States** opposes the changes proposed by Brazil to paragraph 10.127 of the interim report. The United States considers that Brazil is attempting to substitute its own view that, regardless of the expected price level or other factors, upland cotton producers are insulated from market signals and that marketing loan and counter-cyclical payments always have effects on the production of upland cotton that lead to significant price suppression. The Panel, in Section X.7 of the interim report, has examined, *inter alia*, the US evidence of the relative stability of the US share of world production and exports over the entire period of the FSRI Act of 2002, and has rejected Brazil's extreme view that US upland cotton producers are always insulated from market price signals. The United States also submits that even Brazil's proposed edits concede that producers are responding to market signals when expected prices are above the market loan rate.

7.29 The **Panel** agrees with Brazil that certain statements in paragraph 10.127 of the interim report (paragraph 10.127 of this Report) do not entirely accurately reflect the Panel's findings regarding the issue of the insulation of US cotton producers form market prices. The Panel's finding is that whether expected market prices at the time of planting are above the levels that will trigger marketing loan and counter-cyclical payments is a factor that affects the *degree* of insulation of US cotton producers from market price signals but not the existence of such insulation *per se*. The Panel has amended the paragraph to better convey this idea.

7.30 With respect to paragraph 10.146 of the interim report, (paragraph 10.146 of this Report), **Brazil** requests the Panel to delete the term "necessarily" from the last sentence of the paragraph. Brazil states that the inclusion of this word could be read as suggesting that, absent a clear "discernable temporal coincidence", there is an increased burden for a complaining Member to demonstrate adverse effects. Brazil considers that this is particularly troublesome in proceedings under Article 21.5 of the DSU because there is already a finding adopted by the Dispute Settlement Body that the challenged subsidies cause adverse effects. Similarly, a complaining Member that challenges a long-existing distortion of a market caused by long-term subsidization might not be able to establish that the effects of subsidies *increased* simply because the market distortion has continued to exist for a long time. In Brazil's view, as in the original proceeding, the existence of a "discernable temporal coincidence" can be a useful factor to assess in an adverse effects claim. However, it is not an indispensable element for establishing causation.

7.31 The **United States** objects to Brazil's request, arguing that there is no basis for Brazil's argument that the word "necessarily" in the last sentence of paragraph 10.146 of the interim report relates to the question of a party's burden of proof. The United States considers that the Panel is merely stating its own findings based on the evidence presented with respect to causation. The United States also submits that Brazil actually seems to imply that the burden of demonstrating adverse effects in proceedings under Article 21.5 of the DSU should be less "because there already is a finding adopted by the Dispute Settlement Body that the challenged subsidies cause adverse effects". In making this argument, Brazil ignores the fact that since the "challenged subsidies" in this proceeding are not the same ones as those at issue in the original proceeding, there is no finding with respect to payments made outside of MY 1999-2002. Moreover, as stated by the Panel in paragraph 9.3 of the interim report, "[t]he general rules regarding the allocation of the burden of proof in WTO dispute settlement require that a party claiming a violation . . . assert and prove its claim. These rules also apply to proceedings under Article 21.5 of the DSU." Thus, Brazil must make a showing of adverse effects, assuming that its claim with respect to the marketing loan payment and counter-cyclical payment programmes is properly before the Article 21.5 compliance panel in the first place.

7.32 The **Panel** rejects Brazil's request to delete the term "necessarily" from the last sentence of paragraph 10.146 of the interim report (paragraph 10.146 of this Report). The Panel disagrees with Brazil's analysis of the implications of the use of this term. The word "necessarily" in the last sentence of paragraph 10.146 simply underlines the point that price suppression can exist even though "recent years have not witnessed the sharp decline in the world market price for upland cotton that occurred during the period considered by the original panel". The Panel therefore considers that there is no basis for Brazil's argument that this word can somehow be interpreted as implying a view of the Panel that "absent a clear 'discernible temporal coincidence', there is an increased burden for a complaining Member demonstrating (sic) adverse effects" and that "a complaining Member would be required to explain that the absence of a discernable temporal coincidence does not break any causal link between the subsidies and the adverse effects."

7.33 The **United States** requests that paragraph 10.162 of the interim report (paragraph 10.162 of this Report) be amended to indicate that the new data begins with MY 2003, based on the more recent USDA cost survey, and that the MY 2002 data originates with the 1997 USDA survey. **Brazil** objects to the US request, noting that USDA Survey Data is updated annually. The **Panel** has decided to substitute "data" for "updated information" at the beginning of the second sentence of paragraph 10.162 of the interim report.

7.34 With regard to the Panel's statement in the last sentence of paragraph 10.166 of the interim report (paragraph 10.166 of this Report) that "[w]e therefore consider the inclusion of land, labour and capital recovery costs in fixed (overhead) costs as appropriate, being in accordance with the recommended methodology", the **United States** requests the Panel to differentiate between paid and unpaid labour costs and to treat paid labour costs as variable. The United States notes that with respect to paid labour that does not have farm ownership claims, there is a difference in opinion on whether to classify the cost as fixed or variable, and that, as a conservative measure, the United States considers paid labour cost as a variable cost. **Brazil** has not commented on this request of the United States.

7.35 The **Panel** does not consider that the change requested by the United States is appropriate. Whether paid labour costs are classified as variable or fixed will have no effect on the cost of production analysis. The Panel sees no reason why it should make a ruling on this matter when such a ruling would not affect its cost of production analysis.

7.36 **Brazil** requests the Panel to make changes to the text of paragraph 10.176 of the interim report (paragraph 10.176 of this Report), to reflect that there is no requirement that proof of long-term costs be produced over the lifetime of the challenged measure. Brazil notes that many subsidy programmes have been in place for many decades. Moreover, any suggestion that cost of production data needs to cover the lifetime of a measure would be inconsistent with claims of threat of serious prejudice under Articles 5 and 6 of the *SCM Agreement* in particular. Finally, the notion that the full lifetime of a measure should be the basis for assessing proof of adverse effects is inconsistent with the concept of a more recent reference period to assess the existence of present adverse effects.

7.37 The **United States** disagrees with Brazil's argument that the Panel is possibly implying a requirement that proof of long-term costs be produced over the lifetime of a challenged measure. Rather, the Panel simply states that the effect of marketing loan and counter-cyclical payments is "best assessed" over the lifetime of the FSRI Act, but recognizes that data was unavailable for that entire time frame, and relies instead on the data that is available for MY 2002-2006.

7.38 The **Panel** agrees with some of the concerns that Brazil has raised and has therefore made certain of the changes proposed by Brazil. However, the Panel also agrees with the United States that other changes proposed by Brazil attempt to expand the universe of the cost data reviewed by the Panel. The Panel therefore declines to make those changes.

7.39 With respect to paragraph 10.188 of the interim report (paragraph 10.193 of this Report), the **United States** submits that the Panel has not accounted for the argument of the United States that ginning costs should not be included in the calculation of the costs of production of upland cotton lint. The United States submits that it has demonstrated that ginning costs are appropriately excluded from the calculation of costs of production of upland cotton lint, in light of the common practice in the United States of ginning costs being paid out of the proceeds gained by the gin from the sale of the cotton seed separated out in the ginning process. The United States therefore requests the Panel to find that ginning costs should be excluded from the calculation of the costs of production of upland cotton and to make adjustments accordingly to its calculation of cotton revenue costs and returns.

7.40 **Brazil** objects to the United States request for exclusion of ginning costs from the calculation of the costs of production of upland cotton lint. *First*, Brazil observes that such an approach is inconsistent with the original panel's approach, which, in making its cost of production-related findings, relied upon USDA cost data that included ginning costs and market returns from cottonseed. USDA cost of production data shows that the costs associated with ginning are far higher than the market value of cottonseed. An exclusion of ginning costs and revenue would result in manipulated cost of production data that would paint an inappropriately advantageous picture of the situation of US upland cotton farming. Brazil submits, in this respect, that it has explained that the US approach would cut out a large portion of ginning costs and a much smaller portion of upland cotton producers' market revenue from cottonseed. *Second*, Brazil notes that if one were to exclude ginning costs, for accuracy, at the very least, ginning revenues would also have to be excluded. However, the exclusion of such costs and revenues would result in an inadequate basis to assess medium-to-longer-term developments in the industry.

7.41 The **Panel** agrees with the United States that the interim report does not address the argument made by the United States in this proceeding that ginning costs should be excluded from the calculation of the costs of production of upland cotton lint. Without taking a position on whether this argument is correct or not, the Panel has analysed the revenue and cost data in two forms: (i) without cottonseed revenues and ginning costs as the US proposes and (ii) with cottonseed revenues and ginning costs as in the original dispute. The results of this analysis show that whether or not ginning costs are excluded from the calculation of the costs of production of upland cotton lint does not alter the Panel's conclusion that market revenues exceed total costs of production. To reflect this analysis in the final report, we have amended the interim report by adding new paragraphs 10.185-10.188 and by changing the text of paragraphs 10.185-10.191 of the interim report (paragraphs 10.189-10.196 of this Report).

7.42 With respect to paragraph 10.214 of the interim report (paragraph 10.219 of this Report), the **United States** requests that the Panel delete the last sentence, which states that "a good model does not need a lot of extraneous bells and whistles". In the view of the United States, a proper model estimating the degree of price suppression should be constructed to take into account as many relevant economic factors as possible.

7.43 **Brazil** objects to the request of the United States, explaining that the Panel has correctly identified the advantages of Brazil's model. Brazil agrees with the Panel that a "simpler and more accessible model can be readily focused on the specific issue at hand" and that "it should include only relevant economic features that are crucial to a determination whether certain US Government payments led to significant price suppression."

7.44 Notwithstanding Brazil's objection, the **Panel** has accepted the request of the United States to delete the last sentence of paragraph 10.214 of the interim report (paragraph 10.219 of this Report). The Panel explains its assessment of the advantage of Brazil's model in the second and third sentences of the paragraph. The statement in the fourth sentence of the paragraph that "a good model does not need a lot of extraneous bells and whistles" is not essential in this respect and its deletion does not entail a substantive change.

7.45 **Brazil** requests that the Panel delete the phrase "it has not undergone any peer review" from paragraph 10.215 of the interim report (paragraph 10.220 of this Report). Brazil expresses a concern that in future disputes economic models that have not undergone a "peer review" will be heavily discounted or even discarded for that reason alone, leading to a "peer review" requirement for economic models offered, for example, in disputes involving claims of adverse effects under the *SCM Agreement* or in proceedings under Articles 21.5 and 22.6 of the DSU. Brazil submits that from a practical standpoint peer review can be a quite lengthy and costly process. A crucial consideration in determining the issue of "peer review" is the fact that any economic model must be tailored to the particular facts and circumstances of a dispute. Thus, any economic analysis presented to a panel or arbitrator in a case of adverse effects is likely to be very recent in order to reflect current conditions of competition in the relevant market. Given the relatively short time-frames of WTO dispute settlement, it may simply not be possible to secure a timely "peer review" of an economic model specifically tailored to the current conditions of competition. Brazil also submits that a requirement for "peer review" is not supported by an examination of proceedings under Article 22 of the DSU. A number of economic models have been presented to arbitrators, but there is no evidence in any of the Article 22.6 arbitration reports that these models had been "peer reviewed". Finally, Brazil claims that there is no precise definition of "peer review".

7.46 The **United States** notes that the phrase "it has not undergone any peer review" is a simple factual statement. The United States also states, however, that the term "peer review" may not apply as well in this context so that a better means of expressing the concern over potential deficiencies inherent in the economic model would be that the model was not well-known and not widely-used for published research and analysis.

7.47 The **Panel** agrees with Brazil that there exists no requirement that economic models submitted in WTO dispute settlement proceedings must have been the subject of a process of peer review. The Panel also notes that the United States concurs with Brazil that the term "peer review" may not be applicable in this context. In light of these considerations, the Panel has deleted the reference to peer review in the second sentence of paragraph 10.215 of the interim report (paragraph 10.220 of this Report).

7.48 Regarding the Panel's statement in paragraph 10.217 of the interim report (paragraph 10.222 of this Report) that "price suppression has been the outcome of all the simulation results whether one uses the parameter values proposed by Brazil or the FAPRI and ATPSM parameter values proposed by the United States", the **United States** submits that the appropriate question before the Panel is whether there has been significant price suppression, not simply any price suppression. The United States argues that it has submitted the alternative parameter values solely for purposes of showing that, even if one were to employ Brazil's modelling approach, correcting its flawed parameters shows that the price effects are not significant. The United States requests the Panel to clarify that Brazil’s model has not "earn[ed] the confidence of the Panel," and that it therefore has not contributed to the Panel’s finding of significant price suppression.

7.49 **Brazil** objects to the request of the United States. Brazil argues that in its examination of price suppression the Panel has thoroughly examined the evidence and data provided by both parties. Like the original panel, the Panel has considered several elements to be crucial in its analysis. The price suppression results of Brazil's model, applying the parameter sets both of Brazil and of the United States provided additional comfort to the Panel in its finding of price suppression because all parameter sets showed that the effect of the subsidies is to suppress prices. While the Panel has not endorsed a particular set of parameters, this is not a sufficient basis for the United States to request that the Panel find that the model itself did not earn the Panel's confidence.

7.50 The **Panel** rejects the request of the United States, since the Panel has adequately explained the role of the model in its analysis in paragraphs 10.217 and 10.241-10.252 of the interim report (paragraphs 10.222 and 10.246-10.257 of this Report). It is clear from the report that the Panel has used the results of the economic simulation model in conjunction with other factors – the substantial proportionate influence of the United States on the world market for upland cotton, the mandatory, and price-contingent nature and revenue-stabilizing effect of marketing loan and counter-cyclical payments, the order of magnitude of the marketing loan and counter-cyclical subsidies, and the significant gap between the total costs of production of US upland cotton producers and their market revenue – to arrive at its finding that the effect of marketing loan payments and counter-cyclical payments is significant price suppression.

7.51 **Brazil** requests the Panel to amend paragraph 10.226 of the interim report (paragraph 10.231 of this Report). Brazil's concern with respect to this paragraph pertains to the statement of the Panel that "it is not possible for the Panel to determine with any great deal of precision or confidence just how much of the projected decline in US exports of upland cotton is due to the elimination of the Step 2 payments". Brazil considers that, if read in isolation, this statement could be taken to suggest that the Panel considers that it is unable to assess the effects of the withdrawal of the Step 2 subsidies and hence should not have concluded that the withdrawal of these subsidies is insufficient to bring the United States into conformity with Articles 5 and 6 of the *SCM Agreement*. Brazil proposes that the Panel add a statement to recall its finding in paragraph 10.248 of the interim report (paragraph 10.253 of this Report) that "even if the entire decline of US exports is attributable to the repeal of Step 2, we would still find that marketing loan and counter-cyclical payments significantly suppress world prices". Brazil also suggests that the Panel cite the evidence submitted by Brazil that not the entire decline in US exports is attributable to the removal of the Step 2 payments.

7.52 The **United States** disagrees with the change proposed by Brazil. The United States considers that Brazil's proposed change mis-characterizes the Panel's finding in paragraph 10.248 of the interim report (paragraph 10.253 of this Report). The Panel there notes that the "effect of the elimination of this subsidy on US exports and on the amounts of marketing loan payments and counter-cyclical payments suggests that the elimination of this subsidy does not affect the price suppressing effects of the marketing loan payments and counter-cyclical payments in the world market for upland cotton". However, in reaching this conclusion, the Panel does not make the alternative assumption that Brazil claims it does, i.e. that "even if the entire decline of US exports is attributable to the repeal of Step 2, we would still find that marketing loan and counter-cyclical payments significantly suppress world prices".

7.53 The **Panel** declines to make the change proposed by Brazil to paragraph 10.226 of the interim report (paragraph 10.231 of this Report). The Panel considers that the text proposed by Brazil does not correctly reflect the finding of the Panel in paragraph 10.248 of the interim report (paragraph 10.253 of this Report).

7.54 The **United States** requests the Panel to reiterate in paragraph 12.269 of the interim report (paragraph 12.2 of this Report) the conclusion drawn in paragraphs 9.68-9.69 of the interim report (paragraphs 9.70-9.71 of this Report) that it is not necessary for the Panel to make a finding on Brazil's claim of non-compliance by the United States in the period 22 September 31 July 2006. **Brazil** has not commented on this request. The **Panel** has amended paragraph 12.269 of the interim report (paragraph 12.2 of this Report) by inserting a reference to the panel's ruling in paragraph 9.68 of the interim report (paragraph. 9.70 of this Report).

7.55 The **United States** requests that the Panel replace the word "underwrite" by "guarantee" in the first sentence of paragraph 14.5 of the interim report (paragraph 14.5 of this Report) to more accurately describe the GSM 102 and GSM 103 programmes. The United States also requests the Panel to amend the paragraph to reflect the fact that the GSM 103 programme no longer operates. **Brazil** objects to the request of the United States. The **Panel** has made the change requested by the United States as it considers that the term "guarantee" more precisely describes the operation of the programmes at issue than the term "underwrite". The Panel has also amended paragraph 14.5 of the interim report to reflect the fact that the GSM 103 programme no longer operates.

7.56 For clarity, the **United States** suggests that a sentence be inserted after the first sentence of footnote 605 (paragraph 14.30) of the interim report (footnote 621 to paragraph 14.30 of this Report) to describe with more precision what was at issue in the *Brazil – Aircraft (Article 21.5 – Canada)* dispute. The United States further requests that the last sentence of the footnote be revised to reflect more accurately its Opening Statement. **Brazil** does not comment on this request. The **Panel** has amended footnote 605 (footnote 621 in this Report) to reflect the US suggestion.

7.57 **Brazil** requests that the Panel modify the first sentence of paragraph 14.67 of the interim report (paragraph 14.67 of this Report). Brazil notes that, as the next sentence indicates, the source for Brazil's argument regarding re-estimates are not US "budget" documents but are, rather, CCC Financial Statements. The **United States** does not oppose Brazil's request, but suggests alternative language to make it clear that Brazil exclusively referred to the CCC Financial Statements. The **Panel** has amended paragraph 14.67 of the interim report (paragraph 14.67 of this Report) in accordance with the language suggested by the United States.

7.58 Both parties have asked that the Panel make certain changes to paragraph 14.76 of the interim report (paragraph 14.76 of this Report).

7.59 **Brazil**'s concern lies with the use by the Panel of the term "inflated". Brazil is concerned that that word is not neutral and may be misunderstood as indicating that the Panel considered the initial estimate to be flawed through exaggeration or deliberate overstatement. The **United States** objects to Brazil’s proposed edit. The United States considers that adopting Brazil's suggestion would unnecessarily eliminate one of the two points made by the Panel in the last sentence of paragraph 14.76 – the Panel's recognition that it is possible that the initial subsidy estimates are inflated because they do not reflect the actual use of the programme.

7.60 With respect to the same paragraph, the **United States** is concerned that the Panel is imposing an impossible standard to achieve when it indicates that "[i]n no case has the reduction turned a positive subsidy estimate into a negative one" and requests that the Panel eliminate that sentence. The United States submits that re-estimates are not calculated from, or based on, the original subsidy estimates. Consequently, the re-estimate process can never re-capture any difference between the original subsidy estimate and estimates based on the amount of guarantees actually issued. **Brazil** considers that the United States misunderstands what it believes to be the intent of paragraph 14.76.

7.61 The **Panel** has made changes to paragraph 14.76 of the interim report (paragraph 14.76 of this Report) and to footnote 665 of the interim report (footnote 681 of this Report) to make it clear that what is at issue in this paragraph is not the re-estimate process that is mandated under the FCRA. Rather, the Panel, in this paragraph, is merely describing the process by which the initial subsidy estimate is readjusted in the two subsequent budgets that follow the first budget in which a subsidy estimate for a particular cohort is provided, and increasingly takes actual use of the programme into account. The United States argued before the Panel that the initial subsidy estimate is unreliable because it is computed before any actual use is made of the GSM 102 programme. In paragraph 14.76 the Panel responds to that argument of the United States. The Panel therefore declines to delete the sentence identified by the United States. With respect to the use of the word "inflated", the Panel has replaced that term by "overstated" which, it believes, is more neutral and reflective of the Panel's intent.

7.62 The **United States** requests that the Panel clarify its characterization of the US position concerning the initial estimates in paragraph 14.78 of the interim report (paragraph 14.78 of this Report). **Brazil** objects to the US request. The **Panel** has amended the paragraph to remove the word "indirectly" and clarify the terms "by themselves" in order to better reflect the argument of the United States. The Panel does not understand the United States to have requested any other change to the paragraph at issue.

7.63 **Brazil** makes a number of comments with respect to the second sentence of paragraph 14.81 of the interim report (paragraph 14.81 of this Report). *First*, the Panel dismisses the arguments of the United States that the subsidy re-estimates demonstrate that GSM 102, GSM 103 and SCGP programmes were provided at no net cost to government. The Panel states that the evidence provided by the United States "do[es] not *conclusively establish* that the programmes were provided at no net cost to the US Government".[51] Brazil is concerned that this formulation might be read to suggest that the Panel has imposed the burden of proof on the United States, which Brazil understands is not the case. Brazil, therefore, suggests that this passage be reformulated to state that the evidence provided by the United States does not sufficiently rebut the evidence that the programmes were provided at a net cost to the US Government. *Second*, the Panel characterizes negative subsidy numbers as indicative of "profitability". Brazil requests that the Panel refer to the concept of "net cost", which the Panel has used elsewhere, instead of the word "profitable". *Third*, the Panel's statement suggests that the re-estimated data provided by the United States uniformly shows profitability across all cohorts, whereas the data provided by the United States, however, continues to project losses for several cohorts during the period FY 1992-2006. The **United States** objects to Brazil's suggested edits apart from the one which corrects language that would appear to place the burden of proof on the United States.

7.64 The **Panel** has amended the paragraph at issue (paragraph 14.81 of this Report) to adopt Brazil's suggestion with respect to the Panel's use of the term "profitability", a term which the Panel had used as shorthand for the concept of "no net cost to the government." The Panel has also taken note of Brazil's comment with respect to the fact that the re-estimates data submitted by the United States does not project a negative subsidy estimate in respect if all cohorts and has inserted a mention to that effect in a footnote (footnote 689). The Panel disagrees, however, with Brazil that the second sentence of the paragraph may be interpreted as the Panel having imposed the burden of proof on the United States. The Panel has clarified the sentence at issue to better convey the intended meaning of the sentence.

7.65 The **United States** submits that footnote 673 of the interim report (footnote 690 of this Report) does not accurately reflect its arguments concerning the role played by original subsidy estimates in the original panel's conclusion that the programmes at issue fell within the scope of item (j) of the Illustrative List. **Brazil** objects to the US request. The **Panel** considers that footnote 673 of the interim report (footnote 690 of this Report) accurately reflects the argument of the United States in its Response to Panel Question 105 and therefore rejects the request of the United States.

7.66 The **United States** considers that the use of the word "figure" in the third sentence of paragraph 14.83 of the interim report (paragraph 14.83 of this Report) is confusing, as the previous sentence references the CCC's estimated net cash outflow for export credit guarantees as of 30 September 2006, a "figure" that was not before the original panel. Moreover, the United States indicates that while it agrees with the original panel's conclusion that the credit guarantee liability figure does not represent in any sense an actual loss, the United States in no way accepts the original panel's ultimate reliance on the credit guarantee liability figure as an indicator of the estimated long-term loss of the programmes to the US Government. **Brazil** opposes the second aspect of the US request.

7.67 The **Panel** takes note of the concern of the United States with respect to the use of the term "figure" in the sentence at issue and of its concern that it not be depicted as endorsing a view that the "credit guarantee liability" reported in the CCC's Financial Statements indicates a future loss. We have, for this reason, amended and moved the sentence at issue to a new footnote (footnote 699) which quotes from the US Response to Panel Questions 107 and 108 and therefore, in the Panel's view, accurately reflects the arguments made by the United States.

7.68 The **United States** submits that the Panel misconstrues its criticism of Brazil's failure to include cash received when it states, in paragraph 14.86 of the interim report (paragraph 14.86 of this Report) that "including these amounts would not allow a comparison with the re-estimates data submitted by the United States." The United States explains that its point was not to facilitate a

[51] Emphasis added.

comparison with re-estimates data but was simply to offer a more accurate depiction of cash flows during the period of time identified by Brazil. The **Panel** has amended paragraph 14.86 of the interim report (paragraph 14.86 of this Report) to reflect the fact that the comment at issue was not made in response to an argument of the United States but rather reflected an additional reason why the Panel considered it inappropriate to include amounts associated with recoveries on pre-1992 guarantees, as had been suggested by the United States.

7.69 **Brazil** requests that the Panel modify the final two sentences of paragraph 14.94 of the interim report (paragraph 14.94 of this Report). In paragraph 14.94, the Panel suggests that GSM 102 fees are not subject to the OECD Arrangement "because", "the Arrangement only applies to official support for terms of two years or more". This statement implies that GSM 102 guarantees are not subject to the OECD Arrangement because they are provided for tenors not covered by the Arrangement. Brazil notes that, as the Panel correctly observes at paragraph 14.102, however, GSM 102 provides for tenors (over 24 months) which are subject to the OECD Arrangement. The **United States** does not object to Brazil's stylistic edits to this paragraph. The **Panel** has made the changes suggested by Brazil.

7.70 With respect to paragraph 14.96 of the interim report (paragraph 14.96 of this Report), the **United States** asks the Panel to note that the US participation in the elaboration of the MPRs does not mean in any way that the United States views the MPRs as a proper basis for comparison to GSM 102 fees in this case. **Brazil** does not comment on this request. The **Panel** considers that there is no ambiguity in the interim report that the United States considers that the MPRs are not applicable to GSM 102 export credit guarantees (see paragraph 14.92 of the interim report, paragraph 14.92 of this Report) and therefore considers that the addition suggested by the United States is unnecessary.

7.71 **Brazil** and the **United States** request that the Panel correct what they consider to be a factual inaccuracy in paragraph 14.117 of the interim report (paragraph 14.117 of this Report). They indicate that there are 6, rather than 7, eligible country risk categories under the amended GSM 102 programme. The **Panel** has deleted the reference to there being "7" eligible country risk categories in the body of paragraph 14.117, but has added a new footnote to that paragraph to explain that the parties have, in their submissions to the Panel, been inconsistent in designating the number of eligible country risk categories.

7.72 With respect to paragraph 14.115 of the interim report (paragraph 14.115 of this Report), **Brazil** requests that the Panel either provide a citation to documentary evidence in support of the assertion of the United States that it "sets bank limits with respect to each foreign bank obligor" or, alternatively, that the Panel note that this assertion in this respect is unsupported by documentary evidence. The **United States** objects to Brazil's suggestion.

7.73 The **Panel** considers that the main point of the last sentence of paragraph 14.115 does not concern whether the United States has established as a fact that it sets bank limits with respect to each foreign obligor. Rather, the sentence at issue indicates that whether or not such bank limits exist does not alter the Panel's conclusion, in the first sentence of the same paragraph, that "GSM 102 fees are not risk-based insofar as they do not take into account one of the main elements of risk associated with the guarantees, the risk of default that is specific to an individual foreign obligor." In any case, the Panel does not understand Brazil to have challenged, in its submissions to the Panel, the US assertion that it sets bank limits with respect to each foreign bank obligor. The Panel therefore denies Brazil's request.

7.74 The **United States** requests that the Panel delete the parenthetical, in the last sentence of paragraph 14.119 of the interim report (paragraph 14.119 of this Report), to the effect that "meaning that, for the United States, the other programmes were primarily responsible for any net cost to the US Government in the original proceeding". The United States disagrees to the extent that the sentence implies that the United States agrees that the three export credit guarantee programmes resulted in any net cost or loss. **Brazil** objects to the US request. The **Panel** considers that the use of the term "any" in the sentence at issue ensured that the reader would not ascribe to the parenthetical the meaning which the United States suggests may be implied. Nonetheless, the Panel is mindful of accurately reflecting the parties' arguments and has therefore deleted the parenthetical. In any case, the Panel does not regard that sentence as essential to the understanding of the Panel's discussion of this issue.

7.75 **Brazil** requests that the Panel modify the second sentence of paragraph 14.120 of the interim report (paragraph 14.120 of this Report), in which the Panel indicates that it is "therefore unable to assess whether a 46 per cent average fee increase (23 per cent trade-weighted increase) is sufficient to ensure that the GSM 102 programme is not provided at a net cost to the US Government." Brazil has two concerns with this sentence. *First*, Brazil is concerned that this formulation might be read to suggest that the Panel has imposed the burden of proof on the United States, which Brazil understands is not the case. *Second*, Brazil believes that it would be prudent to put the Panel's statement in the context of its overall conclusion, in paragraph 14.131, that the evidence as a whole demonstrates that the GSM 102 export credit guarantee programme is provided against premiums which involve a net cost to the US Government. The **United States** does not comment on Brazil's request with respect to this paragraph. The **Panel** does not consider that the language used in paragraph 14.120 of the interim report (paragraph 14.120 of this Report), gives rise to the concern expressed by Brazil. The Panel therefore rejects Brazil's request to amend this paragraph.

D. EDITORIAL CORRECTIONS

7.76 In addition to the above-mentioned changes, the Panel has made a number of editorial changes and technical corrections.[52]

VIII. PROCEDURAL MATTERS

A. REQUEST OF BRAZIL THAT THE PANEL EXERCISE ITS DISCRETION TO SEEK CERTAIN INFORMATION FROM THE UNITED STATES UNDER ARTICLE 13 OF THE DSU

8.1 On 1 November 2006, prior to the organizational meeting of this Panel, Brazil submitted a document entitled "Brazil's Request to the Compliance Panel to Pose Questions to the United States, under Article 13.1 of the DSU", in which it requested the Panel to "exercise its discretion under Article 13.1 [of the DSU] to request the United States to produce documents and information relating to (a) payments to US producers of upland cotton under the US counter-cyclical payment programme and (b) the export credit guarantee programmes (principally the GSM 102 export credit guarantee programme)".[53] Brazil asserted that all the requested documents and information were "highly relevant to Brazil's claims and the issues before this compliance Panel. Therefore, Brazil considers that it is 'necessary and appropriate' for the compliance Panel to seek the documents and information requested at this early stage of the compliance proceeding". Brazil asked the Panel to "request the United States to produce this information within three weeks of the date the Panel issues its request".

8.2 On 7 November 2006, at the request of the Panel, the United States submitted comments on Brazil's request. The United States requested the Panel to decline Brazil's request stating, *inter alia*,

[52] In the course of the interim review, the Panel has noted that the paragraph numbers cited by the Parties in their submissions are sometimes different from the paragraph numbers that appear in the paper version of the submission the parties are referring to. The Panel understands that this discrepancy is often a result of the improper functioning of the electronic version submitted by one of the parties. The Panel has endeavoured to correct any such discrepancies, but the Panel points out, for the record, that the final report may still contain such discrepancies in the references to paragraph numbering of the parties' submissions.

[53] Excerpt from Brazil's 1 November 2006 submission. See item 1 of Annex D for the full text of this submission.

that "Brazil fails to explain how the Panel can assess whether any of the documents and information [it is seeking] is 'essential' or 'suitable' for the Panel's objective assessment of the matter before it, and not to be used to make Brazil's *prima facie* case for it, before either party has even had the opportunity to present any arguments or any evidence in support of its case".[54]

8.3 On 8 November 2006, the Panel communicated the following to the Parties:

> "The Panel declines to make a decision on Brazil's request at this point of time. The Panel will communicate to the parties its decision on this request after having received and considered Brazil's first submission. In this connection, the Panel reserves its right to amend the timetable (and the working procedures, as necessary) in relation to this issue."[55]

8.4 On 17 November 2006, in accordance with the Panel's timetable, Brazil made its First Written Submission. In relation to its request under Article 13 of the DSU concerning counter-cyclical payments, Brazil stated the following:

> "During informal discussions held [before the establishment of the Panel], Brazil requested the United States to provide the information needed to allocate counter-cyclical payments to upland cotton production in MY 2003-2005. The United States claimed that this information was 'confidential.' In a letter to the compliance Panel dated 1 November 2006, Brazil requested the compliance Panel to request the United States, pursuant to Article 13.1 of the DSU, to produce the exact same type of information that it finally produced during the original proceeding in response to repeated requests by the original panel, updated for MY 2003-2005. Brazil reiterates its request based on the reasons set out in this submission and in its letter of 1 November 2006."[56] (footnotes omitted)

8.5 Brazil also stated:

> "Furthermore, there is every reason to believe that a strong positive relationship continues to exist between upland cotton base acre holders receiving annual counter-cyclical payments and upland cotton production. As during the period MY 1999-2002, the economics of high-cost upland cotton production in the United States compel that a significant majority of US upland cotton be grown on upland cotton base acres (or other types of high-payment base acreage such as rice and peanuts) during MY 2003-2005. Brazil looks forward to receipt of this base and planted acreage information from the United States following a request by the compliance Panel to the United States pursuant to Article 13.1 of the DSU."[57] (footnotes omitted)

8.6 In its First Written Submission, Brazil did not refer to its DSU Article 13 request in relation to export credit guarantee programmes.

[54] Excerpt from the 7 November 2006 comments of the United States. See item 1 of Annex E for the full text of these comments.

[55] Panel's communication to the parties dated 8 November 2006, para. 1. See item 1 of Annex F for the full text of this communication.

[56] Brazil's First Written Submission para. 117.

[57] Brazil's First Written Submission para. 131.

8.7 The United States further explained its position on this matter in a letter of 20 November 2006.[58] On 22 November 2006, Brazil submitted comments on this letter of the United States.[59]

8.8 On 27 November 2006, the Panel sent a communication to the parties stating that it "is of the view that it cannot conclude at this stage that it is necessary and appropriate within the meaning of Article 13 of the DSU to seek the information requested by Brazil before the Panel has had the opportunity to review the arguments and supporting evidence, if any, that will be presented by the United States in response to Brazil's argument regarding the causal relationship between certain subsidies and price suppression for upland cotton".[60]

8.9 On 11 January 2007, Brazil filed its Rebuttal Submission. In making its argument that marketing loan and counter-cyclical payments were trade-distorting, Brazil stated the following:

> "Had the United States produced all data requested by Brazil, this data would allow Brazil to allocate counter-cyclical payments to upland cotton planted on non-upland cotton base acreage under Brazil's Methodology, as determined to be 'appropriate' and conservative by the original panel (as detailed below, Brazil requests the compliance Panel to exercise its discretion under Article 13.1 of the DSU to request that the United States produce the same data for MY 2003-2005 that was available to the original panel for MY 2002)."[61] (footnote omitted)
>
> ...
>
> "As noted above, the limited data that the United States produced (in the context of its flawed argument that counter-cyclical payments have no significant effects on production) does not allow Brazil to update the amounts of counter-cyclical payments it allocates to upland cotton based on its own methodology. Therefore, Brazil reiterates its request, set out in its 1 November 2006 letter to the compliance Panel, that the Panel exercise its discretion and request that the United States produce the same data for MY 2003-2005 that was available to the original panel for MY 2002."[62]

8.10 In its Rebuttal Submission Brazil did not refer to its DSU Article 13 request in relation to export credit guarantee programmes.

8.11 On 17 January 2007, the Panel posed certain questions to the United States and to Brazil on Brazil's request under Article 13 of the DSU.[63] Brazil and the United States submitted their responses to these questions on 19 January 2007.[64] In relation to export credit guarantee programmes[65], Brazil stated that it "continues to believe that the information, documents and data requested in [its request submitted on 1 November 2006] will assist the compliance Panel in making 'an objective assessment of the matter before it,' within the meaning of Article 11 of the [DSU]". In relation to counter-cyclical

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[58] The full text of the US letter dated 20 November 2006 is contained in item 2 of Annex E.

[59] The full text of Brazil's letter dated 22 November 2006 is contained in item 4 of Annex E.

[60] Excerpt from the Panel's communication dated 27 November 2006. The full text of this communication is contained in item 2 of Annex F.

[61] Brazil's Rebuttal Submission para. 165.

[62] Brazil's Rebuttal Submission para. 171.

[63] See item 5 of Annex F for the full text of the questions.

[64] See items 2 and 3 of Annex D for the full text of the responses of the United States and Brazil, respectively.

[65] The question read as follows: "Does Brazil deem that the questions posed [concerning export credit guarantee programs] submitted on 1 November [..] are now unnecessary?"

payments, the United States pointed out that it had actually provided, in an exhibit to its First Written Submission, the data (for MY 2005) sought by Brazil.

8.12 On 22 January 2007, Brazil submitted another letter[66] regarding the data on counter-cyclical payments. In this letter, while acknowledging that the data provided by the United States for MY 2005 corresponded to what Brazil had sought, Brazil pointed out that the United States had still not submitted the data for MY 2003-2004 and MY 2006.

8.13 On 5 February 2007, the United States filed its Rebuttal Submission. In it, the United States reiterated that it had already submitted the data sought by Brazil in respect of counter-cyclical payments, and stated that MY 2006 data were not yet available and that earlier years were not relevant to Brazil's claim of "present" serious prejudice. The United States therefore considered that Brazil's request was moot.[67]

8.14 On 21 March 2007, the Panel issued the following communication to the parties on this matter:

> "The Panel notes that Brazil's request was made prior to the filing of the written submissions in this case and that information on certain items identified in that request has since been provided to the Panel. The Panel also expects to receive information on issues raised in Brazil's request in response to the questions posed by the Panel on 15 March 2007. The Panel considers that at this juncture it is not necessary to seek more information in respect of issues identified in Brazil's request. The Panel may, however, decide to request this information at a later stage of this proceeding and may ask questions to the parties at any time, in accordance with paragraph 7 of the Panel's working procedures."[68]

8.15 The Panel ultimately did not resort to Article 13 of the DSU concerning the above or any other issue.

B. REQUEST OF THE UNITED STATES FOR OPEN HEARING

8.16 During the organizational meeting held on 6 November 2006, the United States stated, in relation to paragraph 2 of the draft working procedures[69], that it preferred the panel meeting to be opened to the public. The United States acknowledged that it could not secure agreement with Brazil on this issue, and requested that, given Brazil's refusal, the working procedures at least should indicate that the portions of the meeting where the United States presented its position be open to the public.

8.17 On 8 November 2006, the Panel sent a communication in which it stated as follows:

> "In relation to paragraph 2 of the working procedures, the Panel has noted that the United States wishes to open up the portion of the meeting where it presents its own views and statements, while Brazil opposes opening the meeting to the public. The Panel draws the attention of the parties that opening up of any portion of the Panel meeting entails logistical considerations. The Panel invites the United States to submit comments, by close of business of Tuesday 21 November, on how exactly it

[66] See item 8 of Annex E for the full text of Brazil's letter.

[67] See US Rebuttal Submission, para. 278.

[68] Excerpt from the Panel's communication dated 21 March 2007. See item 8 of Annex F for the full text of this communication.

[69] The Panel's draft working procedures paragraph 2 read as follows: "The Panel shall meet in closed session. The parties to the dispute, and interested third parties, shall be present at the meetings only when invited by the Panel to appear before it." (This paragraph remained unchanged in the final working procedures.)

> envisages such opening to be logistically meaningful. The Panel reserves its right to amend the working procedures in relation to this matter." [70]

8.18 On 21 November 2006, the United States submitted, in response to the Panel's invitation above, its comments on the possible logistics of opening a specific part of the meeting. The United States explained *inter alia* that it "has invoked its right under Article 18.2 of the [DSU] to make statements of its own positions public and, as an appropriate means to do this, has requested that the Panel exercise its authority to open to the public the US statements and US answers to questions presented in the panel meeting".[71]

8.19 In a letter of 24 November 2006, Brazil indicated that it did not agree with the assertions of the United States, noting *inter alia*, that "nothing in Article 18.2 mandates or implies that to effect a Member's right to disclose its own positions or statements, panels must agree to open meetings to public observation" and that "a Member's right to disclose its own positions cannot prejudice another Member's right to confidentiality".[72]

8.20 On 28 November 2006, the Panel informed the parties as follows:

> "The Panel notes, first, that there is no precedent in WTO dispute settlement practice for a decision to open a (portion of) a panel meeting to the public based on a request by one party to a dispute that is opposed by another party. Second, the Panel has carefully considered the argument of the United States in its letter dated 21 November that in requesting the Panel to open to the public US statements and US answers to questions presented in the panel meeting the United States is exercising its right under Article 18.2 of the DSU, second sentence. The Panel considers that there are various possible ways in which a party can disclose its statements to the public and that the United States has not explained why procedures the United States normally uses to disclose its statements in WTO dispute settlement proceedings to the public would not be adequate in this case. Furthermore, the right of party to disclose its statements of its positions must also be reconciled with the obligation of confidentiality in the third sentence of Article 18.2. Finally, the Panel considers that the practical arrangements proposed by the United States in its letter of 21 November 2006 pose serious practical and logistical difficulties.
>
> For the above reasons, we decline to grant the request made by the United States."[73] (footnote omitted)

C. SERVICING OF SUBMISSIONS

8.21 On 18 December 2006, Brazil sent a letter to the Panel complaining about the late filing of the First Written Submission by the United States[74] and requested that "the compliance Panel reject the United States' submission as not timely filed".[75]

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[70] Panel's communication to the parties dated 8 November 2006, paragraph 3. See item 1 of Annex F for the full text of this communication.

[71] US letter dated 21 November 2006, second paragraph. See item 3 of Annex E for the full text of this letter.

[72] See item 5 of Annex E for the full text of Brazil's letter of 24 November 2006.

[73] Excerpt from the Panel's communication dated 28 November 2006. See item 3 of Annex F for the full text of this letter.

[74] Brazil stated that "the United States [...] filed the electronic version of its submission 12 hours late, on Saturday, 16 December at 5:24 a.m."

8.22 On 19 December 2006, the United States sent a letter to the Panel stating that the Panel should reject Brazil's request, asserting *inter alia* that "the DSU does not authorize the 'rejection' of submissions for the inability of a Member to meet precisely the time by which parties 'should provide their submissions' according to a panel's working procedures. To the contrary, the DSU provides that '[p]anel procedures should provide sufficient flexibility so as to ensure high-quality panel reports, while not unduly delaying the panel process'".[76] (footnotes omitted)

8.23 On 20 December 2006, the Panel communicated the following to the parties:

> "The Panel notes that Brazil requests the Panel to 'reject the United States' submission as not timely filed'. The Panel declines to do so. However, the Panel regrets this delay by the United States, and requests the United States to abide by the deadlines established by the Panel concerning its future submission(s)."[77]

8.24 On 7 February 2007, Brazil sent a letter to the Panel complaining about the late filing of the Rebuttal Submission by the United States.[78] Brazil requested that the compliance Panel "reject the United States' submission as not timely filed".[79]

8.25 On 12 February 2007, the United States sent a letter to the Panel commenting on this letter from Brazil stating *inter alia* that "Brazil has no basis for its request that the Panel reject the US Rebuttal Submission".[80]

8.26 On 16 February 2007, the Panel communicated the following to the parties:

> "The Panel regrets that the United States has missed the deadline for the second time in this Article 21.5 proceeding. The Panel finds it extraordinary that the United States has missed so many deadlines in the original proceeding as well as in this Article 21.5 proceeding.
>
> On the other hand, the Panel considers that there is no provision in the DSU that allows a panel to simply reject an entire submission as not timely. The Panel does not consider that the two cases cited by Brazil support Brazil's request. Thus, we decline to grant the request made by Brazil."[81] (footnote omitted)

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[75] Excerpt from Brazil's letter dated 18 December 2006. See item 6 of Annex E for the full text of this letter.

[76] Excerpt from US letter dated 19 December 2006. See item 7 of Annex E for the full text of this letter.

[77] Excerpt from the Panel's communication to parties dated 20 December 2006. See item 4 of Annex F for the full text of this communication.

[78] Brazil stated that "the United States [...] filed the electronic version of its submission more than 6 hours late - at 11:39 p.m. on Monday, 5 February".

[79] Excerpt from Brazil's letter dated 7 February 2007. (footnote omitted.) See item 9 of Annex E for the full text of this letter.

[80] Excerpt from US letter dated 12 February 2007. See item 10 of Annex E for the full text of this letter.

[81] Excerpt from the Panel's communication dated 16 February 2007. See item 7 of Annex F for the full text of this communication.

D. REQUEST OF THE EUROPEAN COMMUNITIES FOR A FINDING OR RULING ON THE PANEL'S COMPOSITION

8.27 The **European Communities**, a third party to this proceeding, requests the Panel to make "a finding or ruling" with respect to "the propriety of [the Panel's] composition".[82]

8.28 The Panel considers that it is not within its authority under the DSU to make a "finding or ruling" on an issue that has not been raised by any of the parties to the dispute and which concerns the application by the WTO Director-General of the DSU provisions regarding panel composition.[83] The Panel fails to see how the "finding or ruling" requested by the European Communities would contribute to a positive solution to this dispute within the meaning of Article 3.7 of the DSU.

E. LEAST DEVELOPED COUNTRY MEMBERS

8.29 Chad, a least-developed country Member, participated in this proceeding as a third party. In accordance with Article 24.1 of the DSU, particular consideration was given to the special situation of this Member. Chad made a detailed written submission and made an oral statement at the meeting of the Panel with the third parties on 28 February 2007.[84] Chad was represented by a delegation which was headed by its Ambassador to the United Nations and Other International Organisations in Geneva and which also included staff members of the Advisory Centre on WTO Law. In its Submission and Oral Statement, Chad stressed that it had a special interest in this proceeding in light of the critical importance of the cotton sector to its economy and of the commitments that WTO Members have undertaken with respect to cotton in the July 2004 Framework and at the Hong Kong Ministerial Conference. Chad emphasized the benefits for Chad and other Sub-Saharan cotton-producing countries of full implementation by the United States of the DSB recommendations and rulings in this dispute and drew attention, in this regard, to recent studies that provide empirical evidence of the magnitude of these benefits. Chad also submitted detailed legal arguments in support of its view that the United States had not complied with the DSB recommendations and rulings. The Panel refers to the arguments of Chad in the summaries of arguments of the third parties.

IX. GENERAL CONSIDERATIONS AND ISSUES RELATING TO THE SCOPE OF THIS PROCEEDING

A. STANDARD OF REVIEW, BURDEN OF PROOF AND RULES OF TREATY INTERPRETATION

1. Standard of review

9.1 In respect of the standard of review that this Panel must apply, Article 11 of the DSU provides, in relevant part:

> "The function of panels is to assist the DSB in discharging its responsibilities under this Understanding and the covered agreements. Accordingly, a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such

[82] EC Third Party Submission, paras. 6-30; EC Third Party Oral Statement, paras. 2-4.

[83] While the European Communities asserts that there is precedent in WTO dispute settlement practice that supports its position that the Panel has the authority to rule on the propriety of its own composition, and that the Panel is under a duty to address this issue because "it is of fundamental importance for the correct interpretation of the DSU and for the smooth and equitable operation of the WTO dispute settlement system" (EC Third Party Submission, paras. 28-29), the Panel finds the arguments of the European Communities in this regard unpersuasive.

[84] Chad's Written Submission and Oral Statement were prepared with the cooperation of the Advisory Centre on WTO Law.

other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements."

9.2 The Panel is cognizant of the need to give due consideration to the findings of the original panel in this dispute. Proceedings under Article 21.5 of the DSU do not occur in isolation but are part of a "continuum of events". The Panel conducts its analysis of the claims of Brazil "against the background of the original proceedings, and with full cognizance of the reasons provided by the original panel".[85] [86] The parties have expressed views on the issue of the weight that this Panel should accord to the legal and factual findings and reasoning of the panel in the original proceeding.[87] The Panel does not consider that it is necessary or appropriate for it to make a general statement on this question in the abstract.

2. Burden of proof

9.3 The general rules regarding the allocation of the burden of proof in WTO dispute settlement require that a party claiming a violation of a provision of a WTO agreement by another Member assert and prove its claim.[88] These rules also apply to proceedings under Article 21.5 of the DSU.[89] Brazil

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[85] Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 121. In the same report, the Appellate Body stated that "a panel acting pursuant to Article 21.5 of the DSU would be expected to refer to the initial panel report, particularly in cases where the implementing measure is closely related to the original measure, and where the claims made in the proceedings under Article 21.5 closely resemble the claims made in the initial proceedings". Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 109.

[86] We note, in this regard, that in reviewing the findings of a panel in a proceeding under Article 21.5 involving a determination of injury by a domestic investigating authority, the Appellate Body has observed that:

> "doubts could arise about the objective nature of an Article 21.5 panel's assessment if, on a specific issue, that panel were to deviate from the reasoning in the original panel report in the absence of any change in the underlying evidence in the record and explanations given by the investigating authority in a redetermination. These concerns are not, however, based on the binding effect of the adopted findings of the original panel".

Appellate Body Report, *US – Softwood Lumber VI (Article 21.5 – Canada)*, para. 103. The Appellate Body made these observations in addressing an argument of Canada that the panel had "failed to make an objective examination of the matter before it because it failed to apply findings from the original panel report even though these findings had been adopted by the DSB and are binding upon the parties to the dispute." Appellate Body Report, *US – Softwood Lumber VI (Article 21.5 – Canada)*, para. 101.

[87] E.g., Brazil's Response to Panel Question 2; US Response to Panel Question 2.

[88] Appellate Body Report, *US – Wool Shirts and Blouses*, p. 14. With respect to these general rules on allocation of the burden of proof, the Appellate Body recently observed:

> "... in WTO dispute settlement, as in most legal systems and international tribunals, the burden of proof rests on the party that asserts the affirmative of a claim or defence. A complaining party will satisfy its burden when it establishes a *prima facie* case by putting forward adequate legal arguments and evidence. The nature and scope of arguments and evidence required 'will necessarily vary from measure to measure, provision to provision, and case to case'. When a claim is brought against a WTO Member's legislation or regulation, a panel may, in some circumstances, consider that the text of the relevant legal instrument is sufficiently clear to establish the scope and meaning of the law. However, in other cases, a panel may consider that additional evidence is necessary to do so. Once the complaining party has established a *prima facie* case, it is then for the responding party to rebut it.
>
> A panel errs when it sustains a claim for which the complaining party has failed to make out a *prima facie* case. Nevertheless, a panel does not commit legal error merely by omitting to specify which party bears the burden of proof in respect of each claim or defence. Moreover, a panel is not obliged, in every instance, to make an explicit finding that a complaining party

as the complaining party must therefore make a *prima facie* case of violation of the relevant provisions of the WTO agreements invoked by Brazil, which the United States must refute. We also note, however, that it is generally for each party asserting a fact, whether complainant or respondent, to provide proof thereof.[90] In this respect, therefore, it is also for the United States to provide evidence for the facts which it asserts. A *prima facie* case is one which, in the absence of effective refutation by the other party, requires a panel, as a matter of law, to rule in favour of the party presenting the *prima facie* case.

9.4 The Appellate Body recently discussed the application of the general rules on the allocation of burden of proof in the context of Article 21.5 of the DSU as follows:

> "The text of Article 21.5 expressly links the 'measures taken to comply' with the recommendations and rulings of the DSB concerning the original measure. A panel's examination of a measure taken to comply cannot, therefore, be undertaken in abstraction from the findings by the original panel and the Appellate Body adopted by the DSB. Such findings identify the WTO-inconsistency with respect to the original measure, and a panel's examination of a measure taken to comply must be conducted with due cognizance of this background. Thus, the adopted findings from the original proceedings may well figure prominently in proceedings under Article 21.5, especially where the measure taken to comply is alleged to be inconsistent with WTO law in ways similar to the original measure. In our view, these considerations may influence the way in which the complaining party presents its case, and they may also be relevant to the manner in which an Article 21.5 panel determines whether that party has discharged its burden of proof and established a *prima facie* case."[91]

> has met its burden to establish a *prima facie* case in respect of each element of a particular claim, or that the responding party has effectively rebutted a *prima facie* case. Thus, a panel is not required to make an explicit ruling that a complaining party has established a *prima facie* case of inconsistency before examining the responding party's defence and evidence. At the same time, the mere articulation by a panel of the correct rules as to the burden of proof is not sufficient if the panel does not, in fact, properly allocate that burden in the case before it."

Appellate Body Report, *Chile – Price Band System (Article 21.5 – Argentina)*, paras. 134-135.

[89] Appellate Body Report, *Chile – Price Band System (Article 21.5 – Argentina)*, para. 136. New Zealand argues in its Third Party Submission that Article 7.8 of the *SCM Agreement* affects the distribution of burden of proof in this proceeding under Article 21.5 of the DSU. Specifically, New Zealand asserts that:

> "[s]ince an implementing Member has the option of either withdrawing the subsidising measure or removing the adverse effects, a Member that fails to withdraw the measure in question then should have the burden of showing that it has removed the adverse effects. Thus, in the present case proof by Brazil that the measures found by the original panel to cause adverse effects have not been withdrawn should establish a *prima facie* case that implementation has not occurred and the burden should then shift to the United States to prove that the adverse effects caused by those subsidizing measures have been removed."

New Zealand's Third Party Submission, para. 5.06. The Panel finds no support in the text of Article 7.8 of the *SCM Agreement* and Article 21.5 of the DSU for the proposition that in a proceeding under Article 21.5 involving an alleged failure to comply with Article 7.8 of the *SCM Agreement*, a Member which has not withdrawn the subsidy has the burden of showing that it has removed the adverse effects. The Panel also notes Brazil's statement that, in the present case, "Brazil has the burden of demonstrating under Article 7.8 that the United States did not take appropriate steps to remove the adverse effects caused by the original basket of measures". Brazil's Response to Panel Question 26, para. 20.

[90] Appellate Body Report, *US – Wool Shirts and Blouses*, p. 14.

[91] Appellate Body Report, *Chile – Price Band System (Article 21.5 – Argentina)*, para. 136.

3. Rules of treaty interpretation

9.5 Article 3.2 of the DSU requires the Panel to apply customary rules of public international law on the interpretation of treaties. It is generally accepted that these rules can be found in Articles 31-33 of the Vienna Convention on the Law of Treaties of 1969 ("*Vienna Convention*"). Article 31(1) of the *Vienna Convention* provides:

> "A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."

B. SCOPE OF THIS PROCEEDING UNDER ARTICLE 21.5 OF THE DSU

1. Introduction

9.6 Article 21.5 of the DSU provides:

> "Where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures, including wherever possible resort to the original panel. The panel shall circulate its report within 90 days after the date of referral of the matter to it. When the panel considers that it cannot provide its report within this time frame, it shall inform the DSB in writing of the reasons for the delay together with an estimate of the period within which it will submit its report."

9.7 The United States requests that the Panel make preliminary rulings that certain claims of Brazil are outside the scope of Article 21.5 of the DSU because they are not claims relating to the "existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings" of the DSB. The United States makes this request in respect of: (i) claims of Brazil relating to export credit guarantees regarding exports of pig meat and poultry meat; (ii) claims of Brazil relating to the marketing loan and counter-cyclical payment *programmes* in addition to *payments* made under those programmes; and (iii) claims of Brazil regarding non-compliance in a past period.[92]

9.8 The United States also considers that *payments* made under the marketing loan and counter-cyclical payment programmes after 21 September 2005 are not properly within the scope of this proceeding.[93]

2. Whether Brazil's claims relating to export credit guarantees for pig meat and poultry meat are outside the scope of this proceeding

(a) Main arguments of the parties

9.9 The **United States** argues that since export credit guarantees for pig meat and poultry meat were not found to be WTO-inconsistent in the original proceeding they were not subject to DSB recommendations and rulings. Therefore, GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat are not "measures taken to comply" with the recommendations and rulings

[92] US First Written Submission, paras. 22-56; US Rebuttal Submission, paras. 16-71.

[93] The United States did not make the argument that payments made after 21 September 2005 are not within the scope of this proceeding as part of its request for preliminary rulings in its First Written Submission but presented this argument at a later stage of the proceeding. US Comments on Brazil's Response to Panel Question 15; US Response to Panel Question 47; US Comments on Brazil's Response to Panel's Second Set of Questions, paras. 8-14.

of the DSB and these measures and Brazil's claims relating to these measures are not within the scope of this proceeding.[94]

9.10 The United States considers that Brazil confuses the proper standard as to when claims are within the scope of Article 21.5 proceedings and incorrectly assumes that the standard is one of whether there has been a "final resolution" of the issue in the original proceeding. Brazil misinterprets the Appellate Body report in *EC – Bed Linen (Article 21.5 – India)* and confuses two distinct issues: the issue of the scope of a compliance proceeding under Article 21.5 of the DSU, on the one hand, and the issue of when a claim against a specific measure or aspect of a measure can be considered to be "finally resolved" for purposes of WTO dispute settlement, on the other.[95]

9.11 The United States submits that compliance proceedings under Article 21.5 of the DSU may address two types of matters. *First*, that measures taken to comply with DSB recommendations and rulings do not exist. *Second*, that measures taken to comply with DSB recommendations and rulings are not consistent with a covered agreement. If a measure is not subject to any DSB recommendations and rulings because the measure has not been found to be WTO-inconsistent, there is no logical basis for any claim that a Member has not implemented the DSB recommendations and rulings in respect of that measure. Moreover, unless the original measure itself is considered to be a measure taken to comply, there is no basis for claims to be made against the measure alleging that it is inconsistent with a covered agreement. Thus, measures are outside the scope of Article 21.5 of the DSU when they have not been found to be WTO-inconsistent and are not themselves measures taken to comply.[96]

9.12 The United States submits that specific export credit guarantees are "measures" and those guarantees provided in support of exports of pig meat, poultry meat and other scheduled products other than rice have never been subject to any DSB recommendations and rulings and are not measures taken to comply with any DSB recommendations and rulings. Prior WTO dispute settlement reports do not support the proposition that the scope of this proceeding under Article 21.5 can be extended to include claims against measures that were never subject to any DSB recommendations and rulings and that are not measures taken to comply with any such recommendations and rulings.[97]

9.13 **Brazil** requests the Panel to reject the preliminary objection of the United States because this objection is contrary to Appellate Body jurisprudence on the scope of claims properly brought in compliance proceedings.[98] While the Appellate Body held in *EC – Bed Linen (Article 21.5 – India)* that an unappealed finding in a panel report adopted by the DSB must be treated as a final resolution to the dispute in respect of a particular claim and specific component of a measure, this limitation does not apply to Brazil's claims relating to export credit guarantees for pig meat and poultry meat because there has been no such final resolution with respect to these claims.[99] Thus, Brazil argues that it may bring these claims in this proceeding because the original proceeding did not lead to a "final resolution" with respect to these claims.

9.14 Brazil argues that its claims relating to export credit guarantees for pig meat and poultry meat relate to a measure taken to comply within the meaning of Article 21.5 of the DSU. While Brazil's

[94] US First Written Submission, para. 24-30. The United States emphasizes that the relevant question is not whether, as argued by Brazil, Brazil may "re-assert" its claims against export credit guarantees for exports of pig meat and poultry meat, but whether Brazil may do so in the context of a proceeding under Article 21.5 of the DSU.

[95] US Rebuttal Submission, paras. 10-15; US Response to Panel Question 10.

[96] US Response to Panel Question 6.

[97] US Comments on Brazil's Response to Panel Question 6.

[98] Brazil's Submission Regarding US Requests for Preliminary Ruling, para. 7.

[99] Brazil's Submission Regarding US Requests for Preliminary Ruling, paras. 9-12.

claims are product-specific, the measure at issue, the amended GSM 102 programme, applies in the same manner to all products covered by the programme. There is no factual basis for the US argument that the measures at issue are the export credit guarantees for pig meat and poultry meat.[100]

9.15 Further, Brazil submits that the measure subject to its claims is a new measure and that a Member may present any claim in a proceeding under Article 21.5 with respect to a new measure. While panels have determined that a Member may not bring a new claim in a proceeding under Article 21.5 in respect of an aspect of a measure that remains unchanged from the original proceeding and that was not challenged in the original proceeding, that limitation does not apply to the present case because Brazil presents the same claim with respect to a new aspect of a new measure. Referring to the Appellate Body report in *EC – Bed linen (Article 21.5 – India),* Brazil asserts that it should not be held responsible for the absence of a final resolution in the original proceeding.[101]

(b) Main arguments of third parties

9.16 **Australia** submits that Brazil's claim relating to GSM 102 export credit guarantees issued in respect of pig meat and poultry meat may properly be considered by this Panel. The situation in the present case is not that of a measure that was not challenged in the original proceedings or, if challenged, was addressed in those proceedings and not found to be WTO-inconsistent. The claim specifically made by Brazil in its request for establishment relates to the WTO-consistency of a new measure – guarantees issued under the revised GSM 102 programme – the revisions to which were implemented in response to the rulings and recommendations of the DSB. Brazil is entitled to request, and the Panel is required to consider, the new measure in its totality, including the measure's application.[102]

9.17 The **European Communities** considers that in addressing the question whether GSM 102 export credit guarantees relating to pig meat and poultry meat are properly within the scope of this proceeding, the key issue before the Panel is the nexus or the degree of interrelatedness or interdependence between different elements of the measure. Thus, the Panel should examine the original measure at issue and the measure taken to comply and, with particular reference to the elements of the measure that the United States argues are outside the terms of reference of the Panel, enquire into the extent to which these elements are interrelated or interdependent with the measures or elements of measures that the United States accepts as being within the Panel's terms of reference. At first sight, the question of whether US export credit guarantees relating to pig meat and poultry meat circumvent US commitments under the *Agreement on Agriculture* and are inconsistent with the *SCM Agreement* may not be necessarily interdependent with and not even necessarily interrelated with the same question regarding upland cotton. However, there are other factors that merit careful consideration, including the fact that the *SCM Agreement* makes clear that a "programme" can be a measure, that the United States has admitted that the measure at issue is a "programme" within the meaning of the *SCM Agreement*, that the original panel consistently referred to the GSM 102 "programme", and that the United States has elected to amend the GSM 102 programme generally, including with respect to pig meat and poultry meat.[103]

9.18 **Japan** submits that the claim of Brazil regarding GSM 102 export credit guarantees for pig meat and poultry meat is within the scope of this proceeding. The inability of the Appellate Body to complete the analysis with respect to a panel finding reversed by the Appellate Body is similar to the exercise of judicial economy in that in both cases there is no "final resolution" with respect to the

[100] Brazil's Response to Panel Question 6, para. 21; Brazil's Comments on US Response to Panel Question 6.
[101] Brazil's Response to Panel Question 6, paras. 42-47.
[102] Australia's Third Party Submission, paras. 8-11.
[103] EC Third Party Oral Statement, para. 5-13.

claim in question. The recent panel report in *US – Oil Country Tubular Goods Sunset Reviews (Article 21.5 – Argentina)* makes clear that this Panel has the authority to identify and assess the new measure taken by the United States to comply with the DSB recommendations and rulings, including the GSM 102 programme as applied to pig meat and poultry meat.[104]

(c) Evaluation by the Panel

9.19 The United States request the Panel to make a preliminary ruling that Brazil's claims relating to GSM 102 guarantees in respect of exports of pig meat and poultry meat are outside the scope of this proceeding under Article 21.5 of the DSU.[105]

9.20 The Panel recalls that the original panel found that in respect of twelve scheduled products, including pig meat and poultry meat, it had not been established that the United States had applied export credit guarantees constituting export subsidies within the meaning of Article 10.1 of the *Agreement on Agriculture* in a manner resulting in circumvention of export subsidy commitments of the United States.[106] The Appellate Body reversed this finding of the original panel, but considered that there were insufficient undisputed facts in the record to enable it to complete the legal analysis to determine whether the United States had applied export credit guarantees with respect to pig meat and poultry meat in a manner resulting in circumvention of export subsidy commitments of the United States.[107]

9.21 Thus, the issue before the Panel is whether in this proceeding under Article 21.5 of the DSU Brazil may present claims relating to export credit guarantees for pig meat and poultry meat considering that: (i) Brazil presented such claims in the original proceeding; (ii) the original panel rejected these claims; (iii) the Appellate Body reversed the original panel's rejection of these claims, but found itself unable to complete the analysis; such that (iv) the original proceeding did not result in a finding of WTO-inconsistency in respect of export credit guarantees for pig meat and poultry meat.

9.22 The phrase "measures taken to comply with the rulings or recommendations" in Article 21.5 of the DSU limits the scope of Article 21.5 proceedings to a particular category of measures; "[i]f a claim challenges a measure which is not a 'measure taken to comply', that claim cannot properly be raised in Article 21.5 proceedings".[108] Thus, "[i]n an Article 21.5 proceeding, the measure or measures taken to comply go to the heart of [a] panel's mandate".[109] [110]

9.23 The Panel considers that the fact that export credit guarantees for pig meat and poultry meat were not found to be WTO-inconsistent in the original proceeding and were therefore not subject to DSB recommendations and rulings does not necessarily mean that the claims of Brazil with respect to export credit guarantees for pig meat and poultry meat should be found to be outside the scope of

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[104] Japan's Third Party Oral Statement, paras. 3-4.

[105] The United States does not argue that these claims are not covered by Brazil's request for the establishment of a panel (WT/DS267/30). The Panel notes that paragraph 27 of this request refers to "upland cotton and other unscheduled products; and rice, pig meat and poultry meat".

[106] Panel Report, *US – Upland Cotton*, para. 7.881.

[107] Appellate Body Report, *US – Upland Cotton*, paras. 692-694 and 763(f)(i).

[108] Appellate Body Report, *EC – Bed Linen (Article 21.5 – India)*, para. 78. See also Appellate Body Report, *Canada – Aircraft (Article 21.5 – Brazil)*, para. 36; Appellate Body Report, *US – Softwood Lumber IV (Article 21.5 – Canada)*, para. 65.

[109] Panel Report, *US – Countervailing Measures on Certain EC Products (Article 21.5 – EC);* para. 7.35.

[110] Whether a measure identified in a panel request under Article 21.5 is a "measure taken to comply" within the meaning of Article 21.5 is a matter to be decided by the Article 21.5 panel, not by the parties to the dispute. Appellate Body Report, *EC – Bed Linen (Article 21.5 – India)*, para. 78; Panel Report, *US – Countervailing Measures on Certain EC Products (Article 21.5 – EC)*, para. 7.7.

Article 21.5 of the DSU as not relating to "measures taken to comply". The Panel finds support for this view in the reasoning of several recent Appellate Body and panel reports in proceedings under Article 21.5 of the DSU.

9.24 The Panel notes, in particular, the observations of the Appellate Body in *US – Softwood Lumber (Article 21.5 – Canada)*:

> "Some measures with a particularly close relationship to the declared 'measure taken to comply', and to the recommendations and rulings of the DSB, may also be susceptible to review by a panel acting under Article 21.5. Determining whether this is the case requires a panel to scrutinize these relationships, which may, depending on the particular facts, call for an examination of the timing, nature, and effects of the various measures. This also requires an Article 21.5 panel to examine the factual and legal background against which a declared 'measure taken to comply' is adopted. Only then is a panel in a position to take a view as to whether there are sufficiently close links for it to characterize such an other measure as one 'taken to comply' and, consequently, to assess its consistency with the covered agreements in an Article 21.5 proceeding."[111]

9.25 The United States amended its GSM 102 programme in order to comply with the DSB recommendations and rulings in the original proceeding. The amendments made to the programme apply to exports of all products covered under the programme, including pig meat and poultry meat. The Panel does not agree with Brazil's argument that the measure that is the subject of its claims is the amended GSM 102 programme itself and that export credit guarantees with respect to pig meat and poultry meat are not themselves "measures". In the Panel's view, that the amended programme applies to all products in the same manner does not alter the fact that the application of the programme to an individual product constitutes a "measure". Nevertheless, while accepting the argument of the United States that GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat are measures, we consider that these measures have a "particularly close relationship to the declared measure taken to comply and to the recommendations and rulings of the DSB". As noted above, the amended programme applies in the same manner to all products covered by the programme. Furthermore, the Panel notes that most of the legal and factual issues raised by Brazil's claims relating to export credit guarantees pertain to the amended GSM programme in general without distinction between individual products to which the programme applies. In addition, the United States has strongly argued that the Panel should examine Brazil's claim solely under the standard contained in item (j) of the Illustrative List of Export Subsidies, a standard that requires the Panel to analyze the GSM programme as a whole rather than in relation to particular products.[112]

9.26 The Panel also notes that Brazil's claims with respect to export credit guarantees for pig meat and poultry meat are not claims that were rejected in the original proceeding and that relate to an unchanged measure. Rather with respect to a new measure – the application of the amended GSM 102 programme to exports of pig meat and poultry meat – Brazil makes a claim in respect of which the original proceeding did not result in a finding as to whether or not the United States was acting

[111] Appellate Body Report, *US – Softwood Lumber IV (Article 21.5 – Canada)*, para. 77.

[112] We note in this regard that in interpreting the scope of the phrase "measures taken to comply" in Article 21.5, the Appellate Body has taken into consideration the fact that the purpose of Article 21.5 of the DSU is to promote prompt compliance with DSB recommendations and rulings and the consistency of measures taken to comply with the covered agreements by making it unnecessary for complainants to initiate new proceedings. (Appellate Body Report, *US – Oil Country Tubular Goods Sunset Reviews (Article 21.5 – Argentina*), para. 151). The logic of the argument of the United States is that in order to obtain a finding on whether export credit guarantees for pig meat and poultry meat are WTO-inconsistent, Brazil must commence a new panel proceeding in which Brazil will need to make the same legal and factual arguments as in this case.

inconsistently with its WTO obligations.[113] No previous panel or Appellate Body proceeding has addressed the precise question before us in this case of whether a Member may assert a claim in an Article 21.5 proceeding in respect of which the Appellate Body found itself unable to complete the analysis in the original proceeding. We find it significant, however, that the Appellate Body recently held that a claim relating to an aspect of a measure on which the panel in the original proceeding had exercised judicial economy was properly within the scope of Article 21.5 of the DSU.[114] In our view, this demonstrates that a claim relating to a measure that has a sufficiently close nexus with the measure taken to comply or with the DSB recommendations and rulings in the original proceeding can be within the scope of Article 21.5 even where that measure itself has not been the subject of DSB recommendations and rulings in the original proceeding.

9.27 In light of the foregoing considerations, the Panel **finds** that the claims of Brazil relating to export credit guarantees for exports of pig meat and poultry meat are within the scope of this proceeding under Article 21.5 of the DSU.

3. Whether Brazil's claims with respect to the marketing loan and counter-cyclical payment *programmes* are outside the scope of this proceeding

9.28 In support for its request for a preliminary ruling that Brazil's claims regarding the marketing loan and counter-cyclical payment programmes are outside the scope of this proceeding, the United States argues, *first*, that these programmes were not subject to recommendations and rulings of the DSB in the original proceeding and, *second,* that these programmes are not "measures taken to comply" within the meaning of Article 21.5 of the DSU because they have not been changed in response to DSB recommendations and rulings or otherwise.

(a) Whether Brazil's claims with respect to the marketing loan payment and counter-cyclical programmes are outside the scope of this proceeding because these programmes were not subject to recommendations and rulings of the DSB in the original proceeding

(i) Main arguments of the parties

9.29 The **United States** requests the Panel to make a preliminary ruling that Brazil's claims of (threat of) serious prejudice in respect of the marketing loan and counter-cyclical payment *programmes* are outside the scope of this proceeding because these programmes are not measures to which the recommendations and rulings of the DSB in the original proceeding were addressed.[115]

9.30 The United States submits that Brazil made a clear distinction in the original proceeding between its actionable subsidy claims against programmes *per se* and actionable subsidy claims against payments under specific programmes, and that the original panel only made a finding of

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[113] The facts before us are in this respect significantly different from the facts before the panel and the Appellate Body in *EC – Bed Linen (Article 21.5 – India).* In that case, the original panel had rejected a claim of India that a certain aspect of a measure taken by the European Communities was WTO-inconsistent. However, in the Article 21.5 proceeding India raised the same claim with respect to the same unchanged aspect of the original measure.

[114] Appellate Body Report, *US – Oil Country Tubular Goods Sunset Reviews (Article 21.5 – Argentina*).

[115] The United States does not argue that these claims are not covered by Brazil's request for the establishment of a panel (WT/DS267/30), but argues that they are outside the Panel's terms of reference by virtue of the limited terms of reference contained in Article 21.5 of the DSU. The Panel notes that in paragraphs 18 and 20 of this request Brazil refers to the "US marketing loan, and counter-cyclical payment programs under the FSRI Act of 2002, as amended, as well as payments made under those programs" and to "the US marketing loan and counter-cyclical payment programs under the FSRI Act of 2002, as amended, as well as payments mandated to be made thereunder".

WTO-inconsistency with regard to the claim of "present" serious prejudice against certain *payments* made in MY 1999-2002. According to the United States, the original panel specifically rejected or declined to address Brazil's other serious prejudice claims.[116] [117]

9.31 The United States submits that Brazil's claims are outside the scope of this proceeding, regardless of whether they are against the marketing loan and counter-cyclical payment programmes alone or against the programmes in addition to payments under the programmes. The original panel did not make a finding of WTO-inconsistency against the Step 2, marketing loan and counter-cyclical payment programmes or against the programmes in addition to all payments thereunder. In this regard, the United States submits that there is no legal or factual basis for Brazil's assertion that "in the circumstances of this dispute a subsidy payment cannot be divorced from a subsidy programme". As a factual matter, the marketing loan and counter-cyclical payment programmes, i.e. the statutory and regulatory provisions authorizing marketing loan and counter-cyclical payments are distinct from the payments that they authorize. Either the statutory/regulatory provisions themselves or the measures resulting from their application, i.e. particular payments, may be challenged in dispute settlement, but each is a distinct measure. The Appellate Body has clarified that "as such" and "as applied" claims are distinct, and there is no support in any Appellate Body report for Brazil's argument that the real world difference between a statutory/regulatory provision and the measures that it authorizes must be disregarded. With respect to Brazil's argument that because an analysis under Articles 5 and 6 of the *SCM Agreement* focuses on the effects of the subsidy, no distinction can be made between a programme and the payments made under the programme, the United States submits that Brazil does not explain why the focus on effects in Part III of the *SCM Agreement* would require that the statutory and regulatory provisions authorizing payments be conflated with the payments themselves. This argument of Brazil is also in contradiction with the fact that in the original proceeding Brazil itself made separate claims against the payments and the statutory and regulatory provisions.[118]

9.32 The United States asserts that Brazil did not challenge, the original panel did not find, and the DSB did not make any recommendation or ruling against the marketing loan and counter-cyclical payment programmes or against the programmes in addition to the payments under the programmes. The measures that were the subject of Brazil's claims, and the panel's finding, of present serious prejudice were subsidies provided during MY 1999-2002. The absence of any express reference to any legal/regulatory provisions in paragraphs 8.3(d) and 8.1(g)(i) of the original panel report confirms that the actionable subsidy-related conclusion and recommendation laid out therein do not apply to any programme as such, either alone or as part of any invented amalgam of programmes and payments. As illustrated by Section VII:D of the panel report, where the original panel wanted to refer to programmes, as such, and payments together, it expressly stated it was doing so.[119] The United States considers that in arguing that the original panel did make findings of WTO-inconsistency against the marketing loan and counter-cyclical payment programmes as such, Brazil relies on selectively cited language from the panel report taken out of its proper context.[120]

9.33 **Brazil** argues that the preliminary objection of the United States rests on a mischaracterization of the claims of Brazil in this proceeding and of the findings of the original panel.

[116]US First Written Submission, paras. 31-33.

[117] The United States points out that the statement in paragraph 7.1501 of the original panel report that "the United States is obliged to take action concerning its present statutory and regulatory framework as a result of our 'present' serious prejudice finding" is not a recommendation. US First Written Submission, para. 39.

[118] US Rebuttal Submission, paras. 20-28.

[119] US Rebuttal Submission, paras. 30-43.

[120] US Rebuttal Submission, paras. 44-52. See also US Comments on Brazil's Responses to Panel Questions 11 and 15.

Brazil further argues that under established jurisprudence, Brazil's claims fall squarely within the scope of this proceeding.

9.34 Brazil submits that in this proceeding it is not asserting a claim against US marketing loan and counter-cyclical payment programmes "as such". The measures that constitute the subsidies at issue in this proceeding are the statutory and regulatory provisions of the FSRI Act of 2002 relating to upland cotton and the mandatory and price-contingent payments that have been made and will continue to be made during the lifetime of the FSRI Act of 2002, and Brazil makes no distinction between serious prejudice caused by the provisions of the FSRI Act and serious prejudice caused by the payments mandated by those provisions. It follows from the particular nature of the obligations in Articles 5 and 6 of the *SCM Agreement*, which focus on the effects of subsidies, that a payment of a subsidy cannot be divorced from the subsidy programme pursuant to which the payment is made.[121] Brazil argues that the idea that programmes and payments together constitute the subsidy is consistent with the approach of the original panel. Brazil refers to statements in the panel report that indicate that the panel considered that its findings in Section VII:G and its conclusion in paragraph 8.1(g)(i) pertained to both the subsidy programmes under the FSRI Act and the payments mandated under those programmes. Brazil also submits that a review of the submissions of the parties in the original proceeding shows that they both referred to the effects of the programmes as well as the effects of payments under the programmes. Since the original panel necessarily considered all forms of the subsidy, i.e. programmes and specific payments made under the programmes, and since the United States did not appeal the original panel's finding that it was obliged to take action with respect to the statutory and regulatory framework under which subsidies were provided, the United States is precluded from challenging this Panel's authority to review Brazil's claim regarding the marketing loan and counter-cyclical payment programmes.[122]

9.35 Brazil argues that while recent jurisprudence has clarified that the original proceeding imposes limits on the scope of the claims that may be presented in an Article 21.5 proceeding, those limits do not apply to Brazil's claims regarding the marketing loan and counter-cyclical payment programmes.[123] Brazil's claims against the adverse effects flowing from the programmes and the payments mandated under the programmes were identified in Brazil's request for establishment and involve measures taken to comply within the meaning of Article 21.5 of the DSU.[124] Brazil further submits that the United States is factually incorrect in suggesting that the original panel rejected the serious prejudice claims of Brazil in respect of the marketing loan and counter-cyclical programmes.[125] Brazil also submits that the original panel exercised judicial economy with respect to Brazil's claims of threat of serious prejudice and with respect to Brazil's *per se* claims because the panel considered that its finding regarding "present" serious prejudice would oblige the United States to take action concerning its statutory and regulatory framework. Therefore, the exercise of judicial

[121] Brazil's Submission Regarding US Requests for Preliminary Ruling, paras. 31-34.

[122] Brazil's Submission Regarding US Requests for Preliminary Ruling, paras. 36-40.

[123] Brazil's Submission Regarding US Requests for Preliminary Ruling, paras. 41-47. Brazil points out in this connection that the fact that a panel in an original proceeding declines to address certain claims does not prevent a party from raising the same claims in an Article 21.5 proceeding.

[124] Brazil's Submission Regarding US Requests for Preliminary Ruling, paras. 49-50.

[125] In this regard, Brazil refers in particular to the statement in paragraph 7.1501 of the panel report. Brazil also refers to para. 8.1(g)(i) of the report (particularly the phrase "mandatory price-contingent United States subsidy measures"), the definition of the measures at issue in para. 7.1107 of the report, statements in para. 7.1499 of the report, findings of the Panel regarding the "statutory and regulatory framework" providing for the subsidies at issue (for example, the Panel's examination of the "structure, design and operation" of the programmes) and statements reflecting that the Panel assessed the effects caused by statutory and regulatory instruments that provide for the payment of the subsidies along with the magnitude of the payments. Brazil's Submission Regarding US Requests for Preliminary Ruling, paras. 52-62.

economy with respect to these claims confirms that the Panel's finding with respect to "present" serious prejudice covered the subsidy programmes as well the payments made thereunder.[126]

9.36 Brazil summarizes as follows the factors that support its view that the original panel's finding of "present" serious prejudice included the subsidy programmes as well as the payments mandated by the subsidy programmes: (i) the identification by the panel of the measures at issue in the "present" serious prejudice section; (ii) the panel's reasoning regarding the "effect" of those measures; (iii) the panel's reasoning in explaining its decision not to examine Brazil's claims of "as such" violations, and (iv) the panel's description of the implementation action that the United States was obliged to take.[127]

(ii) Main arguments of third parties

9.37 **Argentina** submits that the marketing loan and counter-cyclical payment programmes were subject to the findings and recommendations of the original panel. The panel specifically stated that the measures at issue included "legislative and regulatory provisions currently providing for the payment of measures". Moreover, paragraph 8.1(g)(i) of the panel report refers to "mandatory price-contingent United States subsidy measures". The panel stated that its findings pertained to measures in force and subsidies paid in MY 2002 and that, as a result of its finding of "present" serious prejudice, the United States was "obliged to take action concerning its present statutory and regulatory framework".[128]

9.38 **Australia** considers that the finding of the original panel in paragraph 8.1(g)(i) of its report relates to certain payments rather than to the subsidy programmes as such. However, Brazil is not seeking to challenge the marketing loan and counter-cyclical payment programmes *per se* in this proceeding. The focus of Brazil's case under Articles 5 and 6 of the *SCM Agreement* is the continuing effects of the unamended programmes, i.e. payments made under those programmes, rather than the programmes as such. In this context, it is impossible to analyze the price-contingent subsidy measures still in existence in isolation from the programmes that govern those measures. Insofar as a consideration of those programmes is necessary to determine whether the price-contingent subsidy measures cause significant price suppression, the programmes may properly be considered by this Panel.[129]

9.39 **China** argues that the text of the report of the original panel makes clear that the serious prejudice finding of the panel applies to the marketing loan and counter-cyclical payment programmes. China mentions in this regard references made by the panel to the "legislative and regulatory provisions currently providing for the payment of" certain subsidies, including marketing loan and counter-cyclical subsidies, to "the legislation pursuant to which the granting authority operates" and to the "structure, design and operation of these measures". In addition, the panel specifically stated that, as a result of the panel's finding of serious prejudice, the United States was "obliged to take action concerning its present statutory and regulatory framework".[130]

9.40 **Chad** argues that the original panel described the measures at issue as including "the legislative and regulatory provisions currently providing for the payment of measures". Moreover, the panel explained that, as a consequence of its finding of serious prejudice, the United States was "obliged to take action concerning its present statutory and regulatory framework", and found it unnecessary to address Brazil's claim of threat of serious prejudice. Thus, the original panel clearly considered that its finding of serious prejudice included not simply the payments themselves but also

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[126] Brazil's Submission Regarding US Requests for Preliminary Ruling, paras. 63-71.
[127] Brazil's Comments on US Response to Panel Question 45.
[128] Argentina's Third Party Oral Statement, paras. 5-12.
[129] Australia's Third Party Submission, paras. 14-15.
[130] China's Third Party Submission, paras. 12-13.

the statutory and regulatory measures under which the payments were made. Chad considers that by describing the measures at issue in paragraph 8.1(g)(i) of its report as "mandatory" payments, the panel necessarily included the statutory and regulatory framework that made those payments mandatory. Chad also argues that the United States appears to confuse the issue of whether a statutory provision is challenged as such with the altogether separate issue of whether a statutory provision mandating certain payments can be found to cause serious prejudice. Brazil's claims in the original proceeding were "as applied" claims regarding measures that included legislative and regulatory provisions. The distinction sometimes made in WTO proceedings between "as such" and "as applied" claims does not mean that statutory or regulatory provisions cannot be challenged on an "as applied" basis or that "as applied" claims are necessarily limited to the payments themselves to the exclusion of measures mandating those payments.[131]

9.41 The **European Communities** agrees with the United States that there is a meaningful distinction between an "as such" claim and an "as applied" claim and between a subsidy "programme" within the meaning of the *SCM Agreement* and the provision of subsidies in individual cases under the programme. A claim under Part III of the *SCM Agreement* can pertain to either the subsidy programme, the provision of subsidy in individual instances or both. These measures should normally not be conflated. However, the European Communities considers that where an entitlement is conditional upon the fulfilment of essentially factual requirements and there is no discretion in the hands of a granting authority, it may be justifiable to treat the subsidy programme and payments made under the programme as indivisible for purposes of Article 21.5 proceedings. The European Communities agrees with Brazil that the fact that the United States implemented the DSB recommendations and rulings by withdrawing the Step 2 programme supports the view that there was at least a sufficient nexus between the Step 2 payments and the Step 2 programme. Moreover, that the original panel assessed a bundle of payments under the three different programmes implies that it assumed that there was a sufficient nexus between the payments under the three different programmes. If there is a sufficient nexus between payments and programme for one programme and if there is a sufficient nexus between all payments, this in turn suggests that there is a sufficient nexus between the three programmes, such that the whole bundle can and should be treated as indivisible for the purposes of this compliance panel.[132]

9.42 **India** submits that the original panel clearly described the measures at issue as comprising the "legislative and regulatory provisions currently providing for the payment of measures", including the marketing loan and counter-cyclical payments, and that the panel clearly considered that its findings regarding "present" serious prejudice applied not only to payments but also to the statutory and regulatory framework of the FSRI Act of 2002 and its implementing obligations. Therefore, the obligations of the United States in the implementation period were not limited to payments made in a period in the past.[133]

9.43 **New Zealand** submits that, read properly in the context of the panel's decision as a whole, the finding of the original panel in paragraph 8.1(g)(i) of its report is not limited to the specific payments made in MY 1999-2002 but applies to the measures under which those payments are authorized and hence to the marketing loan and counter-cyclical payment programmes themselves. The panel made a finding with respect to "the mandatory price-contingent United States subsidy measures". Payments are not mandatory subsidy measures; they are simply the means by which the subsidy measures are implemented. Moreover, it is clear from the report that the panel's analysis of the subsidy measures that caused price suppression was of the programmes under the FSRI Act of 2002 under which payments were made. Finally, the statement of the panel in paragraph 7.1501 of its report that "the United States is obliged to take action concerning its present statutory and regulatory framework as a

[131] Chad's Third Party Submission, paras. 22-31.
[132] EC Third Party Oral Statement, paras. 15-21.
[133] India's Third Party Oral Statement, para. 6.

result of our 'present' serious prejudice finding" gives meaning to the finding in paragraph 8.1(g)(i) relating to the "United States subsidy measures" that constituted significant price suppression.[134]

(iii) Evaluation by the Panel

9.44 The Panel interprets the scope of the original panel's finding of "present" serious prejudice based on the terms used by the panel to express that finding. The original panel's finding of "present" serious prejudice is contained in paragraphs 7.1416 and 8.1(g)(i) of the panel report.[135]

9.45 Paragraph 7.1416 of the report reads as follows:

> "In conclusion, in light of all of these considerations, we find that the effect of the mandatory, price contingent United States subsidies at issue – that is, marketing loan programme payments, user marketing (Step 2) payments and MLA payments and CCP payments – is significant price suppression in the same world market for upland cotton in the period MY 1999-2002 within the meaning of Articles 6.3(c) and 5(c) of the *SCM Agreement*."

9.46 Paragraph 8.1(g)(i) of the report reads as follows:

> "the effect of the mandatory price-contingent United States subsidy measures - marketing loan programme payments, user marketing (Step 2) payments, MLA payments and CCP payments - is significant price suppression in the same world market within the meaning of Article 6.3(c) of the *SCM Agreement* constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*;"

9.47 In the Panel's view, there is no basis in the text of these paragraphs to interpret the measures subject to the original panel's finding as including anything other than "subsidies" and "subsidy measures" defined in terms of the four categories of "payments" identified by the panel. The term "payments" in its ordinary meaning does not include the legal provisions or programmes pursuant to which the payments are made.[136] The explicit statement by the panel that the subsidies and subsidy

[134] New Zealand's Third Party Submission, paras. 4.03-4.07.

[135] Paragraph 7.1416 is the concluding paragraph in section VII:G.3 of the report ("Claims under Articles 6.3(c) and 5(c) of the *SCM Agreement*"). Paragraph 8.1(g)(i) appears in the "Conclusions and recommendations" section of the report. We note that the Appellate Body Report in the original proceeding refers to the "finding [of serious prejudice] in paragraphs 7.1416 and 8.1(g)(i) of the Panel Report." Appellate Body Report, *US – Upland Cotton*, paras. 249(c)(i), 395, 496 and 763(c)(i). Thus, for example, in paragraph 763(c)(i), the Appellate Body upheld "the Panel's finding, in paragraphs 7.1416 and 8.1(g)(i) of the Panel Report, that the effect of the marketing loan program payments, Step 2 payments, market loss assistance payments, and counter-cyclical payments (the 'price-contingent') subsidies is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*".

[136] A careful reading of the original panel report as a whole makes it clear that the panel generally equated "subsidies" with "payments" and that the term "payments" in this context does not include legal and regulatory provisions. For example, one of the issues addressed by the panel in response to preliminary objections raised by the United States was whether production flexibility contract payments and market loss assistance payments made under legislation that no longer existed were within the panel's terms of reference. In its discussion of this issue the panel observed *inter alia*:

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

measures at issue are certain kinds of payments, and the absence of any reference to legal provisions or subsidy programmes providing for the payments, therefore necessarily mean that the subsidies and subsidy measures do not include such legal provisions or subsidy programmes.[137] We also note, in this regard, that Section III of the panel report ("Parties' Requests for Findings and Recommendations") identifies the measures subject to Brazil's claims of "present" serious prejudice as "subsidies provided during MY 1999–2002" without mentioning the legal provisions or programmes providing for these subsidies. The panel's finding of "present" serious prejudice in paragraphs 7.1416 and 8.1(g)(i) logically cannot have been broader in scope than the claims of Brazil in respect of which the panel made this finding. Finally, the panel specified the temporal scope of its finding when it stated in paragraph 7.1416 that the effect of the mandatory, price-contingent subsidies at issue was significant price suppression in the period MY 1999-2002.

9.48 In support of its argument that the original panel's finding of "present" serious prejudice applied to payments and programmes, Brazil emphasizes the original panel's explanation as to why the panel considered it not necessary or appropriate to address Brazil's claims of threat of serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement.*[138]

9.49 We find Brazil's emphasis on these paragraphs in the panel report[139] to interpret the scope of the panel's finding of "present" serious prejudice misplaced. *First*, the finding of "present" serious prejudice is contained in paragraphs 7.1416 and 8.1(g)(i), not in paragraphs 7.1499-7.1503. As discussed above, consistent with Brazil's claims, paragraphs 7.1416 and 8.1(g)(i) of the original panel report contain a finding that the effect of certain subsidies and subsidy measures, defined in terms of certain kinds of payments, is significant price suppression constituting serious prejudice to the interests of Brazil in the period MY 1999-2002. These paragraphs do not refer in any way to programmes or legislation. We do not see how the observations made by the panel in paragraphs 7.1499-7.1503 could be used to support an interpretation of the panel's finding of "present" serious prejudice that is inconsistent with the natural meaning of the terms used by the panel in paragraphs 7.1416 and 8.1(g)(i). *Second*, there is no explicit statement in paragraphs 7.1499-7.1503 that the panel had found that serious prejudice to the interest of Brazil was the effect of subsidy programmes or legal provisions establishing subsidy programmes as well as payments made under those programmes. The panel stated in paragraphs 7.1499 and 7.1501 that "[o]ur finding of 'present' serious prejudice thus pertain[s] also to measures in force and subsidies paid in MY 2002..." and that "the Panel's 'present' serious prejudice findings include findings of inconsistency that deal with the FSRI Act of 2002 and subsidies granted thereunder". The panel did not state that it had found that, in addition to subsidies paid in MY 1999-2002, the FSRI Act itself was inconsistent with Articles 5 and 6 of the *SCM Agreement*.

Panel Report, *US – Upland Cotton*, para. 7.108. Thus, the panel understood "the subsidies and domestic support..." to refer to "the payments themselves", as distinguished from the "... programmes or authorizing legislation 'as such'". Where the panel used the concept of payments in a broader sense to encompass regulatory provisions, it made an explicit statement to that effect. See Panel Report, *US – Upland Cotton*, para. 7.337, footnote 466: "In this Section of our report, the Panel will consider the current programmes 'as applied' and 'as such' together. Therefore, references to marketing loan programme, user marketing (step 2), direct, counter-cyclical and crop insurance 'payments' include the legislative and regulatory provisions authorizing those payments, unless otherwise indicated." No such statement can be found in the section of the original panel report that addresses Brazil's claims of serious prejudice.

[137] By using the words "mandatory" and "price contingent" to qualify "United States subsidy measures" the panel characterized the subsidies at issue in terms of certain conditions set out in the legal provisions governing those subsidies, but this does not alter the fact that the panel only made a finding of "present" serious prejudice with respect to subsidies (defined as payments) and not with respect to both subsidies and the legal provisions governing those subsidies.

[138] Brazil's Submission Regarding US Requests for Preliminary Ruling, paras. 36-39, 52, 59-60, 64-71; Brazil's Responses to Panel Questions 11 and 13, paras. 99-102, 105-106, 119, 126-128.

[139] Panel Report, *US – Upland Cotton*, paras. 7.1499-7.1503.

9.50 Similarly, the statement in paragraph 7.1501 of the report of the original panel that "the United States is obliged to take action concerning its present statutory and regulatory framework as a result of our 'present' serious prejudice finding" is an expression of a view about the steps to be taken by the United States under Article 7.8 of the *SCM Agreement* and does not mean that the Panel had found that the "present statutory and regulatory framework" in addition to subsidies paid under that framework had itself caused serious prejudice.[140]

9.51 While the legal provisions or subsidy programmes pursuant to which the subsidies were provided were not themselves part of the measures subject to the original panel's *finding* in paragraphs 7.1416 and 8.1(g)(i), it is clear that in making this finding the original panel took into consideration these legal provisions or subsidy programmes. The panel undertook "an analysis focusing on the existence and nature of the subsidies in question by examining their structure, design and operation with a view to discerning their effects".[141] The panel considered that "the nature of the United States subsidies at issue – in terms of their structure, design and operation – is relevant in assessing whether or not they have price suppressing effects".[142] In finding that there was "significant" price suppression, the panel relied *inter alia* upon the "the market-price contingent, counter-cyclical, nature of the marketing loan programme [and] the user marketing (Step 2) programme".[143] The panel observed that "the structure, design and operation of the marketing loan programme has enhanced production and trade-distorting effects".[144] [145] The panel found that "the structure, design and operation of these three measures constitutes evidence supporting a causal link with the significant price suppression we have found to exist".[146]

9.52 In our view, it is self-evident that in order to properly analyze the effect of a subsidy for purposes of an analysis under Articles 5 and 6 of the *SCM Agreement*, the subsidy must be examined in light of the conditions and criteria contained in the legal and regulatory framework that governs the granting of that subsidy. Therefore, in this sense we concur with the argument of Brazil that it is difficult to divorce a payment of a subsidy from the programme or legal provisions pursuant to which the subsidy is provided. As we understand the position of the United States, the United States does not contest that in order to evaluate whether a subsidy is inconsistent with a Member's obligations it may be necessary to analyze that subsidy in the context of the legal and regulatory framework that defines the conditions under which the subsidy is granted.[147] It would appear that the preliminary objection of the United States reflects a concern that Brazil challenges the programmes *as such*, as

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[140] Contrary to what Brazil argues, this statement cannot be treated as part of the panel's "recommendation". As the panel recalled in paragraph 8.3(d), the obligations of the United States arising from the finding of serious prejudice are defined in Article 7.8 of the *SCM Agreement*. There is no legal basis in the text of the *SCM Agreement* or in the DSU to suggest that where a panel has made a finding of serious prejudice under Articles 5 and 6 of the *SCM Agreement* it has the authority to make a "recommendation" other than in terms of Article 7.8 of the *SCM Agreement*.

[141] Panel Report, *US – Upland Cotton*, para. 7.1194.

[142] Panel Report, *US – Upland Cotton*, para. 7.1289.

[143] Panel Report, *US – Upland Cotton*, para. 7.1332.

[144] Panel Report, *US – Upland Cotton*, para. 7.1295.

[145] Similarly, in discussing the influence of counter-cyclical payments on production decisions, the Panel observed *inter alia*: "The FSRI Act of 2002 provides, on an on-going basis, for payments under certain market conditions. This contrasts with the *ad hoc* nature of the MLA payments. Under the FSRI Act of 2002, United States producers are currently aware that such payments are available under certain conditions and that there is no need to be uncertain as to whether [the] United States Congress may or may not decide to authorize such payments in a given year. This certain claim on future payments under certain conditions increases United States producers' economic stability." Panel Report, *US – Upland Cotton*, para. 7.1302, footnote 1410.

[146] Panel Report, *US – Upland Cotton*, para. 7.1349.

[147] US Comments on Brazil's Response to Panel Question 11, para. 50.

that concept is commonly understood in WTO dispute settlement practice.[148] The references in Brazil's First Written Submission to "programme" and "programmes" and certain statements made by Brazil during this proceeding could indeed be interpreted to suggest that Brazil is challenging programmes as such.[149] However, Brazil has stated explicitly that it is not challenging the marketing loan and counter-cyclical payment programmes *as such.*[150] While Brazil has emphasized that it is not possible to distinguish between the adverse effects of the statutory and regulatory provisions of the FSRI Act relating to upland cotton and the adverse effects of the payments mandated by these provisions[151], Brazil does not request the Panel to find that, independently of their application in individual cases, the marketing loan and counter-cyclical payment programmes "will necessarily be inconsistent with"[152] Articles 5 and 6 of the *SCM Agreement*.

9.53 Given that Brazil is not seeking an "as such" finding, we consider that the preliminary objection of the United States is without object insofar as it would appear to be based on an interpretation of Brazil's claims as claims against programmes *per se*.[153]

9.54 The Panel **finds** that, although the original panel's finding of "present" serious prejudice did not apply to legal provisions or subsidy programmes in addition to subsidies and subsidy measures, it is not necessary for the Panel to make a ruling on the preliminary objection of the United States because Brazil does not request the Panel to find that the marketing loan and counter-cyclical payment programmes are WTO-inconsistent as such. The Panel also concludes that the original panel's finding of serious prejudice was based on an analysis that took into consideration the legal provisions or subsidy programmes pursuant to which the subsidies were provided. The Panel considers that it is

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[148] As stated by the Appellate Body: "[b]y definition, an 'as such' claim challenges laws, regulations, or other instruments of a Member that have general and prospective application, asserting that a Member's conduct—not only in a particular instance that has occurred but in future situations as well—will necessarily be inconsistent with that Member's WTO obligations. In essence, complaining parties bringing 'as such' challenges seek to prevent Members *ex ante* from engaging in certain conduct." Appellate Body Report, *US – Oil Country Tubular Goods Sunset Reviews*, para. 172.

[149] For example, Brazil has stated that "[t]he measures that constitute these 'subsidies' are the statutory and regulatory provisions of the FSRI Act of 2002 that relate to upland cotton, *i.e.* the marketing loan and counter-cyclical payment provisions, and the mandatory and price-contingent payments to US upland cotton farmers that have been and will continue to be made during the lifetime of the FSRI Act of 2002, *i.e.* until MY 2007, unless the measure is extended". Brazil's Submission Regarding US Requests for Preliminary Ruling, para. 31.

[150] Brazil's Rebuttal Submission, Section 2.1.3 ("Brazil's Serious Prejudice Claims Do Not Constitute what the United States Calls 'As Such' Claims"); Brazil's Submission Regarding US Requests for Preliminary Ruling, para. 31 ("The United States claims that Brazil is asserting a claim against US marketing loan and counter-cyclical payment programs 'as such'. This is erroneous. Rather, Brazil is challenging in this proceeding the US subsidies inasmuch as they cause adverse effects."); Brazil's Response to Panel Question 12, para. 112 ("While Brazil has challenged the marketing loan and counter-cyclical 'programs' and their mandatory, price-contingent 'payments', to the extent that they cause adverse effects, it has not asserted an 'as such' claim regarding the marketing loan and counter-cyclical payment programs in the FSRI Act of 2002."). At the meeting of the Panel with the parties Brazil confirmed, in response to a question of the Panel, that it was not seeking a finding of the Panel under Articles 5 and 6 of the *SCM Agreement* against the marketing loan and counter-cyclical payments programmes themselves, as distinguished from the payments made pursuant to those programmes.

[151] See, e.g., Brazil's Rebuttal Submission, paras. 34-35; Brazil's Submission Regarding the US Requests for Preliminary Ruling, paras. 33-34.

[152] *Supra*, footnote 148.

[153] The question of whether a measure can, as such, i.e. independently of its application, be inconsistent with the effects-based disciplines in Articles 5 and 6 raises serious conceptual issues. As Brazil is not seeking a finding that the subsidy programmes are as such inconsistent with Articles 5 and 6 of the *SCM Agreement*, the Panel does not need to address these issues.

appropriate in this proceeding to conduct a similar analysis of subsidies in the context of the legal provisions or subsidy programmes pursuant to which the subsidies are granted.

(b) Whether Brazil's claims with respect to the marketing loan and counter-cyclical payment *programmes* are outside the scope of this proceeding because these programmes have not been changed in response to DSB recommendations and rulings or otherwise and therefore are not "measures taken to comply" within the meaning of Article 21.5 of the DSU

9.55 As discussed above, Brazil does not request the Panel to find that the marketing loan and counter-cyclical payment programmes are WTO-inconsistent as such. For this reason, the Panel does not find it necessary to rule on the objection of the United States that since the marketing loan and counter-cyclical programmes are not "measures taken to comply" within the meaning of Article 21.5 of the DSU, Brazil's claims with respect to these programmes are not within the scope of this proceeding.

4. Whether Brazil's claim regarding the failure of the United States to take measures between 22 September 2005 and 31 July 2006 is outside the scope of this proceeding

(a) Main arguments of the parties

9.56 **Brazil** requests the Panel to find that the United States failed to take any measures to remove the adverse effects or to withdraw the three price-contingent upland cotton subsidy programmes under the FSRI Act of 2002 between 22 September 2005 and 31 July 2006 and that, as a consequence, measures taken to comply with the adverse effects-related recommendations and rulings of the DSB did not exist in this period.[154] Brazil also requests that the Panel conclude that the recommendation under Article 7.8 has not been complied with entirely and remains in effect.[155]

9.57 Brazil argues that under Articles 7.8 and 7.9 of the *SCM Agreement* the United States had until 21 September 2005 (six months after the date of adoption of the reports in the original proceeding) to withdraw the subsidies or to take appropriate steps to remove their adverse effects. Since the United States repealed the Step 2 programme only on 1 August 2006 and did not take any action to amend the marketing loan and counter-cyclical payments provisions of the FSRI Act of 2002, the United States has failed to adopt measures to comply within the implementation period. This means that the Panel can conclude that no measures to comply existed between 22 September 2005 and 31 July 2006.[156] Brazil submits that the panel report in *Australia – Salmon (Article 21.5 – Canada)* provides relevant precedent for a finding in an Article 21.5 proceeding that measures to comply did not exist in a past period.[157]

9.58 The **United States** asserts that Brazil's claim that there were no measures taken to comply in the period between 22 September 2005-31 July 2006 is not within the scope of this proceeding. *First*, assuming (incorrectly) that the DSB actionable subsidy-related recommendations are related to the Step 2, marketing loan, and counter-cyclical programmes, Brazil asserts that it is 'undisputed' that the United States failed to take measures to comply in a timely fashion, before the repeal of the Step 2 programme on 1 August 2006. Thus, in the view of the United States, Brazil does not even assert a 'disagreement' as to the absence of measures taken to comply prior to 1 August 2006.[158] *Second*, the issue of the timeliness of implementation is not within the scope of a panel's mandate under Article 21.5 of the DSU. Specifically, Article 21.5 does not direct a panel to examine whether a

[154] Brazil's First Written Submission, paras. 40 and 461.
[155] Brazil's First Written Submission, para. 46.
[156] Brazil's First Written Submission, paras. 39-46.
[157] Brazil's First Written Submission, para. 46, footnote 37.
[158] See US First Written Submission, para. 50.

Member has implemented actionable subsidy-related recommendations within the six-month period provided for in Article 7.9 of the *SCM Agreement.* The United States submits that not only is there no textual basis for the kind of finding requested by Brazil, but that a finding with respect to a factual situation that no longer exists is also inconsistent with the DSU objective of securing a positive solution to a dispute. The United States submits that prior panel reports in Article 21.5 proceedings support its position that compliance must be examined on the basis of the facts as they stand when a matter is referred to a compliance panel.[159]

9.59 **Brazil** submits that by arguing that there is no disagreement between the parties with respect to the existence of measures taken to comply the United States acknowledges that it has not taken any measures to comply with the adverse effects-related rulings and recommendations of the DSB by the end of the implementation period and requests the Panel to make a finding to that effect. Brazil also argues that Articles 7.9 and 7.10 of the *SCM Agreement* constitute a legal basis for the kind of finding requested by Brazil. Brazil argues that whether measures taken to comply existed within the time-frame specified in Article 7.9 is relevant to an analysis under Article 21.5 of the "consistency" of such measures with the provisions of the covered agreements and that "Brazil's right to pursue the United States' failure to remove the adverse effects or withdraw the subsidy, and the assessment of whether any proposed countermeasures are commensurate, are tied to the date on which the implementation period expires".[160]

(b) Main arguments of third parties

9.60 **Australia** argues that the Panel should refuse the request of the United States for a preliminary ruling regarding Brazil's claim concerning the failure of the United States to take measures to comply within the period 22 September 2005-1 July 2006. Australia considers that an examination under Article 21.5 of the DSU of the "existence" of measures taken to comply can encompass a finding that no measures taken to comply exist. Australia refers, in this respect, to the panel in *Australia – Salmon (Article 21.5 – Canada)*, which found that because the date of entry into force of measures taken to comply by Australia occurred subsequent to the date upon which the reasonable period of time for implementation expired, for the period of time that the new measures did not apply subsequent to that date, "no measures taken to comply existed ... in the sense of Article 21.5". Australia also argues that a preliminary ruling cannot be granted in a way that would void rights under Article 22 of the DSU. Article 22 rights would logically ensue from findings of inconsistency with Articles 7.8 and 7.9 of the *SCM Agreement.* Thus, if the Panel were to accept the preliminary ruling requested by the United States, this would diminish the rights of Brazil under Article 22 of the DSU.[161]

9.61 The **European Communities** disagrees with the view of the United States that Brazil's claim regarding non-compliance in a past period is not within the scope of this proceeding under Article 21.5 of the DSU. The European Communities considers that in making this argument the United States overlooks the fact that any act or omission may be a measure for purposes of WTO dispute settlement. The European Communities also submits that there is nothing in the text of Article 21.5 of the DSU to limit the temporal application of that provision in the manner advocated by the United States.[162]

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[159] US First Written Submission, paras. 49-56.

[160] Brazil's Submission Regarding US Requests for Preliminary Ruling, paras. 77-87.

[161] Australia's Third Party Submission, paras. 18-20.

[162] EC Third Party Oral Statement, paras. 25-30. With respect to the merits of Brazil's claim, the European Communities argues that Members enjoy a certain measure of discretion in the implementation of the obligation under Article 7.8 of the *SCM Agreement* to take appropriate steps to remove the adverse effects of the subsidy or withdraw the subsidy. Article 7.8 does not necessarily require that a Member take positive action. Whether a Member has complied with its obligation under Article 7.8 requires a careful analysis of the

9.62 **Japan** submits that the Panel has the authority to make a finding on Brazil's claim regarding the non-compliance of the United States with the DSB recommendations and rulings in the period 22 September 2005-31 July 2006. Japan specifically rejects, in this regard, the argument of the United States that since there is no disagreement between the parties, Brazil's claim is outside the scope of this proceeding under Article 21.5 of the DSU. Japan agrees with Australia's argument that a failure of the Panel to address Brazil's claim with respect to the alleged non-compliance of the United States in the period 22 September 2005-31 July 2006 would diminish rights of Brazil under Article 22 of the DSU.[163]

9.63 **New Zealand** submits that the United States cannot claim that since it took no implementing action until 1 August 2006, that period is outside the scope of this proceeding. Article 21.5 of the DSU applies to the "existence" of measures, not just to the consistency of measures actually taken to comply with the recommendations and rulings of the DSB.[164]

(c) Evaluation by the Panel

9.64 The United States requests the Panel to make a preliminary ruling that Brazil's claim that the United States failed to take any measures to remove the adverse effects or to withdraw the three price-contingent upland cotton subsidy programmes under the FSRI Act of 2002 between 22 September 2005 and 31 July 2006 and that, as a consequence, measures taken to comply with the adverse effects-related recommendations and rulings of the DSB did not exist in this period, is not properly within the scope of this proceeding under Article 21.5 of the DSU.[165]

9.65 It is not in dispute that the factual situation referred to by Brazil in this request no longer existed at the time of the establishment of the Panel as the United States repealed the Step 2 programme effective 1 August 2006. In this regard, the parties disagree as to whether it is within this Panel's mandate under Article 21.5 of the DSU to make a finding as to whether the United States had complied with its obligations under Article 7.8 of the *SCM Agreement* at the end of the six-month period provided for in Article 7.9 of the *SCM Agreement,* or whether the Panel's mandate under Article 21.5 only allows the Panel to determine whether the United States had complied with its obligations under Article 7.8 of the *SCM Agreement* at the time of the establishment of the Panel.

9.66 Brazil's request is based on two important premises. *First*, the request assumes that under Article 21.5 of the DSU this Panel is required to make findings in relation to factual situations at two different points in time. Specifically, according to the logic of Brazil's argument, the Panel is required to make a finding as to the "existence or consistency with a covered agreement of measures taken to comply" as of the end of the period referred to by Brazil as the implementation period[166] (22 September 2005) in addition to a finding as to "existence or consistency with a covered agreement of measures taken to comply" as of the time of the establishment of the Panel. *Second*, Brazil's request also assumes that the fact that the United States did not take any action in the period 22 September 2005-31 July 2006 with respect to the measures subject to the DSB recommendations and rulings in the original proceeding is a sufficient basis for this Panel to find that the United States

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particular facts and circumstances of each individual case. Therefore, the fact that between 22 September 2005 and 31 July 2006 the United States took no positive action to comply with the recommendations and rulings of the DSB does not necessarily warrant the conclusion that the United States is in breach of Article 7.8. EC Third Party Submission, paras. 34-48.

[163] Japan's Third Party Oral Statement, paras. 8-9.

[164] New Zealand's Third Party Submission, para. 4.02.

[165] The Panel notes that in its request for the establishment of a panel Brazil asserts that "[a]t least during the period 21 September 2005 through 31 July 2006, measures taken to comply did not exist, within the meaning of Article 21.5 of the DSU". WT/DS267/30, para. 12.

[166] Brazil refers to the period of six months mentioned in Article 7.9 of the *SCM Agreement* as the "implementation period". See e.g. Brazil's Response to Panel Question 22, para. 159.

failed to comply with its obligation under Article 7.8 of the *SCM Agreement* to "take appropriate steps to remove the adverse effects or …withdraw the subsidy"[167] and that, as a consequence, no measure taken to comply within the meaning of Article 21.5 of the DSU existed at the end of that period.

9.67 With respect to the first premise of Brazil's argument, the Panel considers that a finding as to the "existence or consistency with a covered agreement of measures taken to comply" as of the end of the "implementation period" of Article 7.9 of the *SCM Agreement* or of the reasonable period of time referred to in Article 21.3 of the DSU, in addition to a finding as to the "existence or consistency with a covered agreement of measures taken to comply" as of the time of the establishment of a panel, would be of little relevance to the effective resolution of disputes. Where a panel makes a finding under Article 21.5 of the DSU that a Member has not complied with the DSB recommendations and rulings in the original dispute, the consequence of that finding is that the Member remains subject to obligations that flow from the recommendation issued in the original proceeding[168] and is thus required to take steps to bring itself into compliance with that recommendation. A finding by the panel that the Member also failed to comply with the DSB recommendations and rulings in the original proceeding at an earlier point in time would have no additional operative value in terms of the nature of the obligations of the Member in question. On the other hand, if a panel under Article 21.5 finds that the Member has brought itself into compliance with the DSB recommendations and rulings as of the time of the establishment of the panel, such a finding logically would supersede and render irrelevant any finding that the Member was not in compliance with those recommendations and rulings at an earlier point in time. Thus, in both cases a finding of a violation at the end of the reasonable period of time would be of a declaratory nature and without practical implications as to the obligations of the Member in question, unless one interprets the DSU to mean that a proceeding under Article 21.5 can create obligations for a Member to take steps that must be effective as of the end of the reasonable period of time. We see no textual support for such a retroactive interpretation of the DSU.

9.68 Brazil argues that the provisions on countermeasures in Articles 7.9 and 7.10 of the *SCM Agreement* provide support for its request that the Panel make a finding that the United States failed to take any measure at the end of what Brazil characterizes as the implementation period.[169] We disagree with this argument. We see nothing in the text of Article 21.5 or of other provisions of the DSU that suggests that, because of considerations relating to the application of Articles 7.9-7.10 of the *SCM Agreement* or Article 22.6 of the DSU, a panel must make a finding as to the existence or consistency of measures taken to comply as of the end of the six-month period set out in Article 7.9 of the *SCM Agreement* or the reasonable period of time rather than as of the time of the establishment of the panel. Nothing in the text or context of Article 21.5 of the DSU indicates that one of the functions of a panel in a proceeding under Article 21.5 of the DSU is to assist arbitrators[170] in proceedings under Articles 7.10 of the *SCM Agreement* or Article 22.6 of the DSU to determine the amount of countermeasures or the amount of suspension of concessions or obligations and that, to this end, the panel must make findings as to the existence or consistency with a covered agreement of measures taken to comply other than as of the date of the establishment of a panel. Brazil also argues that a right to apply countermeasures arises under Article 7.9 of the *SCM Agreement* if the implementing Member fails to comply with Article 7.8 within six months of the date of adoption of the panel report or the Appellate Body report in the original proceeding, and that "[b]y pursuing its claim regarding

[167] Brazil submits that Article 7.8 of the *SCM Agreement* requires affirmative action to remove the adverse effects or withdraw the subsidy and that inaction is not sufficient in this respect. Brazil's Responses to Panel Questions 22, 24-25 and 27.

[168] Panel Report, *US – FSC (Article 21.5 – EC)*.

[169] Brazil's Submission Regarding US Requests for Preliminary Ruling, paras. 79-85; Brazil's Response to Panel Question 21; Brazil's Comments on US Response to Panel Question 23; Brazil's Comments on US Response to Panel Question 43.

[170] Brazil's Response to Panel Question 21.

the non-existence of measures on 21 September 2005, Brazil seeks a multilateral basis for the DSB to authorize countermeasures against the United States for its failure to take any implementation measures by the date required in Article 7.9 of the *SCM Agreement*". However, while a finding by a panel under Article 21.5 of the DSU may be required to provide "a multilateral basis" for DSB authorization of countermeasures under Article 7.9 of the *SCM Agreement*, it does not logically follow that such a panel must make a finding of non-compliance as of the end of the six-month period refered to in Article 7.9 of the *SCM Agreement*.

9.69 Finally, we note that in response to a Panel question as to whether Brazil's request for a finding of non-compliance by the United States as of the end of the six-month period provided for in Article 7.9 of the *SCM Agreement* is supported by prior panel practice in Article 21.5 proceedings, Brazil identifies only one panel report, *Australia – Salmon (Article 21.5 – Canada*). While we acknowledge that this panel report contains findings of non-compliance in past periods[171], the United States points to other panel reports that have concluded that it is not appropriate to make findings of non-compliance under Article 21.5 as of the end of the reasonable period of time.[172]

9.70 Thus, we disagree with Brazil's argument that Article 21.5 of the DSU contemplates a finding on the existence or consistency with a covered agreement of measures taken to comply at the end of the reasonable period of time in addition to a finding on the existence of a measure taken to comply as of the date of the establishment of a panel. We therefore do not need to address the question whether the fact that the United States did not take action before the expiry of the period of six months referred to in Article 7.9 of the *SCM Agreement* is a sufficient basis to find that the United States had not complied with Article 7.8 of the *SCM Agreement* by that date.

9.71 In light of the foregoing considerations, the Panel **finds** that it is not appropriate to make a finding on Brazil's claim that the United States failed to take any measures to remove the adverse effects or to withdraw the three price-contingent upland cotton subsidy programmes under the FSRI Act of 2002 between 22 September 2005 and 31 July 2006 and that, as a consequence, measures taken to comply with the adverse effects-related recommendations and rulings of the DSB did not exist in this period.

5. Whether "payments" made after 21 September 2005 pursuant to the marketing loan and counter-cyclical payment programmes are within the scope of this proceeding

9.72 The Panel now turns to the question of whether payments made under the marketing loan and counter-cyclical payment programmes after 21 September 2005 are properly within the scope of this proceeding.

(a) Main arguments of the parties

9.73 The **United States** argues that the subsidies subject to the obligation in Article 7.8 of the *SCM Agreement* to "take appropriate steps to remove the adverse effects or... withdraw the subsidy" were the subsidies provided during MY 1999-2002 which the original panel had found to cause "present" serious prejudice in MY 1999-2002.[173] Since the only measure subject to the obligation under Article 7.8 were payments made until 31 July 2003 and since the payments made after 21 September 2005 are not measures taken to comply the United States considers that these payments are not properly within the scope of this proceeding.[174] The United States considers that there is no

[171] Panel Report, *Australia – Salmon (Article 21.5 – Canada)*, paras. 7.30, 7.35 and 8.1(i).
[172] Panel Report, *US – Shrimp (Article 21.5 – Malaysia)*, paras. 5.12-5.13; Panel Report, *EC – Bed Linen (Article 21.5 – India)*, para. 6.28.
[173] US Response to Panel Question 18; US Comments on Brazil's Response to Panel Question 15.
[174] US Response to Panel Question 47.

merit to the argument of Brazil that, even assuming that the original panel's findings of "present" serious prejudice were "as applied" findings, subsequent payments under the same programme would still be subject to the implementation obligations of the United States. The Appellate Body report that Brazil cites in support of that argument (*US – Softwood Lumber IV (Article 21.5 – Canada))* said nothing about whether a complaining party could in *post hoc* fashion attempt to add to the measures found to be WTO-inconsistent by asserting that other measures not found to be WTO-inconsistent are similar. Rather that dispute addressed the distinct issue of what measures could be considered to be part of the measure taken to comply. Future payments under the marketing loan and counter-cyclical payment programmes in MY 2003-2007 are not measures taken to comply with any recommendations and rulings. To the contrary, they were original measures that were challenged by Brazil but against which the original panel made no finding of WTO-inconsistency.[175]

9.74 **Brazil** argues that the subsidies subject to the obligation in Article 7.8 of the *SCM Agreement* include the legislative and regulatory subsidy programmes in the FSRI Act and the payments made under those programmes. However, even assuming *arguendo* that the original panel's finding of serious prejudice only applied to payments made in MY 1999-2002, the reasoning of the Appellate Body in *US – Softwood Lumber IV (Article 21.5 – Canada)* supports the view that subsequent payments made under these programmes are subject to the obligation in Article 7.8 because such subsequent payments have "a particularly close relationship" to the recommendations and rulings of the DSB.[176] [177] Brazil also submits that Article 7.8 requires a full and permanent removal of adverse effects and that this means that a Member may not replace a subsidy found to cause adverse effects with another subsidy that continues to cause the same adverse effects. Therefore, even if in this dispute the original panel had made findings limited to payments made in MY 1999-2002, the obligation of the United States under Article 7.8 would not be limited to the removal of the adverse effects of payments made in that period.[178] Brazil argues that if a panel makes a finding of "present" adverse effects, such a finding applies beyond the historical period considered by the panel and that the Member whose subsidies cause such adverse effects is therefore obligated under Article 7.8 to take appropriate steps to fully withdraw the present, ongoing and future effects of the subsidies.[179] Finally, Brazil also argues that the fact that the original panel exercised judicial economy with respect to future payments in 2003-2007 does not prevent Brazil from challenging those payments in this proceeding.

(b) Evaluation by the Panel

9.75 In order to determine whether payments made under the marketing loan and counter-cyclical payment programmes after 21 September 2005 are within the scope of this proceeding, we must consider whether such payments fall within the scope of the phrase "disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings" of the DSB in the original proceeding. In this respect, the Panel's examination of the scope of "measures taken to comply" must also involve an examination of the recommendations and rulings of the DSB.[180]

9.76 With respect to its finding of "present" serious prejudice the original panel recalled in paragraph 8.3(d) of its report that Article 7.8 of the *SCM Agreement* provides as follows:

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[175] US Comments on Brazil's Response to Panel Question 15.

[176] Brazil's Response to Panel Question 15, paras. 145-150; Brazil, Response to Panel Question 24, para. 4.

[177] See also Brazil's Comments on US Response to Panel Question 44, paras. 41-47.

[178] Brazil's Response to Panel Question 24, paras. 13-14.

[179] Brazil's Comments on US Response to Panel Question 24, para. 39.

[180] Appellate Body Report, *US – Softwood Lumber IV (Article 21.5 – Canada)*, para. 68; Appellate Body Report, *US – Oil Country Tubular Goods Sunset Reviews (Article 21.5 – Argentina)*, para.142.

> "Where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member within the meaning of Article 5, the Member granting or maintaining such subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy."

9.77 Under Article 7.8 of the *SCM Agreement* the United States was obligated, with respect to the subsidies subject to the "present" serious prejudice finding of the original panel, to "take appropriate steps to remove the adverse effects or ... withdraw the subsidy".

9.78 It is clear from the context that the adverse effects that must be removed are the adverse effects of the subsidy that has been determined to have resulted in adverse effects. Since the original panel made a finding of present serious prejudice in respect of subsidies provided during MY 1999-2002, the question arises whether the obligation to take appropriate steps to remove the adverse effects only applies to payments of subsidies made in those years.

9.79 It is not in dispute that the United States presently provides marketing loan and counter-cyclical payments on the same legal basis and subject to the same conditions and criteria as the marketing loan payments and counter-cyclical payments that were subject to the panel's finding of "present" serious prejudice. In a situation where the subsidy in question has been found to be a prohibited one, the continued use of the subsidy under the same conditions and criteria is inconsistent with a Member's obligation to "withdraw" the subsidy under Article 4.7 of the *SCM Agreement.*[181] Thus, the concept of "withdrawal" must in any event be interpreted to mean that a Member must cease to act in a WTO-inconsistent manner with respect to that subsidy. If a failure to cease conduct inconsistent with a Member's obligations under Article 3 of the *SCM Agreement* is inconsistent with the obligation to withdraw the subsidy in Article 4.7 of the *SCM Agreement*, we see no logical reason why the same concept should not also apply to the obligation that arises under Article 7.8 of the *SCM Agreement* to withdraw the subsidy or to take appropriate steps to remove the adverse effects of a subsidy that has been determined to result in adverse effects. In our view, the remedy under Article 7.8 must be viewed in its relationship to the obligation in Article 5 not to cause through the use of any subsidy referred to in Articles 1.1 and 1.2 of the *SCM Agreement* adverse effects to the interests of other Members. It must serve to restore conformity with the Member's obligation to avoid causing adverse effects through the use of any subsidy. As a consequence, a Member does not take appropriate steps to remove adverse effects of a subsidy if it continues to provide payments under the same conditions and criteria as the original subsidy in a manner that causes adverse effects. The interpretation advocated by the United States, whereby the obligation under Article 7.8 of the *SCM Agreement* is limited to the removal of the adverse effects caused by subsidies granted in a particular period of time, implies that it would not be possible to review in an Article 21.5 proceeding whether a Member causes adverse effects by continuing to grant subsidies under the same conditions and criteria as the subsidies found to have caused adverse effects. Such an interpretation fails to take into account the relationship between Article 7.8 and Article 5 of the *SCM Agreement* and thus fails to interpret Article 7.8 in its proper context.

9.80 We find further support for this approach in panel and Appellate Body reports on the scope of Article 21.5 of the DSU in which it has been held that "measures taken to comply" include " measures with a particularly close relationship to the declared 'measure taken to comply', and to the recommendations and rulings of the DSB".[182] As explained above, our interpretation of Article 7.8 implies that if a Member continues to make payments of a subsidy on the same legal basis and under

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[181] See Appellate Body Report, *Brazil – Aircraft (Article 21.5 – Canada)*, para. 45; Panel Report, *Brazil Aircraft (Article 21.5 – Canada)*, para. 6.8; Panel Report, *Canada – Aircraft (Article 21.5 – Brazil)*, para. 5.10.

[182] E.g. Appellate Body Report, *US – Softwood Lumber IV (Article 21.5 – Canada)*, para. 77. *Supra,* para. 9.24.

the same conditions and criteria as the subsidy found to have caused serious prejudice in the original proceeding, it must be possible for a panel in a proceeding under Article 21.5 of the DSU to examine a claim that the continued payment of that subsidy causes adverse effects within the meaning of Article 5 of the *SCM Agreement*. To hold that in such a situation a Member that considers itself to be adversely affected by the subsidy must initiate an entirely new proceeding under the DSU would in our view undermine the effectiveness of Article 7.8. Therefore, in light of our interpretation of Article 7.8, we consider that, where payments of a subsidy have been found to cause serious prejudice and the Member in question continues to provide the same subsidy under the same conditions and criteria, there exists "a particularly close relationship" between the subsidy that the Member continues to provide and the recommendations and rulings of the DSB in the original proceeding.

9.81 In light of these considerations, the Panel concludes that to the extent marketing loan payments and counter-cyclical payments made by the United States after 21 September 2005 are provided under the same conditions and criteria as the marketing loan payments and counter-cyclical payments subject to the original panel's finding of "present" serious prejudice, they are subject to the obligation of the United States under Article 7.8 of the *SCM Agreement* to take appropriate steps to remove the adverse effects of the subsidy. As a consequence, we also consider that Brazil's claim that the United States has failed to comply with its obligations under Article 7.8 with respect to these payments is properly before this Panel. In our view this claim pertains to a disagreement between the parties as to the "existence or consistency with a covered agreement of measures taken to comply" with the recommendations and rulings of the DSB.

X. FINDINGS ON BRAZIL'S CLAIMS OF "PRESENT" SERIOUS PREJUDICE UNDER ARTICLES 5(C) AND 6.3 OF THE *SCM AGREEMENT*

A. INTRODUCTION

10.1 **Brazil** requests the Panel to find that the measure taken by the United States to comply with the recommendations and rulings of the DSB, i.e. the amendment of the FSRI Act of 2002 to repeal section 1207(a) providing for Step 2 payments, is insufficient to ensure compliance with those recommendations and rulings because the remaining price-contingent subsidies are inconsistent with Articles 5 and 6 of the *SCM Agreement*. In particular, Brazil requests the Panel to find that the marketing loan and counter-cyclical payment programmes[183] of the FSRI Act of 2002 cause "present" serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement* in the form of significant price suppression and an increase in the US world market share of upland cotton within the meaning of, respectively, Articles 6.3(c) and 6.3(d) of the *SCM Agreement*.

10.2 The **United States** requests that the Panel find that the United States has complied with the recommendations and rulings of the DSB. The United States submits that Brazil fails to substantiate its arguments in support of the claim that the effects of the elimination of the Step 2 programme are

[183] As formulated in para. 461 of Brazil's First Written Submission, Brazil's request is with respect to the marketing loan and counter-cyclical *programmes*. The Panel notes, however, that Brazil has clarified that it does not request the Panel to make a finding that the programmes or legal provisions pursuant to which marketing loan and counter-cyclical payments are made are, as such, inconsistent with Articles 5 and 6 of the *SCM Agreement*. *Supra*, footnote 150. In light of this clarification the Panel will hereinafter refer to the subsidies subject to Brazil's serious prejudice claims as marketing loan and counter-cyclical payments. The Panel emphasizes, however, that as discussed above (*supra*, para. 9.52) a proper analysis of the effect of the marketing loan and counter-cyclical payments for purposes of Articles 5 and 6 of the *SCM Agreement* must examine them in the context of the legal and regulatory framework that defines the nature, conditions and criteria under which these payments will be made.

modest and that Brazil fails to make a *prima facie* case of "present" serious prejudice within the meaning of Articles 5(c) and 6.3(c) and 6.3(d) of the *SCM Agreement*.[184]

10.3 The Panel addresses Brazil's claim of "present" serious prejudice within the meaning of Articles 5(c) and 6.3(c) of the *SCM Agreement* in Section X.B of this Report. The Panel addresses Brazil's claim of "present" serious prejudice within the meaning of Articles 5(c) and 6.3(d) of the *SCM Agreement* in Section X.C of this Report.

B. BRAZIL'S CLAIM OF "PRESENT" SERIOUS PREJUDICE WITHIN THE MEANING OF ARTICLES 5(C) AND 6.3 (C) OF THE *SCM AGREEMENT*

1. Introduction – overview of the main arguments of the parties

10.4 **Brazil** submits that marketing loan and counter-cyclical payments made pursuant to the FSRI Act of 2002 cause significant price suppression in the world market for upland cotton within the meaning of Article 6.3(c) of the *SCM Agreement* and thereby cause "present" serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*. The **United States** submits that Brazil has not made a *prima facie* case under Articles 5(c) and 6.3(c) of the *SCM Agreement*.

10.5 In support of its claim that US marketing loan and counter-cyclical payments cause significant price suppression in the world market for upland cotton, **Brazil** submits that:[185]

(a) US upland cotton production and exports continue to expand and exercise a substantial proportionate influence on prices in the world market for upland cotton.

(b) The level of US planted acreage, production and exports heavily impacts world market prices of upland cotton, as evidenced by data showing broad similarities in the trends of the five major price indices relied upon by the original panel. Moreover, upland cotton prices during MY 2002-2005 have remained well below historic levels.

(c) The magnitude of the marketing loan and counter-cyclical payments remains very large.

(d) The structure, design and operation of the marketing loan and counter-cyclical payments[186] stimulate US upland cotton production by insulating US producers from market forces.

[184] The United States also submits that Brazil has failed to demonstrate that the marketing loan payment and counter-cyclical payment programmes mandate a breach of WTO obligations. US First Written Submission, paras. 196-202. The Panel understands that the United States made this argument in its First Written Submission on the assumption that Brazil was challenging the marketing loan and counter-cyclical payment programmes as such. Because Brazil has made it clear that it does not claim in this proceeding that the marketing loan and counter-cyclical payment programmes at issue are WTO-inconsistent as such (*supra*, footnote 150), we do not need to address this argument of the United States.

[185] Brazil also submits that marketing loan and counter-cyclical payments are specific subsidies, that US and Brazilian upland cotton are like products, that there exists a world market for upland cotton and that the A-Index represents the world market price. See *infra*, paras. 10.20 and 10.42-10.44.

[186] We note that in the title of the relevant section of its First Written Submission, Brazil refers to the structure, design and operation of "US marketing loan and counter-cyclical *payments*", but Brazil elsewhere in the same section also uses the phrase "nature of marketing loan and counter-cyclical payment *programs*, in terms of their structure, design and operation". Brazil's First Written Submission, Section 7.8.

(e) There remains a strong link between high levels of US subsidies and high levels of US planted acreage, production and exports during MY 2002-MY 2005, which is due to the fact that marketing loan and counter-cyclical payments insulate US cotton producers from market price signals.

(f) There remains a discernible temporal coincidence of suppressed world market prices and large marketing loan and countercyclical payments.

(g) Marketing loan and counter-cyclical payments continue to cover a significant portion of US upland cotton producers' long-term costs of production.

(h) Economic studies support a finding that marketing loan and counter-cyclical payments continue to cause significant price suppression.

(i) The factors relied upon by the original panel as the basis for its conclusion regarding the "significance" of the price suppression caused by the subsidies provided by the United States continue to exist.[187]

10.6 Brazil argues that the effects of the US marketing loan and counter-cyclical payments alone cause significant price suppression. Although Step 2 payments caused significant price suppression in and of themselves during MY 2005, this does not detract from the significant, independent price suppressing effects of the marketing loan and counter-cyclical payments. The removal of Step 2 payments has had a relatively modest impact on US production, US exports and world market prices for upland cotton, compared to the effects of marketing loan and counter-cyclical payments.[188] Other factors impacting the world market price of upland cotton do not account for the significant price suppressing effects caused by marketing loan and counter-cyclical payments.[189]

10.7 In support of its argument that Brazil fails to make a *prima facie* case of WTO inconsistency under Articles 5(c) and 6.3(c) of the *SCM Agreement*, the **United States** submits that:

(a) The structure, design and operation of the marketing loan and counter-cyclical payments do not support Brazil's claim of significant price suppression.

(b) The facts demonstrate that US producers and exporters have reacted to market signals and are not "insulated" by the marketing loan and counter-cyclical payments. Brazil fails to demonstrate the alleged strong link between marketing loan and counter-cyclical payments and US planted acreage, production and exports.

(c) "Absolute" increases in US production are the effect of improvements in yields, not the marketing loan and counter-cyclical payments.

(d) Brazil fails to demonstrate a "temporal coincidence" between marketing loan and counter-cyclical payments and the alleged price suppression.

(e) Brazil fails to demonstrate that US producers would "switch to alternative crops" in the absence of marketing loan and counter-cyclical payments.

(f) Brazil attempts to attribute the price effects of other factors to the marketing loan and counter-cyclical payments.

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[187] Brazil's First Written Submission, paras. 88-209.
[188] Brazil's First Written Submission, paras. 191-209.
[189] Brazil's First Written Submission, paras. 210-211.

(g) The econometric modeling cited by Brazil is flawed and greatly exaggerates any effects of removing the marketing loan and counter-cyclical payment programmes.

(h) Brazil has not demonstrated that "the effect" of the marketing loan and counter-cyclical payments is "significant" price suppression.[190]

2. Arguments of third parties

10.8 **Argentina** considers that by maintaining the marketing loan and counter-cyclical payment programmes the United States has failed to comply with its obligation under Article 7.8 of the *SCM Agreement* to take appropriate steps to remove the adverse effects or withdraw the subsidy. The evidence submitted by Brazil demonstrates that the marketing loan and counter-cyclical payment programmes continue to cause adverse effects on the interests of Brazil and other cotton-producing countries such as Argentina in the form of significant price suppression.[191]

10.9 **Australia** submits that the Panel should consider whether the United States, by repealing the Step 2 payment programme while maintaining the two other price-contingent subsidies (payments under the marketing loan and counter-cyclical payment programmes), has taken appropriate steps to remove the adverse effects or withdraw the subsidies within the meaning of Article 7.8 of the *SCM Agreement* in accordance with the DSB recommendations and rulings. Australia recalls, in this respect, that in making its findings the original panel examined each price-contingent subsidy measure in turn before considering the collective operation of those measures, and that it is clear from the panel's analysis that each of the price-contingent measures individually was found to have a trade-distorting effect.[192]

10.10 **Chad** argues that the United States has not properly implemented the original panel's findings regarding the marketing loan and counter-cyclical payment programmes. As the only action undertaken by the United States is the repeal of the Step 2 programme with effect from 1 August 2006, it is clear that the United States has not withdrawn or amended the marketing loan or counter-cyclical payment programmes found to be WTO-inconsistent. Moreover, the repeal of the Step 2 programme cannot be considered to have removed the adverse effects of the marketing loan and counter-cyclical payments. The marketing loan and counter-cyclical payment programmes accounted for the vast majority of the adverse effects found by the original panel. In this respect, Chad points to empirical studies that have found that the measures most detrimental to Chad are the US domestic support programmes, rather than export subsidies under the Step 2 programme. Chad submits that since the United States has not changed the marketing loan and counter-cyclical programmes that were subject to the original panel's finding, this Panel should rely on the legal and factual conclusions drawn by the original panel concerning the existence, nature and potential for price suppression of those measures. The price effects of these measures have continued and indeed gotten worse since the original panel made its finding and Chad and other West African cotton-producing countries have continued to lose market share.[193]

10.11 **India** submits that the original panel examined carefully and separately the individual nature, operation and magnitude and price-suppressing effects of the marketing loan payment programme, the counter-cyclical payment programme and the Step 2 payment programme and found that the vast majority of the price-suppressing and adverse effects were caused by the marketing loan and counter-cyclical payment programmes, rather than by the Step 2 payments. Therefore, the withdrawal of the

[190] US First Written Submission, paras. 204-331.
[191] Argentina's Third Party Submission, paras. 5-8.
[192] Australia's Third Party Submission, paras. 25-31.
[193] Chad's Third Party Submission, paras. 22-46.

Step 2 programme for upland cotton cannot be said to have also removed the adverse effects of the marketing loan and counter-cyclical payment programmes.[194]

10.12 **New Zealand** submits that the various arguments of the United States on the removal of the Step 2 payment programme leave intact the fundamental point made by Brazil, that even in the absence of the Step 2 payment programme the marketing loan and counter-cyclical payment programme still result in significant price suppression within the meaning of Article 6.3.(c) of the *SCM Agreement* and thus cause serious prejudice to the interests of Brazil. Regarding the argument of the United States that Brazil has failed to make a *prima facie* case of WTO-inconsistency of the marketing loan and counter-cyclical payment programmes, New Zealand argues that an approach that would put the burden on Brazil to prove once again what Brazil already proved before the original panel would risk depriving the provisions in Part III of the *SCM Agreement* on actionable subsidies of their useful effect. Similarly, New Zealand considers that the attempt of the United States to reargue what it had argued before the original panel is not consistent with the objective of Article 7.8 of the *SCM Agreement* and of Article 21.5 of the DSU. New Zealand argues that counter-cyclical payments are not real decoupled payments because they are linked to prices. The proposition that marketing loan payments are distorting is self-evident because these payments are amber box measures, the category in which are included the non-prohibited measures with the most distorting effect on production and trade. Moreover, the arguments of the United States on marketing loan payments ignore that it is the expectations of producers that are important, and that those expectations are generated because of the existence of the applied administrative prices under the marketing loan programme, not because of the financial transfers in any year. New Zealand considers that the United States does not and cannot demonstrate that planting decisions of US cotton producers were shaped by market factors. With respect to the arguments of the United States on the econometric modelling provided by Brazil, New Zealand submits that these arguments are either an attempt to reargue what was litigated before, and disposed of, by the original panel and the Appellate Body, or are inconsequential.

3. Preliminary considerations relating to the Panel's evaluation of Brazil's claim under Articles 5(c) and 6.3(c) of the *SCM Agreement*

(a) Text of legal provisions

10.13 Article 5(c) of the *SCM Agreement* provides:

> "No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.:
>
> [...]
>
> (c) serious prejudice to the interests of another Member.[13]
>
> ______________
>
> [13] The term "serious prejudice to the interests of another Member" is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice."

10.14 Article 6.3(c) of the *SCM Agreement* reads as follows:

[194] India's Third Party Oral Statement, para. 5.

> "6.3 Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply:
>
> [...]
>
> (c) the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression, or lost sales in the same market."

(b) Period to be considered by the Panel

(i) Main arguments of the parties

10.15 **Brazil** submits that in analyzing Brazil's claims of "present" serious prejudice the Panel should use as reference period MY 2005 (1 August 2005-31 July 2006), which is the most recently completed marketing year for which complete data is available. The Panel can also use partial data for MY 2006 if such data is credible and reliable. Brazil submits that by conducting a counter-factual analysis the Panel can isolate the effects of the marketing loan and counter-cyclical payments made in MY 2005 from the effects of Step 2 payments made in MY 2005. Brazil argues that the Panel can also use data for the period MY 2002-MY 2005 in order to assess the continued relevance of the findings of the original panel.[195]

10.16 The **United States** argues that Brazil's claims of "present" serious prejudice pertain to the present marketing year, MY 2006. The use of the term "is" in Article 6.3(c) of the *SCM Agreement* ("the effect of any subsidy is ... significant price suppression") means that the relevant period is the immediate present rather than a historical period. While it may be appropriate to use historical data as a proxy for the present period when complete data is not available for that period, where relevant data is available for MY 2006 or part thereof the Panel should consider that data.[196]

(ii) Main arguments of third parties

10.17 The **European Communities** argues that the Panel must examine recent relevant data reasonably available, including, where possible, data for MY 2006.[197]

(iii) Evaluation by the Panel

10.18 The claim of Brazil under Article 6.3(c) of the *SCM Agreement* requires an analysis by the Panel as to whether "the effect of the subsidy … is … significant price suppression". While the *SCM Agreement* does not contain a specific provision on the period to be considered for this purpose[198], the

[195] Brazil's First Written Submission, para. 49; Brazil's Rebuttal Submission, paras. 22-25; Brazil's Oral Statement, paras. 19-20; Brazil's Responses to Panel Questions 28 and 74.

[196] US First Written Submission, para. 229; US Rebuttal Submission, paras. 215-216; US Response to Panel Question 28.

[197] EC Third Party Submission, paras. 53-58; EC Third Party Oral Statement, para. 36. The European Communities considers that in establishing claims of "present" serious prejudice, Members are required to rely on the most recent relevant data reasonably available to them.

[198] The original panel addressed the issue of what it termed the "reference period" to be used in its analysis as follows:

> "The **Panel** concurs with the United States assertion that MY 2002 is a relevant year for our serious prejudice inquiry. It represents a recent period for which essentially complete data exists. The identification of 'significant price suppression' flowing

use of the present tense logically implies the need to make a determination with respect to the present period. The United States has put before us some data relating to MY 2006. Given that our task is to decide whether or not significant price suppression "is" the effect of the marketing loan and counter-cyclical payments at issue in this proceeding we see no reason to exclude data relating to MY 2006 to the extent that it is available.[199] We note that while Brazil has argued that the Panel should rely primarily on data for MY 2005, Brazil does not contest that it is appropriate for the Panel to use data pertaining to MY 2006 to the extent that such data is reliable and credible.[200] An important consideration reinforcing the need to take into account data pertaining to the period since July 2006 is that the "measure taken to comply" by the United States – the elimination of the Step 2 programme – was effective as of the beginning of MY 2006.

10.19 Moreover, while our determination relates to the present period, we agree with the observation of the original panel that consideration of developments over a longer period of time "provides a more robust basis for a serious prejudice evaluation than merely paying attention to developments in a single year".[201]

(c) Whether marketing loan and counter-cyclical payments are specific subsidies

10.20 The Panel considers that marketing loan payments and counter-cyclical payments to US upland cotton producers pursuant to the relevant provisions of the FSRI Act of 2002 are "subsidies" within the meaning of Article 1.1 of the *SCM Agreement*, which are "specific" within the meaning of Article 1.2 of the *SCM Agreement* and that Part III of the *SCM Agreement* therefore applies to these measures.[202] We recall, in this regard, that the original panel found that the measures at issue in that case, including marketing loan payments and counter-cyclical payments, constituted "subsidies"

> from 'the effect of the subsidy' calls for an evaluation of this effects-based phenomenon that cannot be conducted in the abstract. Rather, discerning adverse effects of subsidies seems to us to require reference to a recent historical period. We believe, however, that it is important for the establishment of "current" serious prejudice that such prejudice would be established to exist up to, and including, a recent point in time.
>
> We also believe that subsidies granted prior to MY 2002 are relevant to our evaluation. Consideration of developments over a period longer than one year, while not necessarily required (at least in Articles 5(c) and 6.3(c)) provides a more robust basis for a serious prejudice evaluation than merely paying attention to developments in a single recent year. It may put such developments in a broader temporal context. In addition, having found that the subsidies exist and have been provided over a longer period of time than one year, it would be inappropriate to look at trends only in the last year to arrive at any conclusion on serious prejudice. It may, for example, be that the market may well already be distorted in a given year due to subsidies."

Panel Report, *US – Upland Cotton*, paras. 7.1198-7.1199.

[199] Indeed, the failure to take into account relevant and available data placed before us pertaining to the period since July 2006 would not be consistent with the requirement under Article 11 of the DSU that a panel "make an objective assessment of the matter before it, including an objective assessment of the facts of the case…"

[200] We note that the original panel, which was established on 18 March 2003, considered data covering the period MY 2002, which ended on 31 July 2003. Thus, the panel took into account data covering a period of 4 ½ months following its establishment.

[201] *Supra*, footnote 198.

[202] Article 5 of the *SCM Agreement* applies to "any subsidy referred to in paragraphs 1 and 2 of Article 1" of the *SCM Agreement*. Thus in order for any measure to be an "actionable subsidy" subject to the provisions in Articles 5-7 of the *SCM Agreement* the measure must be a "specific subsidy" within the meaning of Articles 1.1 and 1.2 of the *SCM Agreement*.

within the meaning of Articles 1.1(a) and 1.1(b) of the *SCM Agreement* and that these subsidies were "specific" within the meaning of Article 2 of the *SCM Agreement*.[203] It is not disputed that the provisions of the FSRI Act of 2002 concerning marketing loan and counter-cyclical payments have not been changed since the original panel conducted its analysis. The United States has not contested the argument made by Brazil in this proceeding that marketing loan and counter-cyclical payments constitute specific subsidies.[204]

(d) Magnitude of the marketing loan and counter-cyclical payments

10.21 The original panel considered that while a serious prejudice analysis under Part III of the *SCM Agreement* does not require a precise quantification of the amount of a subsidy[205], "the general order of magnitude of a subsidy may be a relevant consideration in a serious prejudice analysis in a particular case (where such information is probative and readily available)".[206] The Appellate Body held that the magnitude of a subsidy and its relationship to prices is a relevant factor to consider in an analysis of whether the effect of a subsidy is significant price suppression[207], but that Article 6.3(c) of the *SCM Agreement* does not oblige a panel "to quantify precisely the amount of a subsidy benefiting the product at issue in every case. A precise, definitive quantification of the subsidy is not required".[208] However, the Appellate Body also considered that the original panel could have been more explicit as to what it meant by referring to "very large amounts" of subsidies.[209]

10.22 The Panel provides below an overview of the factual information submitted by the parties with regard to the magnitude of the marketing loan and counter-cyclical payments to US upland cotton producers.

(i) Marketing loan payments

10.23 The Panel considers that the figures provided by the parties regarding the marketing loan payments made by the United States to upland cotton producers in MY 2004 and MY 2005[210] are in the same "general order of magnitude."[211]

10.24 The following table compares the figures provided by Brazil and the United States on the magnitude of marketing loan payments:

[203] Panel Report, *US – Upland Cotton*, paras. 7.1120 and 7.1154.
[204] Brazil's First Written Submission, paras. 64-78.
[205] Panel Report, *US – Upland Cotton*, paras. 7.1167, 7.1177 and 7.1179.
[206] Panel Report, *US – Upland Cotton*, footnote 1289.
[207] Appellate Body Report, *US – Upland Cotton*, para. 461.
[208] Appellate Body Report, *US – Upland Cotton*, para. 467.
[209] Appellate Body Report, *US – Upland Cotton*, para. 468.
[210] Brazil's First Written Submission, paras. 108 and 111 (Table 6) and Exhibit Bra-471; US Response to Panel Question 4, paras. 13-14; Brazil's Comments on US Response to Panel Question 4, para. 14 and Exhibit Bra-639.
[211] *Supra*, para. 10.21.

Table 1: Marketing Loan Payments, MY 2002-2005

(million US$)

Source	MY 2002	MY 2003	MY 2004	MY 2005
Brazil's First Written Submission, Table 6	898	184	1,842	1,257
US Response to Panel Question 4	–	–	1,780	1,269
Brazil's Comments on US Response to Panel Question 4	–	–	1,812	1,269

10.25 Brazil has also provided data on projected marketing loan payments in the period MY 2006-2010. This data shows that the projected amount of marketing loan payments in MY 2006 is US$650 million based on USDA Budget Estimates[212], US$475 million based on data from the Food and Agricultural Policy Research Institute ("FAPRI")[213], and US$757 million based on February 2007 USDA stochastic projections.[214] [215]

(ii) Counter-cyclical payments

10.26 The parties disagree on the magnitude of counter-cyclical payments made by the United States to upland cotton producers. This disagreement is the result of different approaches to

[212] According to Table 26 of the First Written Submission of Brazil, which is based on USDA Budget Estimates, marketing loan payments are expected to amount to US$650 million in MY 2006, US$541 million in MY 2007, US$433 million in MY 2008, US$407 million in MY 2009 and US$407 million in 2010. Brazil's First Written Submission, paras. 281-282 and Exhibit Bra-456.

[213] In Table 27 of its First Written Submission Brazil provides estimates of marketing loan payments in the period MY 2006-2010 based on the July 2006 FAPRI Baseline Update for US Agricultural Markets. This Table indicates that the amount of marketing loan payments will be US$475 million in MY 2006, US$190 million in MY 2007, US$50 million in MY 2008, US$0 in MY 2009 and US$0 in MY 2010. Brazil's First Written Submission, para. 286 (Table 27) and Exhibit Bra-479.

[214] In response to a question of the Panel, Brazil explains that the figures in Table 27 of its First Written Submission reflect deterministic projections of outlays, which by their very nature tend to underestimate outlays. The most up to date (February 2007) USDA deterministic and stochastic projections of upland cotton budget outlays show that the degree of this underestimation is very significant. According to the February 2007 USDA stochastic projections, the amounts of marketing loan payments will be US$757 million in MY 2006, US$798 million in MY 2007, US$515 million in MY 2008, US$468 million in MY 2009 and US$477 million in 2010. Brazil's Response to Panel Question 89, para. 189 (Table 4). The United States submits that Brazil's response is incorrect because the figures on government outlays in Table 27 of Brazil's First Written Submission were not projected by FAPRI but were estimated by Brazil. Moreover, the values reported by FAPRI are, in fact, based on a stochastic approach. US Comments on Brazil's Response to Panel Question 89.

[215] The United States considers that the FAPRI data provided by Brazil on the projected amounts of marketing loan payments are entirely consistent with a market report of the International Cotton Advisory Committee and recent projections by the US Congressional Budget Office of higher world market prices for cotton in MY 2006 and MY 2007. At these higher prices, any marketing loan payments are likely to be small. US Response to Panel Question 82. Brazil contests this argument of the United States. Brazil considers that in making this argument the United States is making the mistake of relying on expected prices without taking into account the probability that actual prices will be lower than expected prices. Brazil refers in this respect to the USDA February 2007 stochastic projections of marketing loan payments, which are higher than the July 2006 FAPRI projections. Brazil argues that the February 2007 USDA projections are more reliable than the July 2006 FAPRI projections. Brazil's Comments on US Response to Panel Question 82.

the question of how the counter-cyclical payments at issue in this case should be allocated[216] to actual production of upland cotton.

10.27 Two main issues have arisen in this regard. *First*, as in the original proceeding, Brazil has used two methodologies for allocating counter-cyclical payments to actual production of upland cotton, referred to as "Brazil's methodology" and the "cotton-to-cotton" methodology.[217] Whereas Brazil asserts that "Brazil's methodology" was endorsed in the original proceeding, the United States argues that this allocation methodology was specifically rejected by the Appellate Body. *Second*, the parties disagree on whether counter-cyclical payments should be allocated in accordance with the methodology found in Annex IV of the *SCM Agreement*.

10.28 According to the First Written Submission of **Brazil**, "counter-cyclical payments allocated to actual upland cotton production" amounted to US$869 million in MY 2002, US$260 million in MY 2003, US$913 million in MY 2004 and US$914 million in MY 2005.[218] In its Rebuttal Submission, Brazil asserts that, calculated in accordance with the "cotton-to-cotton" methodology, the amounts of counter-cyclical payments allocated to upland cotton were US$851.5 million in MY 2002, US$237.2 million in MY 2003, US$823.5 million in MY 2004 and US$832.0 million in MY 2005.[219] In its Opening Statement, Brazil, referring to Exhibit Bra-625, submits that applying (an updated) "Brazil's methodology", counter-cyclical payments allocated to cotton production amounted to US$868 million in MY 2005 and that applying (an updated) "cotton-to-cotton" methodology, the amount of counter-cyclical payments allocated to cotton production was US$838 million in MY 2005.[220] [221] Brazil asserts, in this regard, that the original panel described "Brazil's methodology" as

[216] The counter-cyclical payments at issue in this case are calculated on the basis of historical cotton base acres and are not tied to actual production of upland cotton. We recall in this respect the observations of the original panel:

> "The PFC, MLA, DP and CCP programmes permit planting flexibility and do not require production. Eligibility for these payments depends on production of specific covered commodities in a base period, not the year of the payment. Payments are calculated with respect to these 'base acres', at a rate specific to each covered commodity, as described in Section VII:C of this report. Recipients who hold upland cotton base acres, in respect of which payments are calculated at the upland cotton rate, could have since ceased production of upland cotton. Recipients who hold other base acres, in respect of which payments are calculated at the rate for other specific covered commodities, could have since commenced production of upland cotton." (footnote omitted, emphasis added)

Panel Report, *US – Upland Cotton*, para. 7.635.

[217] For a description of "Brazil's methodology" see Panel Report, *US – Upland Cotton*, para. 7.642 and footnote 836. For a description of the "cotton-to-cotton" methodology see Panel Report, *US – Upland Cotton* para. 7.641 and footnote 835.

[218] Brazil's First Written Submission, para. 111 (Table 6) and Exhibit Bra-471. Brazil explains that these allocated amounts of counter-cyclical payments are derived by multiplying (a) the ratio of allocated upland cotton counter-cyclical payments in MY 2002 (869.4 million) to total upland cotton counter-cyclical payments in MY 2002 (US$1.309 billion) by (b) total upland cotton counter-cyclical payments in MY 2003-2005. Brazil's First Written Submission, paras. 116-118. The figure of US$869.4 million for allocated counter-cyclical payments in MY 2002 is based on the application of "Brazil's methodology".

[219] Brazil's Rebuttal Submission, paras. 173-174, Table 5. Brazil observes that the limited data provided by the United States in this proceeding does not enable Brazil to update the amounts of counter-cyclical payments allocated to upland cotton based on "Brazil's methodology".

[220] Brazil's Opening Statement, para. 40.

[221] With regard to the difference between the figures mentioned in Brazil's First Written Submission, Rebuttal Submission and Opening Statement, Brazil has explained, in response to Panel Question 66, that: (i) the figures in Table 6 of Brazil's First Written Submission reflect an allocation according to "Brazil's Methodology" using data available at the time of the preparation of that submission; (ii) the figures in Table 5 of Brazil's Rebuttal Submission reflect an allocation according to the "cotton-to-cotton methodology" using the

"appropriate" and that the Appellate Body endorsed "Brazil's methodology" when it affirmed the original panel's findings.[222] [223]

10.29 Brazil submits that the argument of the United States on the allocation of counter-cyclical payments on the basis of the methodology set out in Annex IV of the *SCM Agreement* is inconsistent with the findings of the panel and the Appellate Body in the original proceeding. Brazil considers that the calculation provided by the United States is in any event incorrect and that, correctly applied, the amount of counter-cyclical payments allocated to cotton production in accordance with Annex IV of the *SCM Agreement* is US$577 million in MY 2005.[224]

10.30 The **United States** submits that there is no basis for Brazil's argument that counter-cyclical payments should be allocated according to "Brazil's methodology" since that methodology was only addressed in the original panel's Peace Clause analysis and was not relied upon by the panel. Moreover, the methodology was specifically rejected by the Appellate Body.[225] In response to a question of the Panel, the United States indicates that it has "tested" the figures in Table 5 of Brazil's Rebuttal Submission and that applying the "cotton-to-cotton" methodology the figures for counter-cyclical payments allocated to cotton production are US$820 million in MY 2004 and US$825 million in MY 2005.[226]

10.31 The United States submits that under Article 6.3(c) of the *SCM Agreement* Brazil must identify the subsidized product for each of the types of subsidies from which it claims serious prejudice.[227] In this regard, the United States considers that in the case of counter-cyclical payments, which are not tied to the production or sale of any particular product, Annex IV of the *SCM Agreement* contains an appropriate, economically neutral, allocation methodology.[228] The amount of counter-cyclical payments allocated to upland cotton production in accordance with this methodology is US$386.6 million in MY 2005.[229]

10.32 The following tables compare the results of the various calculations provided by the parties of the amounts of counter-cyclical payments to US upland cotton producers.

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data in the table in paragraph 224 of the US First Written Submission; (iii) the figures in paragraph 40 of Brazil's Opening Statement reflect allocations according to, respectively, "Brazil's methodology" and the "cotton-to-cotton methodology" using the updated data provided by the United States in Exhibit US-64; and (iv) the figures in Table 5 of Brazil's Rebuttal Submission do not supersede the figures in Table 6 of Brazil's First Written Submission.

[222] Brazil's Comments on US Response to Panel Question 3, para. 7; Brazil's Opening Statement, para. 40. Brazil refers to paragraph 469 of the Appellate Body Report as support for this contention.

[223] Brazil argues that while the methodology applied by the Appellate Body might have related to counter-cyclical payments with respect to upland cotton base only, the finding that "support to" upland cotton exceed support decided in 1992 includes any support for upland cotton and is not limited to counter-cyclical payments for upland cotton base only. Brazil's Comments on US Response to Panel Question 3, para. 9.

[224] Brazil's Comments on US Response to Panel Question 3.

[225] US Rebuttal Submission, paras. 278-280.

[226] US Response to Panel Question 4, para. 16.

[227] US Response to Panel Question 3, para. 7. The United States refers in this regard to the statement of the Appellate Body in the original proceeding that the "subsidized product" must be properly identified for purposes of significant price suppression under Article 6.3(c) of the *SCM Agreement* and that, if challenged payments do not in fact subsidize the "subsidized product", this may undermine the conclusion that the effect of the subsidy is significant price suppression. Appellate Body Report, *US – Upland Cotton*, para. 472.

[228] US Response to Panel Question 3, paras. 7-11. The United States notes that Annex IV of the *SCM Agreement* is not directly applicable to Articles 5(c) and 6.3(c), but that it provides essential context as it is the only allocation methodology that Members have agreed in the *SCM Agreement* and that specifically deals with the question of how to allocate subsidies that are not tied to the production or sale of a given product. US Response to Panel Question 3, para. 10.

[229] US Response to Panel Question 3, para. 12.

Table 2A: Counter-Cyclical Payments (non-Annex IV Methodology), MY 2002-2005

(million US$)

Source	MY 2002	MY 2003	MY 2004	MY 2005
Brazil's First Written Submission Table 6	869.0	260.0	913.0	914.0
Brazil's Rebuttal Submission Table 5	851.5	237.2	823.5	832.0
US Response to Panel Question 4	–	237.0	820.0	825.0
Brazil's Opening Statement	–	–	–	868/838
Brazil's Comments on US Response to Panel Question 4	–	–	–	868.0

Table 2B: Counter-Cyclical Payments (Annex IV Methodology), MY 2004-2005

(million US$)

Source	MY 2004	MY 2005
US Response to Panel Question 3 (Annex IV methodology)	437.3	386.6
Brazil's Comments on US Response to Panel Question 3 (Annex IV methodology (a))	540	468
Brazil's Comments on US Response to Panel Question 3 (Annex IV methodology (b))	–	577

10.33 Brazil submits data on projected counter-cyclical payments in MY 2006-2015. Based on USDA Budget Estimates, allocated counter-cyclical payments to US upland cotton producers are projected to amount to US$715 million in MY 2006, US$516 million in MY 2007 and US$449 million in MY 2008, MY 2009 and MY 2010.[230] Based on the July 2006 FAPRI Baseline Update for US Agricultural Markets, projected allocated counter-cyclical payments are US$912 million in MY 2006, US$825 million in MY 2007, US$732 million in MY 2008, US$679 million in MY 2009 and US$686 million in MY 2010.[231]

10.34 The Panel first addresses the argument of the United States that counter-cyclical payments calculated on the basis of cotton base acres should be allocated to cotton production in accordance with Annex IV of the *SCM Agreement.*

10.35 We recall that the original panel and the Appellate Body rejected the view that Article 6.3 of the *SCM Agreement* requires a precise quantification of the subsidy and that the allocation methodology provided for in Annex IV of the *SCM Agreement* should be used in this connection.[232]

[230] Brazil's First Written Submission, para. 282 (Table 26).

[231] Brazil's First Written Submission, para. 286 (Table 27).

[232] Panel Report, *US – Upland Cotton*, paras. 7.1159-7.1190; Appellate Body Report, *US – Upland Cotton*, paras. 461-473. We note that the original panel discussed the issue of whether and how subsidies should be quantified and allocated in an analysis under Article 6 of the *SCM Agreement* in response to an argument of the United States that Brazil had failed to properly identify "the subsidized product for each of the types of subsidies from which it claims serious prejudice". Panel Report, *US – Upland Cotton*, para. 7.1159. In

We see no basis to accept in this proceeding the same argument of the United States that was rejected by the panel and the Appellate Body in the original proceeding. We also note that the methods actually relied upon by the panel and the Appellate Body to determine the amounts of counter-cyclical payments allocated to upland cotton production were not based on the methodology set out in Annex IV of the *SCM Agreement*. Thus, we reject the argument of the United States that for the purposes of this proceeding the amount of counter-cyclical payments benefiting upland cotton production should be determined by using the allocation methodology provided for in Annex IV of the *SCM Agreement*.

10.36 With respect to the disagreement between the parties as to the appropriateness of using "Brazil's methodology" to allocate the cotton base acres counter-cyclical payments to actual production of upland cotton, we consider that it is clear from the Appellate Body report in the original proceeding that the Appellate Body did *not* endorse that methodology. *First*, in the context of its analysis of issues raised with respect to the application of Article 13 (b)(ii) of the *Agreement on Agriculture*, the Appellate Body made the following observations:

> "We underline that these Panel findings do not pertain to *all* payments to *current* producers of upland cotton, but rather are limited to payments to producers with respect to historic *upland cotton* base acres. Indeed, we see little in the Panel's finding or on the record that would allow us to discern a link between the support-conferring measures with respect to non-cotton historical base acres and current production of upland cotton. We do not, therefore, accept the methodology submitted by Brazil that included, in the Article 13(b)(ii) calculation, payments with respect to both cotton and non-cotton base acres flowing to current production of upland cotton. We believe that only the 'cotton to cotton' methodology, included by the Panel in 'Attachment to Section VII:D' to its Report as an 'appropriate' alternative calculation, sufficiently demonstrates a discernible link between payments under base acre dependent measures (related to upland cotton) and upland cotton."[233] (footnotes omitted, original emphasis)

10.37 Thus, in upholding the panel finding that the US domestic support measures in question granted support to upland cotton in excess of that decided during MY 1992[234], the Appellate Body

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our view, the considerations which led the original panel to reject the argument that Brazil had failed to properly identify the product benefiting from the subsidies at issue remain relevant.

[233] Appellate Body Report, *US – Upland Cotton*, para. 380. In paragraph 384 of the Report, the Appellate Body observed:

> "For the reasons stated above, we conclude that payments with respect to upland cotton base acres to producers currently growing upland cotton under the production flexibility contract, market loss assistance, direct payment and counter-cyclical payment measures, calculated in accordance with the 'cotton to cotton' methodology, are support granted to the specific commodity upland cotton in the sense of Article 13(b)(ii) of the *Agreement on Agriculture."*

> Finally, the Appellate Body stated that

> "In our review above, we have concluded that, for purposes of the comparison envisaged by Article 13(b)(ii), the values of the four measures, namely, production flexibility contract payments, market loss assistance payments, direct payments and counter-cyclical payments in the years 1999, 2000, 2001, and 2002 are properly determined by using the 'cotton to cotton' methodology, and we have therefore modified the Panel's findings in this regard...."

Appellate Body Report, *US – Upland Cotton*, para. 392.

[234] Appellate Body Report, *US – Upland Cotton*, para. 393.

calculated the amount of counter-cyclical payments to upland cotton in accordance with the "cotton-to-cotton" methodology.[235]

10.38 *Second*, in reviewing the serious prejudice finding of the original panel, the Appellate Body upheld the panel's conclusion regarding the amount of the subsidies at issue. In this respect, the Appellate Body referred *inter alia* to paragraph 7.641 of the original panel report, which is the paragraph that contains figures reflecting the "cotton-to-cotton" methodology.[236] The Appellate Body referred to the same figures as support for its observation that even using certain alternative allocation methodologies, the panel's conclusion regarding the general magnitude of price-contingent subsidies stood.[237]

10.39 The Panel considers that Brazil has not presented any persuasive argument as to why it would be appropriate to apply in this proceeding an allocation methodology that was specifically rejected by the Appellate Body in the original proceeding.

10.40 In light of the above considerations, the Panel concludes that the amount of counter-cyclical payments allocated to upland cotton production must be calculated based on the "cotton-to-cotton" methodology. The information before us indicates that in MY 2005 this amount was US$838 million.[238]

10.41 Finally, the Panel notes that the parties have also made arguments on the likely impact of the removal of Step 2 payments on the amounts of marketing loan and counter-cyclical payments in future years. The Panel addresses that issue below in Section X.B.11 of this Report.

(e) Product at issue, like product, relevant "market" and "price"

10.42 The Panel notes that the parties agree that the product at issue for purposes of Brazil's claims of "present" serious prejudice is upland cotton lint.[239] Brazil recalls that the original panel had found that US upland cotton is like Brazilian upland cotton and submits evidence to demonstrate that this finding remains valid.[240] The United States has not contested Brazil's position on this issue.[241]

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[235] Appellate Body Report, *US – Upland Cotton*, Annex 2, Tables 1-3.

[236] Appellate Body Report, *US – Upland Cotton*, para. 468 and footnote 631.

[237] Appellate Body Report, *US – Upland Cotton*, para. 469 and Annex 2, Table 3. The notes to the Tables in Annex 2 state explicitly that "[t]he values of production flexibility contract payments, market loss assistance payments, direct payments, and counter-cyclical payments are based on the 'cotton to cotton' methodology, discussed *supra*, paras. 377-380. Figures are drawn from Panel Report, para. 7.641". Thus, we disagree with Brazil that the Appellate Body's observations in paragraph 469 amount to an endorsement of "Brazil's methodology". Brazil's Opening Statement, para. 40.

[238] Exhibit Bra-625 and US Response to Panel Question 55. The Panel notes that this question was posed to the United States with the explanation that the Panel "is not asking whether the US agrees with these [i.e. 'Brazil's methodology' and the 'cotton-to-cotton'] methodologies".

[239] US Response to Panel Question 3, para. 9; Brazil's Comments on US Response to Panel Question 3, para. 4. The Panel recalls in this respect that the original panel explained that, as used in the panel's report, the term "upland cotton" ordinarily refers to upland cotton lint. Panel Report, *US – Upland Cotton*, footnote 258. It is the Panel's understanding that in this proceeding Brazil and the United States also use the term "upland cotton" to refer to upland cotton lint.

[240] Brazil's First Written Submission, para. 80 and Annex II ("Declaration by Andrew Macdonald").

[241] The original panel observed that it was not entirely clear from the text of Article 6.3(c) of the *SCM Agreement* whether the requirement to establish a "subsidized product" and a "like product" applies to a price suppression analysis. The panel nevertheless decided to address these concepts because its "examination of 'prices' in the world market necessarily relate[d] to 'prices' of certain 'products' ". Panel Report, *US – Upland Cotton*, footnote 1333. The Appellate Body noted that since the panel and the participants agreed that US upland cotton and Brazilian upland cotton must be "in the same market" it was not necessary to decide whether

10.43 Under Article 6.3(c) of the *SCM Agreement*, the Panel must determine whether the effect of the subsidy is significant price suppression "in the same market". Brazil submits that in this case the relevant market for purposes of Article 6.3(c) is the world market for upland cotton. We note that the original panel found that the term "same market" in Article 6.3(c) can be interpreted "as including a geographical area which may embrace the entire world"[242] and that such a "world market" did, in fact, exist in the case of upland cotton.[243] The Appellate Body upheld these conclusions of the panel.[244] We note that the United States does not contest that the relevant market for purposes of our analysis under Article 6.3(c) is the world market for upland cotton. Therefore, in determining whether the effect of the subsidies at issue is significant price suppression "in the same market", we will treat the world market for upland cotton as the relevant market.

10.44 As pointed out by Brazil, the original panel found that the relevant "price" for purposes of its analysis under Article 6.3(c) was the world market price for upland cotton, as represented by the A-Index.[245] [246] Brazil submits that this Panel should adopt the same approach and use the A-Index as reflecting the world market price for upland cotton. The Panel finds the arguments of Brazil in this regard persuasive.[247] The Panel also notes that the United States has not contradicted Brazil's arguments regarding the existence of a world market price for upland cotton and the A-Index as representing this world market price.[248] In light of these considerations, the Panel finds that a world "market" exists for upland cotton and that the A-Index represents the "price" relevant to the analysis of price suppression under Article 6.3(c) of the *SCM Agreement*.[249]

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the "like product" requirement applied to a price suppression analysis. Appellate Body Report, *US – Upland Cotton*, para. 407 and footnote 453. The panel in *Korea – Commercial Vessels* concluded that the concept of "like product" does not apply to an analysis of price suppression or price depression under Article 6.3(c) of the *SCM Agreement*. Panel Report, *Korea – Commercial Vessels*, paras. 7.538-7.560.

[242] Panel Report, *US – Upland Cotton*, para. 7.1243. See also Panel Report, *Korea – Commercial Vessels*, paras. 7.564-7.565.

[243] Panel Report, *US – Upland Cotton*, paras. 7.1246-7.1247.

[244] Appellate Body Report, *US – Upland Cotton*, paras. 410-411.

[245] Panel Report, *US – Upland Cotton*, para. 7.1274.

[246] The original panel described the "A-Index" as "a composite of an average of the five lowest price quotes from a selection of the principal upland cottons traded in the world market obtained by Cotlook, a private UK-based organization". The panel clarified in a footnote that "the prices are quoted c.i.f. Northern Europe". Panel Report, *US – Upland Cotton*, paras. 7.1264 and footnote 1374. Brazil has explained in this proceeding that in March 2003 the basis for the calculation of the A-Index was changed to reflect the fact that Asian importers now account for three quarters of total imports of upland cotton. The A-Index proper now reflects values for delivery c.i.f. to Far Eastern ports (A(FE)Index). Cotlook continues to publish an A(NE)Index which reflects values for delivery c.i.f. Northern European ports. Brazil submits that the A(FE)Index and the A(NE)Index are almost perfectly aligned and that the technical change in the A-Index does not affect the conclusion that the A-Index represents the world market price for upland cotton. Brazil's First Written Submission, paras. 85-86 and Annex II (Declaration by Andrew Macdonald), footnote 4.

[247] Brazil's First Written Submission, para. 84.

[248] The United States has argued in this proceeding that the fact that the A-Index had to be changed to reflect the growing importance of China in the world market supports the US argument that price trends for upland cotton cannot be explained without taking into account the influence of China. US First Written Submission, paras. 312-313. However, the United States has not contested that the A-Index represents the world market price of upland cotton.

[249] We also note that the Appellate Body held in the original proceeding that it was sufficient for the original panel to analyze the price of upland cotton in general in the world market and that the panel was not required to find significant price suppression specifically with respect to the price of Brazilian upland cotton in the world market. Appellate Body Report, *US – Upland Cotton*, paras. 415-418.

(f) Significant price suppression as the effect of the subsidy

10.45 The original panel defined "price suppression" as referring to "the situation where 'prices' – in terms of the 'amount of money set for sale of upland cotton' or the 'value or worth' of upland cotton – either are prevented or inhibited from rising (i.e. they do not increase when they otherwise would have) or they do actually increase, but the increase is less than it otherwise would have been".[250] The Appellate Body ruled that this description of the meaning of "price suppression" reflected the ordinary meaning of that term.[251] [252] In this proceeding neither party has contested this definition of "price suppression".

10.46 The Panel considers that, as discussed in the Appellate Body report in the original proceeding[253], a determination of whether price suppression exists is difficult to separate from an analysis of the effect of the subsidy. Brazil has explained that in light of the comments of the Appellate Body in the original proceeding[254], it has adopted a "unitary" approach, which does not separate the question of the existence of significant price suppression from the issue of the causal relationship between significant price suppression and the subsidies at issue.[255] The United States has not questioned this "unitary" approach in this proceeding.[256] Therefore, while we note that the original panel determined in three separate analytical steps that (i) there was price suppression in the world market for upland cotton, (ii) this price suppression was significant and (iii) a causal relationship existed between this significant price suppression and certain price-contingent subsidies[257], in this proceeding we will not make a determination as to whether significant price

[250] Panel Report, *US – Upland Cotton*, para. 7.1277.

[251] Appellate Body Report, *US – Upland Cotton*, para. 424.

[252] Similarly, the panel in *Korea – Commercial Vessels* noted that the parties in that dispute understood the term "price suppression" in Article 6.3(c) of the *SCM Agreement* "to refer to the situation where prices have not increased when, or have increased less than, they otherwise would have". Panel Report, *Korea – Commercial Vessels*, para. 7.533.

[253] Appellate Body Report, *US – Upland Cotton*, para. 433. ("...the ordinary meaning of the transitive verb 'suppress' implies the existence of a subject (the challenged subsidies) and an object (in this case, prices in the world market for upland cotton). This suggests that it would be difficult to make a judgment on significant price *suppression* without taking into account the effect of the subsidies.") See also Panel Report, *Korea – Commercial Vessels*, para. 7.537:

> "...the existence of a flat or declining price trend, on its own, would not be a sufficient basis on which to conclude that prices were 'suppressed' or 'depressed'. For such a conclusion to be reached, the *causes* of these observed trends would need to be examined. In other words, price depression is not simply a decline in prices but a situation where prices have been 'pushed down' *by something*. Price suppression is where prices have been restrained *by something*. In other words, for a finding of 'price suppression' or price depression' in the sense of SCM Article 6.3(c), there must not only be a flattened or downward price trend as a prerequisite, but in addition this trend must be the result of an exogenous factor, namely the subsidy or subsidies in question. Thus, the analysis that seems to be called for by the Agreement (by virtue of the concepts of price suppression and price depression themselves), concerns what the price movements for the relevant ships would have been in the absence of (i.e. 'but for') the subsidies at issue." (emphasis original)

[254] Appellate Body Report, *US – Upland Cotton*, paras. 432-434.

[255] Brazil's First Written Submission, paras. 55-58.

[256] In the original proceeding the United States argued before the Appellate Body that the panel had erred in adopting a bifurcated approach under which the original panel made a finding of price suppression before making a prior finding of the effect of the subsidy. Appellate Body Report, *US – Upland Cotton*, para. 430. The Appellate Body rejected that argument and held that "the text of Article 6.3 (c) does not, however, preclude the approach taken by the Panel to examine first whether significant price suppression exists and then, if it is found to exist, to proceed further to examine whether the significant price suppression is the effect of the subsidy." Appellate Body Report, *US – Upland Cotton*, para. 431.

[257] Panel Report, *US – Upland Cotton*, paras. 7.1275-7.1363.

suppression exists separately from whether significant price suppression is the effect of the subsidies at issue.[258]

10.47 Closely related to this, the Panel notes the argument of Brazil that an analysis of price suppression under Article 6.3(c) is necessarily of a counterfactual nature, focusing on the situation that would exist but for the subsidies at issue. The United States has not contested this argument of Brazil. We note that the original panel did not explicitly use the concept of a counterfactual analysis and that the panel did to some extent rely on an analysis of trends in prices.[259] At the same time, it is clear that key elements of the panel's analysis involved an examination of the situation that would have existed but for the subsidies at issue. Thus, for example, the panel found that the fact that prices had declined from 1996 through the beginning of 2002 and increased from 2002 was not conclusive as to whether or not there was price suppression: "[w]e need to examine whether these prices were suppressed, that is, lower than they would have been without the United States subsidies in respect of upland cotton".[260] In its analysis of the design, structure and operation of the subsidies at issue the panel found that certain price-contingent subsidies resulted in "lower world market prices than would prevail in their absence".[261] Based on an examination of the costs of production and market revenues of US upland cotton producers, the panel concluded that:

> "United States upland cotton producers would not have been economically capable of remaining in the production of upland cotton had it not been for the United States subsidies at issue and that the effect of the subsidies was to allow United States producers to sell upland cotton at a price lower than would otherwise have been necessary to cover their total costs."[262]

10.48 As noted above, the panel in *Korea – Commercial Vessels* has interpreted Article 6.3(c) of the *SCM Agreement* as requiring a "but for" approach to the analysis of whether the effect of a subsidy is significant price suppression.[263]

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[258] We note that the Appellate Body has stated that "Article 6.3(c) does not set forth any specific methodology for determining whether the effect of a subsidy is significant price suppression" and that "Article 6.3(c) is silent as to the sequence of steps to be followed in assessing whether the effect of a subsidy is significant price suppression". Appellate Body Report, *US – Upland Cotton*, paras. 427 and 431. While the Appellate Body saw no legal error in the approach taken by the original panel, it is clear that the Appellate Body did not consider that Article 6.3(c) required that approach.

[259] Panel Report, *US – Upland Cotton*, paras. 7. 1286-7.1288.

[260] Panel Report, *US – Upland Cotton*, para. 7.1288.

[261] Panel Report, *US – Upland Cotton*, paras. 7.1291 and 7.1295.

[262] Panel Report, *US – Upland Cotton*, paras. 7.1353. The panel concluded its discussion of costs of production in relation to market revenue by observing that "the existence of this gap between upland cotton producers' total costs and market revenue, on the one hand, and the effect of the subsidies, on the other hand, was to sustain a higher level of output than would have occurred in the absence of the United States subsidies at issue". Panel Report, *US – Upland Cotton*, para. 7.1354.

[263] *Supra*, footnote, 253. The panel also observed:

> "As noted *supra*, we believe that the text of Article 6.3(c) implies a 'but for' approach to causation in respect of price suppression/price depression. Price suppression is the situation where prices have been restrained by something, and price depression is the situation where prices have been pushed down by something. So the question to be answered is whether the 'something' is subsidization. Looking at a counterfactual situation, i.e. trying to determine what prices would have been in the absence of the subsidy, seems to us the most logical and straightforward way to answer this question."

Panel Report, *Korea – Commercial Vessels*, para. 7.612. The panel considered that this "but for" approach was consistent with the approaches taken by the panels in *Indonesia – Autos* and in *US – Upland Cotton*.

10.49 Thus, in order to determine whether the effect of marketing loan payments and counter-cyclical payments to upland cotton producers is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*, the Panel will determine whether, but for these subsidies, the world market price[264] for upland cotton "would have increased [significantly], or would have increased by [significantly] more than was in fact the case".[265]

10.50 The Panel concurs with the original panel that the word "significant" in "significant price suppression" in Article 6.3(c) of the *SCM Agreement* relates to the degree of price suppression in the context of the price that has been affected and that the significance of any degree of price suppression may vary from case to case, depending upon the factual circumstances.[266] As stated by the original panel,

> "… for a basic and widely traded commodity, such as upland cotton, a relatively small decrease or suppression of prices could be significant because, for example, profit margins may ordinarily be narrow, product homogeneity means that sales are price sensitive or because of the sheer size of the market in terms of the amount of revenue involved in large volumes traded on the markets experiencing the price suppression."[267]

10.51 Finally, like the original panel, we conduct an examination of the collective effects of the marketing loan and counter-cyclical payments.[268] We recall, in this respect, that the original panel made a finding that certain price-contingent subsidies (marketing loan payments, counter-cyclical payments, Step 2 payments and market loss assistance payments) collectively were a cause of significant price suppression in the world market for upland cotton. The panel did not find that each of these four subsidies, taken individually, was a cause of significant price suppression nor did it pronounce on the relative importance of each of these subsidies in causing significant price suppression.

4. The alleged "substantial proportionate influence" of US upland cotton production and exports

(a) Main arguments of the parties

10.52 **Brazil** submits that US upland cotton production and exports continue to expand and exercise a "substantial proportionate influence" on prices in the world market for upland cotton. In the view of Brazil, the United States is "the single most important market influencing world market prices" of upland cotton.[269] In this connection, Brazil presents data showing that in MY 2005 the US share of world upland cotton production was 20.9 per cent and the US share of the world market for exports of

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[264] We recall that the Appellate Body found that the original panel had not erred by not conducting a separate analysis of Brazilian prices in the world market. Appellate Body Report, *US – Upland Cotton*, paras. 415-418.

[265] Panel Report, *Korea – Commercial Vessels*, para. 7.615.

[266] Panel Report, *US – Upland Cotton*, paras. 7.1328-7.1329. The Panel also notes the observation made by the panel in *Korea – Commercial Vessels*, para. 7.571 that "only price suppression or price depression of sufficient *magnitude* or degree, seen in the context of the particular product at issue, to be able to meaningfully affect suppliers should be found to be 'significant' in the sense of SCM Article 6.3(c)".

[267] Panel Report, *US – Upland Cotton*, para. 7.1330.

[268] Panel Report, *US – Upland Cotton*, para. 7.1192. See also Panel Report, *Korea – Commercial Vessels*, para. 7.616.

[269] Brazil's First Written Submission, para. 89.

upland cotton was 39.6 per cent. During the period MY 2002-2005 the volume of US production increased by 40.7 per cent and the volume of US exports increased by 54.8 per cent.[270]

10.53 The **United States** submits that Brazil's argument that the United States is "the single most important market influencing world market prices" of upland cotton is overly simplistic and inconsistent with the realities of the world cotton market. In particular, Brazil fails to account properly for the important role of China's trade in cotton.[271]

(b) Evaluation by the Panel

10.54 The original panel relied upon what it termed a substantial proportionate influence of the United States in the world upland cotton market as one of four factors that cumulatively supported a finding of a causal link between certain of the challenged subsidies and significant price suppression.[272] This substantial proportionate influence of the United States resulted *inter alia* from the magnitude of US production and export of upland cotton.[273] The United States was the world's second largest producer, and the world's largest exporter, of upland cotton.[274]

10.55 The Appellate Body considered that, when viewed in conjunction with other findings made by the original panel, the "substantial proportionate influence" of the United States in the world market for upland cotton seemed to support the panel's conclusion of the existence of a causal relationship between the price-contingent subsidies and significant price suppression.[275]

10.56 The data provided by the United States[276] indicates that in MY 2005 the US share of world cotton production was 20.9 per cent and that the US share of world upland cotton production averaged 19.7 per cent during the period MY 2002-2005 (see Table 3). The US share of world exports was 40.1 per cent in MY 2005. During the period MY 2002-2005 the US share of world exports averaged 40.5 per cent.

[270] Brazil's First Written Submission, paras. 92-93, Figures 2 and 3.

[271] US First Written Submission, paras. 308-318. US Rebuttal Submission, paras. 387-396.

[272] Panel Report, *US – Upland Cotton*, paras. 7.1347-7.1348.

[273] Panel Report, *US – Upland Cotton*, paras. 7.1285 and 7.1348.

[274] In the period MY 1999–2002, the United States accounted for approximately 20 per cent of world production of upland cotton. The share of the United States in world production of upland cotton was 19.2 per cent in MY 1999, 19.3 per cent in MY 2000, 20.6 per cent in MY 2001 and 19.6 per cent in MY 2002. The share of the United States in world exports of upland cotton was 23.5 per cent in MY 1999, 24.5 per cent in MY 2000, 37.3 per cent in MY 2001 and 39.9 per cent in MY 2002. Panel Report, *US – Upland Cotton*, paras. 7.1282-7.1283.

[275] Appellate Body Report, *US – Upland Cotton*, para. 449:

> "We agree that, in and of itself, the degree of influence of the United States in the world market for upland cotton may not be conclusive as to the effect of the price-contingent subsidies on prices in that market. However, if the price-contingent subsidies increased United States production and exports or decreased prices for United States upland cotton, then the fact that United States production and exports of upland cotton significantly influenced world market prices would make it more likely that the effect of the price-contingent subsidies is significant price suppression. Accordingly, this fact seems to support the Panel's conclusion when read in conjunction with its other findings."

[276] Exhibit US-27.

Table 3: US and World Cotton Exports and Production, MY 2002-2005

MY	**United States** *(in 1000 480 lb bales)*		**World** *(in 1000 480 lb bales)*		**US Share of World Exports and Production**	
	Exports	Production	Exports	Production	Exports	Production
2002	11,900	17,209	30,325	88,251	39.2%	19.5%
2003	13,758	18,255	33,221	95,267	41.4%	19.2%
2004	14,436	23,251	35,022	120,394	41.2%	19.3%
2005	18,036	23,890	44,935	114,142	40.1%	20.9%
Average	**14,533**	**20,651**	**35,876**	**104,514**	**40.5%**	**19.7%**

Source: Exhibit US-27.

10.57 Given that complete data for MY 2006 is not available, the Panel has relied on projections of production and exports provided by the United States.[277] These projections of US and world production and exports were made in February 2007, halfway through MY 2006. According to these projections, the absolute volumes of US cotton production and exports in MY 2006 will decline by 9 per cent and 19.6 per cent, respectively, from MY 2005 levels. Since the average "error" of USDA projections is only 0.1 per cent for US cotton production and 4 per cent for US exports[278], the Panel considers that these USDA projections of a decline in production and exports in MY 2006 are very likely to materialize. Taken together with projections of world production and exports, they indicate that the US share of world upland cotton production is projected to fall from 20.9 per cent in MY 2005 to 18.6 per cent in MY 2006. Further, the US share of world exports of upland cotton is projected to fall from 40.1 per cent in MY 2005 to 36.3 per cent in MY 2006.

[277] The source of the US projections of production and exports is the USDA's World Agricultural Supply and Demand Estimates (WASDE) report, which provides forecasts of supply and demand for major US and global crops and US livestock**.** The February 2007 projection of US production and exports for MY 2006 is contained in Exhibit US-114 while corresponding figures for world production and exports are taken from WASDE 443-27.

[278] Given that a lower degree of certainty attaches to these projections, the Panel asked the United States to provide the information on how final marketing year data on the variables of interest would differ from projections made in February of the same marketing year. The idea is to compare projections made in the middle of a given marketing year with the final estimate for the complete marketing year. The closer February projections are to final estimates of production and export for the same marketing year, the more reliable we judge these projections to be. The United States provided the Panel with this data spanning the period from MY 1992-2005. (Exhibit US-145) Using this information, we have estimated how much these February projections have differed from the final marketing year data:

Table 4: Difference Between Final Estimates And Projections, MY 1992-2005

Item	**Production**	**Exports**
Average difference: (Final estimate minus February projection)	0.1%	4.0%
Standard deviation of difference	0.6%	6.6%

Source: Exhibit US-145.

Over the period MY 1992-2005, projections of US production made in February underestimated the final production number by only an average of 0.1 per cent (with a standard deviation of 0.6 per cent). The corresponding underestimate for US exports is 4 per cent (with a standard deviation of 6.6 per cent). Projections of US cotton production have been more accurate than projections of US exports.

10.58 In our view, even taking into account the projections for MY 2006, the figures on the relative magnitude of US production and exports of upland cotton at present are not significantly different from the figures that formed the basis for the original panel's finding that the United States exerted a substantial proportionate influence on the world market for upland cotton. The US share of world upland cotton production was 19.6 per cent in MY 2002, 20.9 per cent in MY 2005 and is projected to be 18.6 per cent in MY 2006. The US share of world exports of upland cotton was 39.9 per cent in MY 2002, 39.8 per cent in MY 2005 and is projected to be 36.3 per cent in MY 2006. In light of these figures and taking into account other evidence presented by Brazil[279], the Panel considers that the United States exerts a substantial proportionate influence on the world market for upland cotton. This substantial proportionate influence of the United States, analyzed in light of the totality of the evidence before us, as discussed in the next sub-sections, is an element that supports a finding that the marketing loan and counter-cyclical payments to US upland cotton producers cause significant price suppression in the world market for upland cotton.

5. "Structure, design and operation" of the marketing loan and counter-cyclical payments

(a) Main arguments of the parties

10.59 **Brazil** argues that the "structure, design and operation" of the marketing loan and counter-cyclical payments[280] stimulate US upland cotton production by insulating US producers from market forces. In support of this argument, Brazil refers to the magnitude of the marketing loan payments in MY 2004 and MY 2005, the fact that the legislative provisions in question have not been changed, economic studies presented in the original proceeding, and the fact that during most of the period MY 2002-2005 the adjusted world price was below the marketing loan rate. In Brazil's view, these factors show that the conclusion of the original panel that marketing loan payments stimulate production and exports and suppress prices continues to apply.[281] Similarly, the findings of the original panel on the effects of counter-cyclical payments on production, exports and prices of upland cotton also remain applicable. In this regard, Brazil refers to the magnitude of the counter-cyclical payments in MY 2004 and MY 2005, the fact that the legislative provisions in question have not been changed, economic studies presented in the original proceeding, and the continued existence of a strong positive relationship between upland cotton base acre holders receiving annual counter-cyclical payments and upland cotton production.[282] Referring to the original panel's findings that price-contingent US subsidies isolated US cotton farmers from market forces, Brazil argues that data on the importance of marketing loan and counter-cyclical payments in stabilizing US upland cotton farmers' revenues demonstrates that this insulating effect continues today.[283]

10.60 The **United States** argues that Brazil has not provided any persuasive evidence that the structure, design and operation of the marketing loan and counter-cyclical payments programme support Brazil's claims of significant price suppression. With respect to marketing loan payments, the United States submits that an analysis of planting decisions made by US upland cotton producers in light of the conditions that exist at the time of planting (January-March) shows that for the present marketing year, MY 2006, payments under the marketing loan programme did not distort production decisions. Since the average New York futures price in January-March 2006 was well above the marketing loan rate, US upland cotton producers did not expect to receive marketing loan payments

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[279] The Panel notes, in particular, the evidence provided by Brazil on the similarity in trends in certain US domestic prices and the world market price for upland cotton (Brazil's First Written Submission, Figures 4 and 5), a factor also relied upon by the original panel. Panel Report, *US – Upland Cotton*, para. 7.1311. The Panel also notes the analysis prepared by Brazil's consultant of the functioning of the world market for upland cotton. Brazil's First Written Submission, Annex II (Declaration by Andrew Macdonald).

[280] *Supra*, footnote 186.

[281] Brazil's First Written Submission, paras. 123-127; Brazil's Rebuttal Submission, paras. 101-110.

[282] Brazil's First Written Submission, paras. 128-131. Brazil's Rebuttal Submission, paras. 111-118.

[283] Brazil's First Written Submission, paras. 133-136 and Figure 8.

upon harvest, and these payments could not have figured in their planting decisions for MY 2006.[284] The United States submits, in this respect, that even in earlier marketing years planting decisions of US upland cotton producers were not shaped by expectations about marketing loan payments but by market factors. With respect to counter-cyclical payments, the United States argues that (i) research based on recent empirical data does not support Brazil's claim that counter-cyclical payments have significant trade-distorting effects; (ii) significant amounts of decoupled payments are capitalized into higher land values; and (iii) data comparing base acres to planted acreage does not demonstrate that counter-cyclical payments have significant effects on production.[285] The United States also submits that Brazil does not demonstrate that the size of the outlays under the marketing loan and counter-cyclical payment programmes support the existence of a causal link.[286]

(b) Evaluation by the Panel

10.61 The question before the Panel is whether the structure, design and operation of marketing loan payments and counter-cyclical payments provided by the United States pursuant to the FSRI Act of 2002 support a finding that the effect of these subsidies is "present" significant price suppression in the world market for upland cotton within the meaning of Article 6.3(c) of the *SCM Agreement*.

10.62 Because Brazil asserts that, based on the evidence which it has submitted in this proceeding, this Panel should reach the same conclusions as the original panel regarding the price suppressing effects of the structure, design and operation of the marketing loan payments and counter-cyclical payments, we begin by providing a summary of the original panel's analysis that formed the basis for those conclusions.

10.63 The original panel first examined the "nature" of the subsidies in determining whether price suppression existed in the world market for upland cotton.[287] The panel considered that the "nature of the US subsidies at issue – in terms of their structure, design and operation – is relevant in assessing whether or not they have price suppressing effects".[288] The panel attached particular importance to the "directly price-contingent" nature of certain subsidies.[289]

10.64 Regarding marketing loan payments, the original panel pointed out that under the marketing loan programme benefits to producers resulted when the adjusted world market price was below the marketing loan rate and that the payments were mandatory[290], that the magnitude of the marketing loan payments was counter-cyclical and increased with the difference between the adjusted world price and the marketing loan rate[291], and that the marketing loan payments insulated the revenue of US

[284] US First Written Submission, paras. 226-235; US Rebuttal Submission, paras. 268-275.

[285] US First Written Submission, paras. 207-225; US Rebuttal Submission, paras. 224-267.

[286] US First Written Submission, paras. 236-241; US Rebuttal Submission, paras. 267-280.

[287] Panel Report, *US – Upland Cotton*, paras. 7.1289-7.1307. In determining whether price suppression existed in the world market for upland cotton, the panel also considered the relative magnitude of the US production and exports and the general price trends. Panel Report, *US – Upland Cotton*, paras. 7.1281-7.1288.

[288] Panel Report, *US – Upland Cotton*, para. 7.1289.

[289] The panel explained that in light of certain guiding considerations outlined earlier in its report, the distinction between "directly price-contingent" subsidies and other subsidies before it was critical "in terms of the nexus which the subsidies have to any price suppression and to the subsidized product". Thus, the panel considered it highly relevant that certain US subsidies under consideration, including marketing loan programme payments and counter-cyclical programme payments were "directly linked to world market prices". Panel Report, *US – Upland Cotton*, paras. 7.1289-7.1290.

[290] Panel Report, *US – Upland Cotton*, para. 7.1291.

[291] Panel Report, *US – Upland Cotton*, paras. 7.1292-7.1294. The panel also observed that the data before it showed that "the marketing loan subsidy by the United States government, at certain points, was greater than the market value of the product" and that "it accounted for *more than half* of the difference between the adjusted world price and the marketing loan rate (and thus of United States upland cotton producer revenue)". Panel Report, *US – Upland Cotton*, para. 7.1294 (original emphasis).

upland cotton producers from a decline in the adjusted world price.[292] The panel considered that the marketing loan payments "stimulate production and exports and result in lower world market prices than would prevail in their absence"[293] and that the "structure, design and operation of the marketing loan programme has enhanced production and trade-distorting effects".[294] The panel also observed that data for the period MY 1999-2002 showed that, because of the impact of marketing loan payments on production of upland cotton, a decline in US prices did not result in a decline in US production or export, that the structure of the measure affected world market prices generally, and that for most of the period under consideration the adjusted world market price was below the marketing loan rate.[295] Finally, the panel noted that the amount of the subsidies was "very large".[296]

10.65 Also as part of its examination of whether price suppression existed, the original panel stated the following with respect to counter-cyclical payments:

> "We agree with the view of USDA economists that, due to their market-price contingency, [counter-cyclical payments] may influence production decisions indirectly by reducing total and per unit revenue risk associated with price variability in some situations. In the price range from the loan rate up to the target price minus the [direct payments] rate, changes in producer revenues due to changes in market prices are partly offset by the countercyclical payments if the base acreage crop is planted, thereby reducing total revenue risk associated with price variability. We have confirmed a strong positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production. Moreover, the payments are mandatory, under certain market conditions."[297] (footnotes omitted)

10.66 It is clear from these statements that a key element in the original panel's analysis of the structure, design and operation of marketing loan payments and counter-cyclical payments was the idea that the price-contingent nature of these subsidies made US upland cotton production less responsive to market prices by insulating the revenue of US upland cotton producers from declines in prices. It is also clear, however, that closely related to this, the panel attached importance to the magnitude of these subsidies in the period under consideration.

10.67 The original panel highlighted these two themes in its conclusion on the existence of price suppression:

> "As we have just indicated, several of the United States subsidies are directly linked to world prices for upland cotton, *thereby numbing the response of United States producers to production adjustment decisions when prices are low*. We have readily available information on the record showing us that *the price-contingent subsidies in question involve very large amounts of United States government money benefiting United States upland cotton*. In our view, the collective operation of these subsidies was akin to a very large, counter cyclical, deficiency payment laced with additional enhancements. We believe that the structure, design and operation, particularly of the

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[292] Panel Report, *US – Upland Cotton*, para. 7.1294: "The further the adjusted world price drops, the greater the extent to which United States upland cotton producers' revenue is insulated from the decline, numbing United States production decisions from world market signals."

[293] Panel Report, *US – Upland Cotton*, paras. 7.1291 and 7.1295.

[294] Panel Report, *US – Upland Cotton*, paras. 7.1295.

[295] Panel Report, *US – Upland Cotton*, paras. 7.1294 and 7.1296.

[296] Panel Report, *US – Upland Cotton*, para. 7. 1297.

[297] Panel Report, *US – Upland Cotton*, para. 7.1302.

price-contingent subsidies, constitutes strong evidence supporting a finding of price suppression."[298] [299] (emphasis added)

10.68 Having found that price suppression existed[300] and that this price suppression was significant[301], the original panel also referred to the structure, design and operation of the price-contingent subsidies at issue in its examination of whether this significant price suppression was the effect of certain of the subsidies at issue. The panel again emphasized the "insulating" effect and the magnitude of the price-contingent subsidies at issue:

"Second, we recall our examination of the nature of the United States subsidies at issue. In particular, we recall that several of the United States subsidies – marketing loan programme payments, the user marketing (Step 2) payments, MLA payments and CCP payments – *are directly linked to world prices for upland cotton, thereby insulating United States producers from low prices*. We believe that the structure, design and operation of these three measures constitutes evidence supporting a causal link with the significant price suppression we have found to exist. Furthermore, while we do not believe that it is strictly necessarily to calculate precisely the amount of the subsidies in question, we observe that we have readily available information on the record showing us that *the price-contingent subsidies in question involve very large amounts of United States government money benefiting United States upland cotton production*."[302] (emphasis added, footnote omitted)

10.69 By contrast, the original panel considered that Brazil had not established that significant price suppression was the effect of certain subsidies – production flexibility payments, direct payments and crop insurance payments – that were not price-contingent. The panel considered that these non-price contingent subsidies were "more concerned with income support than directly with world price effects" and were "of a different nature, and thus effect" than the price-contingent subsidies.[303]

10.70 The Appellate Body upheld the original panel's finding that the effect of certain price-contingent subsidies was significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement* constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*, and in so doing rejected various arguments of the United States, including in respect of the panel's analysis of the structure, design and operation of the marketing loan and counter-cyclical subsidies.[304]

10.71 It is not in dispute that the conditions of application of the marketing loan and counter-cyclical payments, as defined in the relevant provisions of the FSRI Act of 2002, are the same at present as when the original panel analyzed these measures. Therefore, there has been no change with respect to the mandatory, price-contingent and counter-cyclical nature of these subsidies.

10.72 Apart from the fact that the provisions of the FSRI Act of 2002 regarding marketing loan payments and counter-cyclical payments have remained unchanged, Brazil refers to several other factors, including the magnitude of these subsides in recent years, in light of which Brazil considers that this Panel should reach the same conclusions as the original panel regarding the effects of the

[298] Panel Report, *US – Upland Cotton*, para. 7.1308.
[299] The panel considered that the parallelism between declining US price and world market prices in the period under consideration was evidence that increased US production and supply had caused price suppression. Panel Report, *US – Upland Cotton*, paras. 7.1309-7.1311.
[300] Panel Report, *US – Upland Cotton*, para. 7.1312.
[301] Panel Report, *US – Upland Cotton*, para. 7.1333.
[302] Panel Report, *US – Upland Cotton*, para. 7.1349.
[303] Panel Report, *US – Upland Cotton*, paras. 7.1307 and 7.1350.
[304] Appellate Body Report, *US – Upland Cotton*, paras. 395-496.

structure, design and operation of marketing loan payments and counter-cyclical payments on production, exports and prices of US upland cotton.[305]

10.73 The United States does not contest that the effect of marketing loan and counter-cyclical payments on revenues of US upland cotton producers *could* affect acreage and production of upland cotton. However, the United States argues that the relevant question is whether, taking into account the particular structure and design of the marketing loan and counter-cyclical payment programmes and the way that they operate under marketing conditions at present, payments under the programmes are *in fact* having production effects, and if so, whether the *degree* of the effect is so significant that it is resulting in "present" significant price suppression. The United States submits that in this proceeding Brazil has failed to demonstrate, through a proper analysis of the factors actually considered by US upland cotton producers in their annual planting decisions and of the way that marketing loan and counter-cyclical payments interact with these planting decisions, that the effect of marketing loan and counter-cyclical payments is to induce US upland cotton producers to increase the level of upland cotton acreage above what it would have been in the absence of those payments. The United States emphasizes in this respect that a proper analysis of annual planting decisions of upland cotton producers must take into account the fact that producers must base their planting decisions on expectations with regard to factors such as weather, demand, supply, prices of upland cotton and other crops, and variable costs. Moreover, the United States considers that Brazil has not demonstrated that the degree of any effect of marketing loan and counter-cyclical payments on production is such as to cause "present" significant price suppression.[306]

10.74 In our view, the United States made the same arguments in the original proceeding. For example, before the original panel the United States argued, with regard to *marketing loan payments*, that "Brazil has failed to make a proper analysis of the conditions actually faced by producers in making production decisions using futures prices, which reveals no expected impact from marketing loans except for MY 2002".[307] In this connection, the United States also submitted that "[i]n no marketing year from 1999-2001 would the marketing loan rate have impacted planting decisions and in marketing year 2002 the marketing loan rate did not prevent price-responsive acreage adjustment".[308]

10.75 As noted above, the original panel considered, in respect of marketing loan payments, that "the payments stimulate production and exports and result in lower world market prices than would prevail in their absence" and that "the structure, design and operation of the marketing loan programme has enhanced production and trade-distorting effects".[309] It is clear from these statements that the panel did not consider that the fact that in certain years expected market prices at the time of planting exceeded the marketing loan rate meant that marketing loan payments had only minimal effects on production in those years.[310] However, while the United States argued before the Appellate Body that "the Panel failed to address the relevant economic decision faced by United States upland

[305] *Supra*, para. 10.59.

[306] E.g. US Rebuttal Submission, paras. 222 and 287-291; US Opening Statement paras. 62-64; US Reponses to Panel Questions 51, 53 and 54. US Comments on Brazil's Response to Panel Question 62.

[307] US Further Rebuttal Submission (18 November 2003), Section IV.G.

[308] US Further Rebuttal Submission (18 November 2003), Section IV.G.6.

[309] Panel Report, *US – Upland Cotton*, paras. 7.1291 and 7.1295.

[310] The United States interprets these statements to mean that the panel noted "that the particular design and operation of the marketing loan program is such that it may have more than non- or minimally-trade-distorting effects given the particular market conditions that prevail." US Response to Panel Question 54, para. 105. While we do not disagree that the panel's analysis must be understood in the context of the "particular market conditions" that prevailed in the period considered by the panel, it is clear that the panel did not adopt the particular methodology for analyzing the relevance of market conditions advocated by the United States in the original proceeding.

cotton farmers at the time of planting, namely, the decision of whether to plant upland cotton or alternative crops (and how much of each)" [311], the Appellate Body rejected this argument.[312]

10.76 We also note that specifically with regard to the argument of the United States that marketing loan payments have minimal effects on planting decisions if the expected market price at the time planting decisions are made is above the marketing loan rate, the Appellate Body observed:

> "During the oral hearing, the United States presented data to show that, when planting decisions were made for the 1999, 2000, 2001, and 2003 upland cotton crops, the *expected* upland cotton price upon harvest was higher than the marketing loan rate. Accordingly, the United States contends, the marketing loan program payments would have had only a minimal effect on planting decisions, because farmers would have expected to receive a higher price from the sale of their upland cotton and no marketing loan program payments.
>
> We note, based on the evidence provided by the United States, that, for four of the five upland cotton crops between 1999 and 2003, the *expected* harvest price at the time of making planting decisions was always substantially higher than the *actual* price realized at the time of harvest of the crop. This suggests that although farmers had expected higher prices in making their planting decisions, they were also aware that if actual prices were ultimately lower, they would be 'insulated' by government support, including not only marketing loan program payments but also counter-cyclical payments, which were based on a target upland cotton price of 72.4 cents per pound. We are therefore satisfied that the Panel adopted a plausible view of the facts in connection with expected prices and planting decisions, even though it attributed to these factors a different weight or meaning than did the United States. As the Appellate Body has said, it is not necessary for panels to 'accord to factual evidence of the parties the same meaning and weight as do the parties'."[313] (emphasis original, footnotes omitted)

10.77 Thus, even if expected market prices at the time of planting are higher than the marketing loan rate and producers do not expect to receive marketing payments at that time[314], the availability of marketing loan payments can be considered to influence planting decisions. While US upland cotton producers may be uncertain at the time of planting as to whether actual harvest prices will be below the marketing loan rate, there is no uncertainty as to the fact that, if actual harvest prices are below the marketing loan rate, they will receive marketing loan payments. Therefore, the logic of the original panel's analysis regarding the revenue-stabilizing impact of the price-contingent, counter-cyclical nature of marketing loan payments and the consequent impact on the level of production applies even

[311] Appellate Body Report, *US – Upland Cotton*, para. 440. In arguing that the original panel had ignored the relevant production decision faced by US cotton farmers at the time of planting, the United States referred to the panel's conclusion that the price-contingent subsidies are linked to world prices for upland cotton "thereby numbing the response of United States producers to production adjustment decisions when prices are low". Appellate Body Report, *US – Upland Cotton*, para. 38.

[312] Appellate Body Report, *US – Upland Cotton*, paras. 440-445. The Appellate Body considered that the original panel had, in fact, addressed upland cotton planting decisions, expected prices and expected market revenue in paragraph 7.1362 of its report. Appellate Body Report, *US – Upland Cotton*, para. 441.

[313] Appellate Body Report, *US – Upland Cotton*, paras. 444-445.

[314] We note that Brazil disagrees with the United States that in most recent years US upland cotton producers have not expected to receive marketing loan payments. See Brazil's Rebuttal Submission, paras. 104-105.

if one accepts that, as argued by the United States, it is necessary to take into account producers' price expectations.[315]

10.78 We note that the Appellate Body also upheld the original panel's conclusion in paragraph 7.1349 of the panel report that the fact that certain subsidies were directly related to the world market prices for upland cotton supported a finding of the existence of a causal relationship between these subsidies and significant price suppression. In that context, the Appellate Body reviewed and affirmed the conclusions drawn by the original panel from its earlier assessment of the structure, design and operation of the price-contingent subsidies, including the panel's statements concerning the effects of these subsidies on production and exports.[316]

10.79 The United States argues that Article 11 of the DSU requires this Panel to carry out an "objective assessment of the matter before it" and that "there is no basis to automatically adopt for purposes of this proceeding the same factual conclusions drawn by the original panel about the effects of the marketing loan, counter-cyclical payment, and Step 2 payments in a different period".[317]

10.80 We note, in this regard, that in its discussion of the argument of the United States concerning the role of expected market prices, the Appellate Body referred to the fact that in four of the five years under consideration the actual market price at the time of harvest was below the expected market price at the time of planting.[318] The evidence shows that this pattern has persisted in more recent years.[319] The Panel also has evidence before it, provided by Brazil but not contested by the

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[315] Brazil does not disagree that it is "important to look at the way that the marketing loan and counter-cyclical payments programs actually operate and interact with production decisions". Brazil's Comments on US Response to Panel Question 51, para. 71. Brazil also agrees that the expectations of US cotton producers are a relevant factor to consider in an assessment of the effects of the marketing loan and counter-cyclical payments. Brazil's Comments on US Response to Panel Question 51, paras. 70-80.

[316] Appellate Body Report, *US – Upland Cotton*, para. 450:

> "The second reason the Panel provided for finding a 'causal link' was its view that the price-contingent subsidies 'are directly linked to world prices for upland cotton'. This conclusion flowed from the Panel's earlier assessment—in connection with its analysis of significant price suppression—of the *nature* of the price-contingent subsidies. The nature of a subsidy plays an important role in any analysis of whether the effect of the subsidy is significant price suppression under Article 6.3(c). With respect to marketing loan program payments, the Panel found that '[t]he further the adjusted world price drops, the greater the extent to which United States upland cotton producers' revenue is insulated from the decline'. As a result, during the 1999-2002 marketing years, United States production and exports remained stable or increased, even though prices of United States upland cotton decreased. The Panel found that Step 2 payments stimulate domestic and foreign demand for United States upland cotton by 'eliminating any positive difference between United States internal prices and international prices of upland cotton'. The Panel stated that Step 2 payments 'result in lower world market prices than would prevail in their absence'. Finally, the Panel found that market loss assistance payments and counter-cyclical payments are made in response to low prices for upland cotton and stimulate United States production of upland cotton by reducing the 'total and per unit revenue risk associated with price variability'. The United States contends that the Panel's analysis of the price-contingent subsidies was 'deficient'. However, the Panel found that the price-contingent subsidies stimulated United States production and exports of upland cotton and thereby lowered United States upland cotton prices. This seems to us to support the Panel's conclusion that the effect of the price-contingent subsidies is significant price suppression." (original emphasis, footnotes omitted)

[317] US Response to Panel Question 54, para. 102.

[318] *Supra*, para. 10.76.

[319] Brazil submits that a comparison of the adjusted world price and the average December price of the futures contract at the time of planting shows that in the period 1996-2005 the adjusted world price was on

United States, that in most recent years the adjusted world price has been below the marketing loan rate.[320]

10.81 Given that in most recent years actual market prices have been lower than expected market prices at the time of planting and that the adjusted world price has been below the marketing loan rate, the Panel considers that it is reasonable to conclude that the fact that US cotton producers know that they will receive marketing loan payments whenever the adjusted world price is below the marketing loan rate continues to be an important factor affecting the level of acreage planted to cotton (and thus the level of production), even when, as in MY 2006, the expected market price for upland cotton at the time of planting is higher than the marketing loan rate.[321] The Panel also notes in this regard that according to FAPRI and USDA data, the projected amount of marketing loan payments in MY 2006 is very significant.[322]

10.82 Thus, in arguing that because the expected market price for MY 2006 was above the marketing loan rate, marketing loan payments did not significantly affect the planting decisions of upland cotton producers, the United States makes an argument that was already rejected by the panel and the Appellate Body in the original proceeding.[323] Nothing in the facts presented to the Panel in this proceeding would appear to warrant a conclusion different from the conclusion drawn by the panel and the Appellate Body in the original proceeding.

10.83 Moreover, while the discussion in the preceding paragraphs has focused on the impact of the structure, design and operation of marketing loan payments on acreage and production when analyzed from the short-term perspective of how these payments interact with annual planting decisions, the Panel considers that this impact should also be analyzed from the long-term perspective of how these subsidies influence the economic viability of US upland cotton farming. Article 6.3(c) of the *SCM Agreement* does not prescribe a particular methodology for determining whether significant price suppression is the effect of a subsidy. It is clear to us that whether production of a particular product is higher than would have been the case in the absence of the subsidy is often a critical issue in establishing whether the effect of the subsidy is significant price suppression. However, nothing in the text of Article 6 suggests that this can only be examined from a short-term perspective. In our view, the type of effect of a subsidy on production relevant to the analysis under Article 6.3(c) can also be demonstrated on the basis of a longer-term perspective that focuses on how the subsidy affects decisions of producers to enter or to exit a given industry. The Panel considers, in this regard, that the evidence on the record, notably the evidence regarding the role of marketing loan and counter-cyclical payments in covering the difference between the market revenue of US upland cotton producers and their costs of production, supports the view that these subsidies have a long-term impact on acreage and production of upland cotton by affecting decisions of US cotton farmers to enter or exit cotton farming. The Panel addresses this issue below in section X.B.9.

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average 17.3 per cent below the December futures contract price. Brazil's Rebuttal Submission, para. 105 and Exhibit Bra-564.

[320] Data submitted by Brazil shows that for most of the period from August 1999 to February 2007, the adjusted world price was below the marketing loan rate. Brazil's Response to Panel Question 62, Figure 1, and Exhibit Bra-673.

[321] In order to assess the significance of the effect of marketing loan payments on acreage and production under current conditions, we obviously must take into consideration other factors, such as the magnitude of these subsidies and their importance to the revenues of US upland cotton producers. We discuss these factors below.

[322] *Supra*, para. 10.25 and accompanying footnotes.

[323] We recall, in this respect, the observation made by the Appellate Body that "doubts could arise about the objective nature of an Article 21.5 panel's assessment if, on a specific issue, that panel were to deviate from the reasoning in the original panel report in the absence of any change in the underlying evidence in the record…" Appellate Body Report, *US - Softwood Lumber VI (Article 21.5 – Canada)*, para. 103.

10.84 The Panel now turns to the issues that have been raised in this proceeding specifically with respect to the design, structure and operation of *counter-cyclical payments.* In this regard, the parties disagree on (i) whether recent economic literature referred to by the United States contradicts Brazil's claim that counter-cyclical payments have significant trade-distorting effects and whether significant amounts of decoupled payments are capitalized into higher land values, and (ii) whether the existence of what Brazil characterizes as a strongly positive relationship between US upland cotton farmers and upland cotton production demonstrates that counter-cyclical payments have significant effects on production.

10.85 The Panel first considers the recent economic literature referred to by the United States.

10.86 The **United States** argues that recent economic literature that reflects the results of research based on empirical data finds no evidence that counter-cyclical payments are the cause of any significant changes in plantings.[324] In the view of the United States, these new studies and reviews show that counter-cyclical payments have no effects on crop-specific production decisions and minimal effects on overall production.

10.87 **Brazil**, for its part, criticizes the studies referred to by the United States and submits other new studies.[325] Brazil contends that these studies are consistent with the original panel's finding that counter-cyclical payments sustain high levels of acreage, production and exports.[326]

10.88 The **United States** also argues that the question of whether counter-cyclical payments are capitalized into higher land values has a bearing on the extent to which counter-cyclical payments provide incentives to farm operators to increase production of upland cotton. If a significant part of upland cotton farm land is rented by operators instead of being owned by them and if most of the counter-cyclical payments end up as higher land values, and thus in landowners' rather than operators' hands, then there may be little production effect from the payments. In this regard, the United States refers to studies that the United States claims find that decoupled payments, such as counter-cyclical payments, are capitalized into land values and land rents.[327]

10.89 **Brazil** argues that the price-contingent nature of counter-cyclical subsidies means that they can be very large in one year and small or non-existent in another year and that, hence, such payments are not as easily capitalized into land values as decoupled payments. Brazil submits that a comparison of actual land rents and the amount of direct and counter-cyclical payments per acre demonstrates that only a relatively small portion of the counter-cyclical payments could possibly be shifted to land rents

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[324] The studies referred to by the United States include: "Risk Considerations in Supply Response: Implications for Counter-Cyclical Payments' Production Impact" by William Lin and Robert Dismukes (Exhibit US-34); "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" by Paul Westcott (Exhibit US-35); "US Agricultural Policy: Overview and Recent Analyses" by Edwin C. Young, Anne Effland, Paul Westcott and Demcey Johnson (Exhibit US-40); and "Another Look at Decoupling: Additional Evidence on the Production Effects of Direct Payments" by B. Goodwin and A. Mishra (Exhibit US-41).

[325] The new studies submitted by Brazil include: "Are 'Decoupled' Farm Payments Really Decoupled? An Empirical Evaluation" by B. K. Goodwin and A. Mishra (Exhibit BRA-618); "Farm-Level Production Effect From Participation in Government Commodity Programs: Did the 1996 Federal Agricultural Improvement and Reform Act Make a Difference?" by Nigel Key, Ruben Lubowski and Michael Roberts (Exhibit BRA-566); "Supply Response to Counter-Cyclical Payments and Base Acre Updating under Uncertainty: An Experimental Study" by Christopher R. McIntosh, Jason F. Shogren and Erik Dohlman (Exhibit BRA-565); and "How Distorting Are Direct Payments?" by Erik J. O'Donoghue and James Whitaker (Exhibit BRA-568).

[326] Brazil's Rebuttal Submission, para. 144.

[327] These include the USDA ERS study "Structure and Finances of US Farms: 2005 Family Farm Report" reproduced in Exhibit US-67 and the OECD study "A Review of Empirical Studies of the Acreage and Production Response to US Production Flexibility Contract Payments Under the Fair Act and Related Payments Under Supplementary Legislation" reproduced in Exhibit US-32.

or capitalized into the value of land.[328] While Brazil recognizes the possibility that certain landowners might capture a portion of counter-cyclical payments, this assessment does not change the fact that upland cotton counter-cyclical payments are tied to prices and increase US upland cotton production and exports.

10.90 The Panel recalls that in assessing the production impact of counter-cyclical payments, the original panel relied upon several USDA studies[329] to conclude that, due to their market-price contingency, counter-cyclical payments "may influence production decisions indirectly by reducing total and per unit revenue risk associated with price variability in some situations".[330] As the United States points out in this proceeding, these studies did not reflect experience with the counter-cyclical payment programme itself.[331] The Panel therefore considers that the studies cited by the United States and Brazil in this proceeding are relevant insofar as they provide new information not available to the original panel reflecting the experience with the operation of counter-cyclical payments to upland cotton. Both academics and USDA staff have contributed to this recent literature. This is we believe the most recent set of studies available. The Panel has reviewed this new literature and weighed the findings of the experts carefully.[332] The conclusion that we draw from our review of this literature is the same as that of the original panel i.e. that "due to their market-price contingency, [counter-cyclical payments] may influence production decisions indirectly by reducing total and per unit revenue risk associated with price variability in some situations". [333]

10.91 Turning to the literature cited by the United States, the Panel notes that none of the recent studies submitted by the United States specifically analyzes the experience with counter-cyclical payments to growers of upland cotton. We find that:

(a) Instead of counter-cyclical payments, fully decoupled payments or programmes that antedated the counter-cyclical programme (such as the production flexibility contract payments) were studied. For instance, the Goodwin and Mishra study published in 2005[334] examines the extent to which production flexibility contract or Agricultural Market Transition Act (AMTA) payments under the FAIR Act affected the acreage decisions of a set of farms in the US Corn Belt who grew corn, wheat, and soybeans.

(b) Instead of empirical studies of the effects of counter-cyclical payments:

(i) A survey of other studies was undertaken. The Young, Effland, Westcott and Johnson paper[335] presents an overview of recent US agricultural policies under the 1996 and 2002 Farm Acts. The paper surveys recent analyses regarding the effects of those policies;

[328] Brazil's Rebuttal Submission, paras. 146-148.

[329] The studies include the USDA paper "The 2002 Farm Act, Provisions and Implications for Commodity Markets" (November 2002), reproduced in Exhibit BRA-42 and a 2002 USDA ERS report to the United States Congress contained in "Farm Program Payments and the Economic Viability of Production Agriculture", reproduced in Exhibit BRA-130.

[330] Panel Report, *US – Upland Cotton*, para 7.1302.

[331] The FSRI Act of 2002, which authorized countercyclical payments for the first time, entered into force only on 13 May 2002. The period examined by the panel in determining "present" serious prejudice was MY 1999-2002.

[332] Attachment 1 (Section XIII), contains a summary of the studies submitted by the parties.

[333] Panel Report, *US – Upland Cotton*, para. 7.1302.

[334] See *supra*, footnote 324.

[335] See *supra*, footnote 324.

(ii) A simulation of the effects of these payments was undertaken. The Lin and Dismukes study[336] attempts to simulate the acreage effects of counter-cyclical payments for three crops – corn, soybeans and wheat. The simulation is based on an acreage model, which was estimated using state-level data during 1991-2001 (before counter-cyclical payments came into effect), drawn from farms in the Northcentral region of the United States; and

(iii) A conceptual analysis of the effects of counter-cyclical payments was attempted. The Westcott paper[337] considers the case of a hypothetical corn farmer who plants all of his hundred acres of corn base with corn. It examines how the farmer's revenues are affected by counter-cyclical payments (among other subsidies) depending on realizations of the market price.

Thus, the relevance of these studies to the present dispute is somewhat limited. We also note some variation in the type and quality of the studies: some are published or slated to be published in academic journals while others are articles in newsletters or unpublished manuscripts.

10.92 Many of these observations also apply to the studies provided by Brazil. While the parties have drawn widely differing conclusions from these studies, the Panel has also found that the studies tend to converge on some important points. *First*, there is no disagreement in the recent literature cited by both parties that counter-cyclical payments can or may have production effects. *Second*, the studies cited by the parties are also in some agreement about the mechanisms by which these payments can encourage additional production. Increased wealth can reduce risk aversion, leading farmers to increase production. The presence of direct payments will allow credit-constrained farmers to finance the purchase of more farm inputs. Farmers may be willing to produce more output since counter-cyclical payments, which vary with the output price, can reduce revenue risk. Payments may allow producers to cover fixed costs and thus may allow marginal farmers who would otherwise be forced to shut down to remain in production. If farmers believe that future payments are based on current production, because of the possibility of updating base acres, they may increase the current production of those crops for which they expect to receive future payments.[338]

10.93 Where the studies differ is in their assessment of the magnitude of these production effects. The studies cited by the United States argue that the production effects of counter-cyclical payments are likely to be small, while the papers cited by Brazil contend that the effects are substantial. Almost all of the papers have focused on the acreage response by farmers to the payments. There appears to have been a surge of interest in the research community on the question of the production effects of decoupled payments. It would seem that this recent literature is fairly divided on the magnitude of the production impact of counter-cyclical payments. Academics and USDA economists can be found on both sides of the question.

10.94 With respect to the issue of whether counter-cyclical payments are capitalized into higher land values, the Panel considers that this in no way implies that the payments have no production effects. While the OECD study cited by the United States concluded that most of the impact of production flexibility contract and market loss assistance payments pass-through to higher land values, enough seems to have been left in the hands of farm operators to create a modest production effect. Given that counter-cyclical payments, in contrast to production flexibility contract payments, are price-contingent, there is a presumption that the output effect of counter-cyclical payments will be higher than that of the production flexibility payments.

[336] See *supra*, footnote 324.
[337] See *supra*, footnote 324.
[338] The Panel understands that the issue of base acreage updating is not an issue before it.

10.95 Thus, in our assessment, the current state of this academic and policy research is such that even though the experts disagree among themselves about the exact magnitude of the production effects of counter-cyclical payments, there is no disagreement about the direction of those effects nor on the mechanisms by which the production effects are transmitted. Thus, counter-cyclical payments can increase production and these production effects occur because increased wealth reduces risk aversion, the availability of the payments relieves credit constraints and provides some insurance from fluctuations in revenues and the payments allow farmers to cover fixed costs of production.

10.96 The Panel now turns to the arguments of Brazil and the United States on the issue of whether the relationship between upland cotton farmers receiving counter-cyclical payments and upland cotton production supports a finding that the effect of counter-cyclical payments, by virtue of their structure, design and operation, is significant price suppression in the world market for upland cotton.

10.97 In support of its argument that the structure, design and operation of the counter-cyclical payments insulate US cotton producers from market forces and thereby stimulate production, **Brazil** submits that there continues to be a "strong positive relationship" between upland cotton base acre holders receiving annual counter-cyclical payments and upland cotton production.[339] The overwhelming majority of US upland cotton is grown on farms holding upland cotton base. Moreover, the evidence also shows that the amount of upland cotton acreage of recipients who over-planted their cotton base remains at a low level compared to 1999-2001. Brazil considers that it is unimportant that, as argued by the United States, some 40 per cent of upland cotton base acreage is not planted to upland cotton and that an average of 17 per cent of upland cotton acreage is on farms with cotton planted acreage that exceeded cotton base acreage or on farms with no cotton base acreage.[340] Brazil submits that its claim pertains to the effect of counter-cyclical subsidies in *maintaining* production of US upland cotton by keeping current producers of upland cotton in business and that it is not arguing that counter-cyclical subsidies *induce* production. Therefore, the focus of the analysis should be on the relationship between current US upland cotton producers and upland cotton counter-cyclical subsidies. From this perspective, the key fact is that the overwhelming majority of current US upland cotton production is undertaken by historic upland cotton producers that receive upland cotton-counter-cyclical payments. The percentage of US upland cotton acreage on farms with upland cotton base acres is essentially the same as in the period considered by the original panel. Similarly, the fact that cotton producers planted 40 per cent fewer acres to cotton than in the base period is irrelevant to Brazil's claim that counter-cyclical subsidies received by current producers of upland cotton are critical to ensure a profit for those farms that currently do produce upland cotton. In any event, this percentage is essentially the same as in the period considered by the original panel. Brazil submits that the fact that, as argued by the United States, US upland cotton was grown historically and continues to be grown today in certain regions of the United States supports Brazil's argument that by providing for counter-cyclical payments based on historical base acres the US Congress intended to support current production of upland cotton.[341]

[339] Brazil's First Written Submission, para. 131. Brazil refers to the statement of the original panel that the evidence before the Panel showed "a strongly positive relationship between those recipients who hold upland cotton base acres and those who continue to plant upland cotton..." Panel Report, *US – Upland Cotton*, para. 7.637.

[340] Brazil's Rebuttal Submission, paras. 153-165.

[341] Brazil's Comments on US Responses to Panel Questions 29 and 54. Brazil submits that in MY 2005, 83 per cent of cotton planted acreage was on cotton base acreage. This is the more significant portion of US upland cotton acreage. Moreover, of the remaining 17 per cent, 12 per cent was on farms that "overplanted" their cotton base acreage and 5 per cent was on farms that did not have any upland cotton base acreage. In other words, 95 per cent of US upland cotton acreage is on farms that hold upland cotton base. These facts, according to Brazil, demonstrate that there continues to be a strong positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production. In regard to the argument of the United States that 40 per cent of upland cotton base acres are not currently planted to upland

10.98 The **United States** argues that data comparing base to planted acreage does not demonstrate that counter-cyclical payments have significant effects on production. The fact that there is some overlap between current and historic production of upland cotton in the United States is not remarkable. What is notable is that the data shows that counter-cyclical payments do not induce recipients to continue planting cotton. Over the period MY 2002-2005 an average of 17 per cent of US cotton planted acreage was on farms with cotton planted acreage that exceeded cotton base acres or on farms with no cotton base acres at all. Moreover, traditional US cotton producers receiving counter-cyclical payments planted approximately 40 per cent fewer cotton acres over MY 2002-2005 than in the period used to calculate cotton base acres.[342] Brazil's attempts to dismiss these facts as unimportant are inexplicable and baseless. Given that Brazil is arguing that counter-cyclical payments induce US producers to produce cotton even though they are not required to do so to receive the payments, it would seem to be very important whether in fact, US producers holding upland cotton base acres are continuing to produce upland cotton and if so, whether they are producing cotton in such a way as to evidence the significant production effects that Brazil has alleged. Brazil fails to explain what the fact that 95 per cent of US upland cotton planted acreage was on farms that held upland cotton base acreage has to do with its claim that counter-cyclical payments have significant production inducing effects. The United States notes in this respect that the same "positive relationship" exists between upland cotton production and recipients of direct payments, which were not found to have significant price suppressing effects in the original proceeding.[343] The facts show that US farmers use the planting flexibility afforded by the direct and counter-cyclical payments and that counter-cyclical payments do not induce producers to grow cotton where they would not otherwise have done so. Upland cotton is grown in a limited number of regions in the United States where the weather and other conditions are ideal for upland cotton production. The fact that many farmers who planted upland cotton in the historical period continue to produce some cotton today simply means that it makes sense for these producers to grow cotton given their experience and expertise, their equipment and the particular growing conditions. Therefore, what matters in order to assess the effects of counter-cyclical payments on production is not the percentage of farms producing upland cotton that received upland cotton counter-cyclical payments but the level of acreage planted to cotton *vis-à-vis* upland cotton base acres.[344]

10.99 The Panel notes that the original panel found a "strongly positive relationship between recipients who currently plant upland cotton and those whose payments are calculated with respect to upland cotton base acres and whose payments are therefore calculated at the upland cotton–specific payments rate".[345] More specifically, the panel determined on the basis of data provided by the United States that:

> "a very large proportion of farms with upland cotton base acres continue to plant upland cotton in the year of payment. The data provided also shows that the overwhelming majority of farms enrolled in the programmes which plant upland cotton also hold upland cotton base."[346] (footnote omitted)

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cotton, Brazil notes that at no time in recent history has US upland cotton acreage been 18.4 million acres – the amount of upland cotton base. The high level of upland cotton base relative to production reflects the fact that with consecutive base updates, US farms elected to update only if that would increase their high payment upland cotton base. In case an update would have decreased high payment upland cotton base in favour of lower payment crop base, US farms declined to update. Thus, US upland cotton base acres are not a reliable measure to compare to annual US upland cotton acreage.

[342] US First Written Submission, paras. 220-225.

[343] US Rebuttal Submission, paras. 263-266.

[344] US Response to Panel Question 29; US Response to Panel Question 54, paras. 109-111.

[345] Panel Report, *US – Upland Cotton*, para. 7.583.

[346] Panel Report, *US – Upland Cotton*, para. 7.636. The panel provided precise figures on these relationships in Tables A-1 and A-2.

10.100 The original panel provided figures on this relationship in Tables A-1 and A-2 of its report and observed that:

> "These figures show a strongly positive relationship between those recipients who hold upland cotton base acres and those who continue to plant upland cotton, despite their entitlement to plant other crops, which is indicative of the relationship between payments calculated with respect to upland cotton base acreage and recipients who plant upland cotton. These figures also show that upland cotton production within these four programmes is almost exclusively taking place on farms which hold upland cotton base acres."[347]

10.101 The original panel referred to this positive relationship in support of certain aspects of its findings on serious prejudice.[348] With respect to the structure, design and operation of counter-cyclical payments the panel observed:

> "We agree with the view of USDA economists that, due to their market-price contingency, CCPs may influence production decisions indirectly by reducing total and per unit revenue risk associated with price variability in some situations. In the price range from the loan rate up to the target price minus the DP payment rate, changes in producer revenues due to changes in market prices are partly offset by the countercyclical payments if the base acreage crop is planted, thereby reducing total revenue risk associated with price variability. *We have confirmed a strong positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production.* Moreover, the payments are mandatory, under certain market conditions."[349] (footnotes omitted, emphasis added)

10.102 The evidence provided by Brazil in this proceeding shows that the facts regarding the relationship between base acres and planted acreage are not significantly different from the facts that formed the basis for the Panel's conclusion regarding the existence of a "strongly positive relationship" between upland cotton base acre holders receiving annual counter-cyclical payments and upland cotton production.[350] The United States has not questioned the factual accuracy of the data submitted by Brazil on the existence of this relationship. In other words, the United States does not contest that, as argued by Brazil, the overwhelming majority of current US upland cotton production is undertaken by historic upland cotton producers that receive upland cotton counter-cyclical payments. Rather, the United States contests that this relationship supports Brazil's claim of significant price suppression. However, the Panel concurs with Brazil that this relationship between upland cotton base acre holders and upland cotton production is significant in that it suggests that cotton counter-cyclical payments play a role in maintaining the level of acreage and production at a higher level than would otherwise be the case. In addition, as noted above, this relationship is essentially the same as in the period considered by the original panel. We therefore see no basis in this proceeding to arrive at a conclusion different from that of the original panel with respect to this issue.

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[347] Panel Report, *US – Upland Cotton*, para. 7.637.

[348] Panel Report, *US – Upland Cotton*, paras. 7.1119, 7.1226, 7.1302, footnote 1417 and para. 7.1362.

[349] Panel Report, *US – Upland Cotton*, para. 7.1302.

[350] Table 3 of Brazil's Rebuttal Submission shows that in MY 2005, 95 per cent of US upland cotton planted acreage was planted on farms that received upland cotton counter-cyclical payments. This table is an updated version of a table in the original panel report that showed that the percentage of upland cotton planted acres on farms with upland cotton base acres was 92.9 in MY 1999, 92.0 in MY 2000, 91.3 in MY 2001 and 96.1 in MY 2002. Panel Report, *US – Upland Cotton*, para. 7.636, Table A-2. In addition, the Panel notes that while the United States emphasizes that 40 per cent of upland cotton base acreage is not planted to upland cotton, Brazil has pointed out that during the period considered by the original panel this percentage was similar.

10.103 The Panel therefore finds that a strongly positive relationship exists between recipients of upland cotton counter-cyclical payments who hold upland cotton base acres and those who continue to plant upland cotton and that this factor is an element that provides support for a finding that the counter-cyclical payments, because of their structure, design and operation, have price-suppressing effects.

10.104 In conclusion, based on an analysis of the arguments and evidence presented to the Panel in this proceeding regarding the structure, design and operation of the marketing loan and counter-cyclical payments to US upland cotton producers, the Panel considers that these subsidies affect the level of US upland cotton acreage and production as a result of their mandatory and price-contingent nature and their revenue-stabilizing effect. In this respect, the Panel concurs with the view of the original panel that these subsidies protect or "insulate" revenues of US upland cotton producers when prices are low. It is important to emphasize, however, that in determining whether the structure, design and operation of these subsidies support a finding of significant price suppression *under current factual conditions*, we need to consider this factor in conjunction with other facts. The Panel considers, in this regard, that viewed together with other evidence on the record, including the fact that the adjusted world price in most recent years has been below the marketing loan rate, the magnitude of the marketing loan and counter-cyclical payments, the importance of these subsidies as a share of the revenues of US upland cotton producers and their role in covering a significant part of the costs of production of these producers[351], it is reasonable to conclude that without these subsidies the level of US upland cotton acreage and production would likely be significantly lower.

10.105 As discussed above[352], the original panel relied upon the design, structure and operation of the marketing loan and counter-cyclical payments in conjunction with the magnitude of the subsidies. We therefore now turn to the argument of Brazil that the magnitude of the marketing loan and counter-cyclical payments supports a finding that the effect of marketing loan and counter-cyclical payments is significant price suppression.

6. Alleged "large magnitude" of the marketing loan payments and counter-cyclical payments

(a) Main arguments of the parties

10.106 **Brazil** argues that the magnitude of US marketing loan and counter-cyclical payments under the FSRI Act of 2002 remains very large and that this is evidence supporting the existence of a causal link between these two subsidies and significant price suppression in the world market for upland cotton. The elimination of Step 2 payments has not significantly reduced the overall magnitude of the price-contingent subsidies.[353] Brazil considers that the significance of the magnitude of the marketing loan and counter-cyclical payments must be assessed in light of the fact that, as found by the original panel, these subsidies are provided in respect of a fungible, widely-traded product. Because of the high subsidization rate from the marketing loan payments and counter-cyclical payments, US producers and exporters have a significant advantage over their competitors in securing sales in the world market. Brazil submits that the large magnitude of the marketing loan payments is highly significant in light of their trade-distorting nature. The panel and Appellate Body reports in the original proceeding and the panel reports in *Indonesia – Autos* and *Korea – Commercial Vessels*

[351] *Infra*, Sections X.B.6 and X.B.9.
[352] *Supra*, paras. 10.66-10.67.
[353] Brazil asserts that while the *ad valorem* rate of subsidization from Step 2 payments was 6.7 per cent in MY 2005, the *ad valorem* subsidization rate from marketing loan payments and counter-cyclical payments in MY 2005 was 42 per cent.

support the view that the amount of a subsidy is an important factor to consider in a price suppression analysis.[354]

10.107 The **United States** submits that Brazil does not demonstrate that the size of the outlays under the marketing loan and counter-cyclical payment programmes supports the existence of a causal link between these payments and the existence of significant price suppression.[355] Labelling the annual amounts of marketing loan and counter-cyclical payments as "large" or "very large" says nothing about the effects of these payments on world market prices. The size of outlays under the marketing loan and counter-cyclical payment programmes cannot be meaningfully addressed apart from an actual examination of their design, structure and operation. Brazil provides no evidence to substantiate its contention that marketing loan and counter-cyclical payments provide an "enormous advantage" to US producers and exporters "to secure sales" in the world market. While Brazil appears to suggest that US exporters use marketing loan and counter-cyclical payments to undercut foreign cotton prices, Brazil provides no evidence to support this assertion. Moreover, Brazil has failed to explain the relevance of this assertion to its claim, which is a claim of price suppression rather than price undercutting.[356]

(b) Evaluation by the Panel

10.108 The original panel considered that a precise quantification of the amount of a subsidy was not required in a serious prejudice analysis under Part III of the *SCM Agreement*[357], but that "the general order of magnitude of a subsidy may be a relevant consideration in a serious prejudice analysis in a particular case (where such information is probative and readily available)".[358] The panel noted that as it had readily available information on the general order of magnitude of many of the subsidies at issue, it would take this into account in determining whether or not significant price suppression and/or serious prejudice existed.[359] The panel relied upon the magnitude of the subsidies at issue, which it characterized as "very large", as a factor supporting its findings that price suppression existed[360], that this price suppression was significant[361] and that a causal link existed between certain price-contingent subsidies and the significant price suppression which it had found to exist.[362]

10.109 The Appellate Body held that the original panel had not erred in its assessment of the amount of the subsidies for the purposes of its analysis under Article 6.3(c) of the *SCM Agreement*.[363] The Appellate Body also held that the magnitude of a subsidy and its relationship to prices is a relevant factor to consider in an analysis of whether the effect of a subsidy is significant price suppression [364],

[354] Brazil's First Written Submission, paras. 107-119; Brazil's Rebuttal Submission, paras. 167-179.
[355] The United States addresses this issue as part of its arguments on the design, structure and operation of the subsidies at issue. US First Written Submission, paras. 236-241; US Rebuttal Submission, paras. 276-280.
[356] US First Written Submission, paras. 236-241; US Rebuttal Submission, paras. 276-280.
[357] Panel Report, *US – Upland Cotton*, paras. 7.1167, 7.1177 and 7.1179.
[358] Panel Report, *US – Upland Cotton*, footnote 1289.
[359] Panel Report, *US – Upland Cotton*, para. 7.1194. The "readily available information" referred to by the panel was information contained in section VII:D and in footnote 895 of the panel report.
[360] Panel Report, *US – Upland Cotton*, paras. 7.1297 and 7.1308.
[361] Panel Report, *US – Upland Cotton*, para. 7.1332.
[362] Panel Report, *US – Upland Cotton*, para. 7.1349.
[363] Appellate Body Report, *US – Upland Cotton*, para. 473.
[364] The Appellate Body stated:

> "Beginning with the text of Article 6.3(c), we note that this provision does not state explicitly that a panel needs to quantify the amount of the challenged subsidy. However, in assessing whether 'the effect of the subsidy is ... significant price suppression', and ultimately serious prejudice, a panel will need to consider the

but that Article 6.3(c) of the *SCM Agreement* does not oblige a panel "to quantify precisely the amount of a subsidy benefiting the product at issue in every case. A precise, definitive quantification of the subsidy is not required".[365] The Appellate Body also considered that although the panel could have been more explicit as to what it meant by the "very large amounts" of subsidies, the information before the panel clearly supported the panel's general statements on the magnitude of the subsides.[366]

10.110 We have summarized the data on record with respect to the magnitude of marketing loan payments and counter-cyclical payments in Tables 1 and 2.[367] The evidence before the Panel indicates that in MY 2005 the total amount of marketing loan payments to upland cotton producers and of counter-cyclical payments allocated to upland cotton was higher than in MY 2002.[368] We also note that the amount of marketing loan payments and counter-cyclical payments in MY 2005 is of the same order of magnitude as the total amount in MY 2002 of the price-contingent subsidies subject to the original's panel finding of "present" serious prejudice.[369] At the same time, we also note that the amount of projected marketing loan payments in MY 2006 is significantly less than the amount of marketing loan payments in MY 2005.[370]

10.111 The Panel considers, in light of the approach taken by the panel and Appellate Body in the original proceeding, that in determining whether the magnitude of the subsidies at issue in this proceeding supports a finding that the effect of these subsidies is significant price suppression, it is necessary to examine this factor in relation to other factors. Thus, the relevance of the magnitude of the subsidies in this connection must also be assessed in light of our analysis above of the structure, design and operation of the subsidies. We recall, in this respect, our conclusion regarding the important revenue-stabilizing effect of these mandatory, price-contingent subsidies. In the latter regard, the evidence before us indicates that marketing loan and counter-cyclical payments play a

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> effects of the subsidy on prices. The magnitude of the subsidy is an important factor in this analysis. A large subsidy that is closely linked to prices of the relevant product is likely to have a greater impact on prices than a small subsidy that is less closely linked to prices. All other things being equal, the smaller the subsidy for a given product, the smaller the degree to which it will affect the costs or revenue of the recipient, and the smaller its likely impact on the prices charged by the recipient for the product. However, the size of a subsidy is only one of the factors that may be relevant to the determination of the effects of a challenged subsidy. A panel needs to assess the effect of the subsidy taking into account all relevant factors."

Appellate Body Report, *US – Upland Cotton*, para. 461 (footnote omitted).

[365] Appellate Body Report, *US – Upland Cotton*, para. 467.

[366] Appellate Body Report, *US – Upland Cotton,* para. 468.

[367] *Supra*, paras. 10.24 and 10.32.

[368] As can be seen from Tables 1 and 2, the total amount of marketing loan payments in MY 2005 was US$1.269 billion and the amount of counter-cyclical payments allocated to upland cotton was US$838 million**.** The total amount of marketing loan and counter-cyclical payments to US upland cotton producers was US$2.107 billion in MY 2005. In MY 2002, the amount of marketing loan payments was US$898 million while the amount of counter-cyclical payments allocated to upland cotton was US$851.5 million.

[369] According to Table 6 in Brazil's First Written Submission, the amount of Step 2 payments in MY 2002 was US$429 million. No market loss assistance payments were made in MY 2002. Thus, the total amount of marketing loan and counter-cyclical payments to upland cotton producers and of Step 2 payments to upland cotton users and exporters was US$2.179 billion in MY 2002.

[370] As noted above, Brazil has pointed to three different projections of the amount of marketing loan payments MY 2006: US$650 million, US$475 million and US$757 million. Brazil argues that the more recent and reliable of these projections is the February 2007 USDA projection (US$757 million). However, even if we take the lowest of the three figures mentioned by Brazil we note that the total amount of marketing loan and counter-cyclical payments in MY 2006 is projected to be well above US$1 billion.

significant role in stabilizing the revenues of US upland cotton producers.[371] The share of marketing loan payments and counter-cyclical payments in total revenues of US upland cotton producers was 35 per cent in MY 2004 and 27 per cent in MY 2005.[372] This data on the share of marketing loan and counter-cyclical payments in US upland cotton producers' revenues is especially important in light of our finding regarding the gap between costs of production and market revenues of US upland cotton producers.[373] In our view, when considered in conjunction with other factors, the order of magnitude of the marketing loan payments and counter-cyclical payments supports a finding of significant price suppression, even when account is taken of the decline in the amount of marketing loan payments projected for MY 2006.[374]

7. Alleged "link between high levels of US subsidies and high levels of US planted acreage, production and exports"

(a) Main arguments of the parties

10.112 **Brazil** argues that there remains a strong link between high levels of US subsidies and high levels of US planted acreage, production and exports during MY 2002-2005, which is due to the fact that marketing loan and counter-cyclical payments insulate US cotton producers from market price signals.[375] Brazil asserts in this connection that, regardless of the type of price examined, US planted acreage, production and exports do not respond significantly to market prices and have increased significantly in recent years.[376] [377] Brazil provides graphs demonstrating that while US acreage does not show any relationship to futures prices, foreign acreage reacts to changes in expected prices.[378] Brazil also provides graphs demonstrating that US upland cotton production and exports do not respond significantly to changes in either movements or absolute levels of the US farm price.[379]

10.113 Brazil provides a table to show the amounts of US planted and harvested acreage, yields, US production and US exports of upland cotton over the MY 1999-2005 period that were achieved under the revenue protection afforded US upland cotton producers by the effects of the marketing loan and counter-cyclical payment programmes.

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[371] Brazil's First Written Submission, para. 133, Figure 8; Brazil's Comments on US Response to Panel Question 51, para. 72, Figure 1.

[372] Brazil's First Written Submission, para. 135.

[373] *Infra*, Section X.B.9

[374] *Supra*, footnote 370.

[375] Brazil's First Written Submission, para. 137.

[376] Brazil's First Written Submission, paras. 139-149; Brazil's Rebuttal Submission, paras. 209-231.

[377] Brazil asserts that US planted acreage, after falling slightly in MY 2002 and 2003, has increased every year since. MY 2006 acreage, planted in the spring of 2006, is estimated to be the highest in five years, and, at 14.96 million acres, only a half-million acres below the ten-year high reached in MY 2001. Overall, US planted acreage during MY 2002-2005 has remained at levels that are similar to 10- and 15-year averages – periods during which US upland cotton producers also benefited from large US subsidies. Brazil's First Written Submission, para. 140 and Exhibit Bra-447 (Upland Cotton Supply and Use).

[378] Brazil's First Written Submission, Figure 9; Brazil's Rebuttal Submission, Figures 8 and 9.

[379] Brazil's First Written Submission, Figures 10 and 11.

Table 5: US Upland Cotton Production, Exports and Acreage, MY 1999-2006

MY	1999	2000	2001	2002	2003	2004	2005	2006
Production (million bales)	16.294	16.799	19.603	16.531	17.823	22.505	23.260	
Exports (million bales)	6.303	6.303	10.603	11.266	13.220	13.618	17.437	
Planted acres (million acres)	14.584	15.347	15.499	13.714	13.301	13.409	13.975	14.995
Harvested acres (million acres)	13.138	12.884	13.560	12.174	11.826	12.809	13.534	
Yield (bales per acre)	1.240	1.304	1.446	1.358	1.507	1.757	1.719	

Source: Brazil's First Written Submission, Table 12.[380]

10.114 Brazil asserts that the record amount of US upland cotton production in MY 2001 was surpassed in MY 2004 by 15 per cent and that MY 2005 saw yet another record level of production. Production in MY 2005 was 43 per cent higher than in MY 1999.[381] Since MY 1999, US exports have increased even more rapidly than production. In MY 2005, US upland cotton exports were 177 per cent higher than in MY 1999. MY 2001, 2002, 2003, 2004 and 2005 each established new record volumes of US exports. Exports in MY 2005 were, in fact, larger than total US upland cotton *production* in MY 1999, 2000 and 2002.[382]

10.115 Brazil submits that in arguing that US cotton producers are not insulated from market signals the United States makes arguments that were already rejected in the original proceeding. According to Brazil, the United States effectively asks this Panel to overturn the finding of the panel and Appellate Body that the structure, design and operation of the marketing loan and counter-cyclical subsidies insulate US upland cotton producers from market forces by stabilizing their revenue at very high levels. Adverse effects within the meaning of Articles 5 and 6 of the *SCM Agreement* result not from increases as such but from production and exports in excess of what would have been the levels of production and exports in the absence of the subsidies. But for the marketing loan and counter-cyclical payments, US producers would have been more responsive to market price signals. The very fact that the US shares of world production and exports have remained stable is evidence of the effect of the marketing loan and counter-cyclical subsidies.[383]

10.116 Brazil submits that the argument of the United States that US cotton planting decisions should be explained by the ratio of upland cotton futures prices to soybeans futures prices was already rejected by the panel and Appellate Body in the original proceeding and is not supported by the evidence submitted by the United States.[384]

10.117 The **United States** argues that US upland cotton producers and exporters have reacted to market signals and are not insulated by the marketing loan and counter-cyclical payment programmes. *First*, stable US shares of world production and exports confirm that the marketing loan and counter-

[380] Brazil compiled this table from Exhibit Bra-447 (Upland Cotton Supply and Use) and, for planted acreage in MY 2006, Exhibit Bra-449 (Cotton and Wool Outlook, USDA, October 2006, p. 9, accessed October 2006 at http://usda.mannlib.cornell.edu/usda/current/CWS/CWS-10-13-2006.pdf). Brazil notes that evidence on harvested acres, yield per harvested acre, production, and exports is not yet available for MY 2006.

[381] Brazil's First Written Submission, para 147.

[382] Brazil's First Written Submission, para 148.

[383] Brazil's Rebuttal Submission, paras. 195-208. Brazil also submits that the US share of world production has in fact increased in MY 2005.

[384] Brazil's Rebuttal Submission, paras. 214-215.

cyclical payment programmes are not insulating US producers from market signals.[385] The fact that these shares have been stable shows that US upland cotton producers are affected by market signals in the same ways as foreign producers.[386] According to the United States, Brazil has no credible answer to a fundamental question in this regard – if US producers continue to plant and produce, and US exporters continue to export, in circumstances where "any rational non-subsidized producer" would have "reduced plantings, production, and exports," why has US share of world production and world exports not increased over the life of the FSRI Act of 2002?[387] The United States submits that it has not argued that adverse effects within the meaning of Articles 5 and 6 of the *SCM Agreement* can only be found if there are increases in production, acreage and exports, but that increased US share of production is a necessary implication of Brazil's theory of market insulation.

10.118 Second, the United States argues that Brazil fails to demonstrate the alleged strong link between marketing loan and counter-cyclical payments and US planted acreage, production and exports. Brazil's analysis of the sensitivity of US planted acreage, production and exports to prices is flawed in that it does not properly reflect the factors taken into consideration by US farmers when making their production decisions. Since farmers do not only consider the cotton futures price but also take into account other factors, such as weather conditions, prices of competing crops, changes in technology, labour and input prices and marketing efforts, it is not surprising that planted acreage does not correlate with the cotton futures price.[388] Regarding Brazil's comparison of US cotton production to the farm price, the United States submits that Brazil firstly assumes, incorrectly, that planting decisions could be explained through an examination of cotton prices alone. Moreover, in comparing US upland cotton production in a marketing year to the average US farm price for the same marketing year, Brazil assumes that US farmers know at the time that they plant what the actual farm price will be in the upcoming marketing year, which does not start until August. Finally, producers do not decide on production, but on plantings. Ultimate production is affected by weather and other factors affecting yields.[389]

10.119 The United States argues that it is apparent from Brazil's chart[390] that foreign acreage (even harvested acreage) is many orders of magnitude greater than US planted acreage. Plotted against each other in a chart, US planted acreage will inevitably appear to be flat relative to foreign acreage.[391] The United States also submits that a comparison of US acreage and foreign acreage to futures prices of upland cotton shows that neither US nor foreign harvested acreage moves closely in line with futures prices of cotton alone.[392]

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[385] US First Written Submission, Section VI.C.2(a). The United States provides charts to show that the US shares of world production and exports of upland cotton have remained stable over the life the FSRI Act of 2002 in paras. 243 and 247 of its First Written Submission. In paras. 283-284 of its Rebuttal Submission, the United States provides charts to show that the US share of world production has been stable from well before either the marketing loan or the counter-cyclical payment programme came into effect.

[386] With respect to the increase in the US share of world exports in the period MY 1999-2002, the United States argues that this increase did not reflect an increase in US share of world production. In other words, US producers were not increasing their production relative to foreign producers in order to gain market share, as Brazil has suggested. Rather, a greater proportion of US production was being exported. The reason for this was the decline in US mill use resulting from the declining competitiveness of the US textile industry and increasing US imports of textiles and clothing in the same period. US First Written Submission, para 249.

[387] US Rebuttal Submission, para 283.

[388] US First Written Submission, paras. 255-261.

[389] US First Written Submission, para 262-263. The United States also argues that, if one compares both US and foreign production to movements in the A-Index, the same alleged "absence" of a "link" between absolute production levels and prices is apparent in both cases. US First Written Submission, para. 265.

[390] Brazil's Rebuttal Submission, para. 221, Figure 8.

[391] US Rebuttal Submission, para 303.

[392] US Rebuttal Submission, para 308.

10.120 The United States argues that "absolute" increases in US production are "the effect" of improvements in yields, not the marketing loan and counter-cyclical payment programmes.[393]

10.121 **Brazil** submits that there is no legitimate basis for the United States to claim that increased yields alone accounted for increased US production and increased US exports in MY 2004 and 2005. Brazil agrees that for the portion of US upland cotton planted acreage that would have been planted even without the effects of the US subsidies, the increased yields alone accounted for an increase in resulting production and exports. However, for the portion of US upland cotton planted acreage that would not have been planted but for the marketing loan and counter-cyclical payment revenue, the increased yields secured on such acreage – and hence also the resulting production and exports – are linked to the effects of the US subsidies.[394]

(b) Evaluation by the Panel

10.122 The Panel notes that in support of its argument that there exists a strong link between high levels of US subsidy payments and high levels of US planted acreage, production and exports, Brazil argues that US cotton producers are insulated from market price signals.[395] In Brazil's view, the price-contingent marketing loan and counter-cyclical payments act to ensure that US upland cotton producers' total revenue per unit remains largely unaffected by price movements. Brazil refers in this respect to the findings of the panel and the Appellate Body in the original proceeding.

10.123 Brazil has also sought to provide factual support for its argument that US producers do not react to market price signals by comparing US planted acreage and futures prices of cotton. Brazil argues that, as during the time period assessed by the original panel, US planted acreage continues to show no obvious relationship to market price signals.[396] By contrast, the United States asserts that the futures price of cotton is not the sole basis for a farmer's planting decision as many growers, in the United States and elsewhere have several alternative crops to consider. In this respect, the United States submits that a comparison between, on the one hand, US cotton planted acreage and, on the other hand, the ratio of cotton futures prices to soybeans futures prices rebuts Brazil's argument that US cotton producers are insulated from market price signals.[397] Brazil contests that this comparison supports the argument of the United States.[398]

[393] US First Written Submission, Section VI.C.3, page 87. See also US Rebuttal Submission, Section IV.C.2, page 108.

[394] Brazil's Rebuttal Submission, paras. 229-231.

[395] Brazil's First Written Submission, para. 137.

[396] Figure 9 in Brazil's First Written Submission compares the average price of the December cotton futures contract in February (a proxy for farmers' pre-planting expectations of market prices during the beginning of the marketing year) with US upland cotton planted acreage. Brazil argues that this figure shows that US planted acreage does not move with futures prices in at least three of the last four planting seasons. Brazil argues that the graph demonstrates that, in 2003, US planted acreage declined even though futures prices indicated much higher prices for the December 2003 harvest. Similarly, in February 2004, planted acreage only increased slightly (108,000 acres) despite the highest February futures prices for the December contract in the previous five years. And with futures prices falling significantly in February 2005, US upland cotton farmers planted 566,000 more acres than the previous year. Brazil's First Written Submission, para. 143.

[397] Thus, during January, February and March, US growers would be looking at the levels of the upcoming December futures contract on cotton, September futures contract for corn, and November futures contract for soybeans. To demonstrate this, the United States presents another figure providing a comparison of US planted acreage to the ratio of cotton futures and soybean futures prices. The United States claims that the figure shows that, when the expected cotton futures price is high relative to the expected soybean futures price, planted acreage tends to increase. When the opposite is true – and the ratio is small – cotton planted acreage tends to decrease. US First Written Submission, paras. 257-259.

[398] Brazil's Rebuttal Submission, para. 215. Brazil asserts that a close examination of the figure presented by the United States demonstrates that US acreage and the cotton to soybean futures price ratio move

10.124 The Panel finds that the data presented by Brazil supports the argument of Brazil that the cotton futures prices does not seem to explain US cotton planted acreage. The Panel also agrees with Brazil that the evidence provided by the United States regarding the relationship between, on the one hand, the ratio of cotton futures prices to soybeans future prices and, on the other hand, US planted acreage does not provide an adequate explanation for the observed changes, particularly for the period MY 2003 to 2006. The Panel notes, in this regard, that the ratio of cotton futures prices to soybean futures prices and US cotton planted acreage only moved in the same direction in MY 2006. In MY 2003, the ratio of cotton futures prices to soybeans futures prices increased sharply while cotton planted acreage declined. The ratio decreased in both MY 2004 and MY 2005, while planted acreage increased in both years. Thus, even if we agree with the argument of the United States that futures prices of alternative crops to cotton need to be taken into account, the data does not support an important role for this ratio of cotton futures prices to soybeans futures prices.

10.125 The major argument raised by the United States to rebut Brazil's argument that US upland cotton producers do not react to market price signals concerns the relative stability of the US share of world production and exports over the entire period of the FSRI Act of 2002. In the view of the United States, the stable US share of world production reflects the fact that US production has increased and decreased in much the same way as production elsewhere in the world, undermining Brazil's claims that the marketing loan and counter-cyclical payment programmes have "insulated" US producers from world market price signals.[399] As the United States puts it, whatever signal the "world market" is sending, US producers are receiving it clearly and responding to it in much the same way as their foreign counterparts.[400] Similarly, increases in the volume of US exports during MY 2002-2005 were not disproportionately greater than the increase in the volume of exports from foreign suppliers. In the view of the United States, this indicates that, contrary to Brazil's allegations, US exports were affected by the changes in the marketplace in much the same way as exports of foreign producers.[401]

10.126 Brazil has responded to this by arguing that the relevant economic decision of cotton producers to consider is not production nor exports but planted acreage. However, neither Brazil nor the United States appear to have access to recent data on foreign planted acreage. Brazil presents a figure which compares US planted acreage and foreign harvested acreage to movements in futures prices of cotton.[402] Referring to this figure, Brazil contends that changes in foreign harvested acreage and futures prices moved in the same direction in seven out of eight years. By contrast, changes in US planted acreage and futures prices move in the same direction in only three out of eight years. In the remaining five years, they move in different directions.[403] The United States objects to the comparison because Brazil compares foreign harvested acreage (instead of foreign planted acreage) with US planted acreage.

10.127 The fact that the US share of world cotton production and exports has remained relatively constant in MY 2002-2005 suggests to us that US producers have increased production and exports in proportionately the same way as foreign cotton producers. In our view, Brazil's claim of insulation of US producers from market price signals applies in particular when expected prices are below their intervention levels (the market loan rate or the target price under the counter-cyclical programme).

in parallel in only 3 of the 8 years identified. In the other five years, the development is either in the opposite direction (3 years) or in the same direction, but to very different degrees (2 years). In Brazil's view, this is hardly evidence of US upland cotton acreage being "generally" responsive to the cotton to soybean futures price ratio.

[399] US First Written Submission, para. 244.
[400] US Rebuttal Submission, para. 285.
[401] US First Written Submission, para. 248.
[402] Brazil's Rebuttal Submission, Figure 9.
[403] Brazil's Rebuttal Submission, para. 224.

However, the degree of insulation is less when expected cotton prices are above their intervention levels. In such a situation, US cotton producers should respond to higher expected cotton prices much in the same way as foreign cotton producers. Thus, the Panel is of the view that the stable US share of world production and exports does not mean an absence of insulation of US producers from market price signals. What it means is that the degree of price insulation that the original panel found is now weaker possibly because prices are not as depressed as during the period examined by the original panel.

8. Alleged "discernible temporal coincidence" of suppressed world market prices and large marketing loans and counter-cyclical payments

(a) Main arguments of the parties

10.128 **Brazil** argues that the existence of a "discernible temporal coincidence" of suppressed world market prices and large marketing loan payments and counter-cyclical payments is one of many factors that cumulatively support a finding of a causal relationship between marketing loan and counter-cyclical payments and significant price suppression in the world market for upland cotton. Brazil refers to the finding of the original panel of a "discernible temporal coincidence of suppressed world market prices and the price-contingent United States subsidies" and submits that developments in MY 2001-2005 regarding the same factors relied upon by the original panel show that there remains such a discernible temporal coincidence between suppressed world market prices and large marketing loan and counter-cyclical payments. Brazil refers, in this respect, to the increase in US production of upland cotton; the high US share in world production for upland cotton; the historically low level of upland cotton prices; the increase in US exports and the record US share in world exports of upland cotton. Brazil also asserts that during MY 2002-2005, lower world and US prices for upland cotton are matched with higher levels of marketing loan and counter-cyclical payments and that the original panel's finding regarding the influence of the New York futures price and the A-Index price continues to be valid.[404]

10.129 The **United States** submits that Brazil fails to show any discernable temporal coincidence between the marketing loan and counter-cyclical payment programmes and any alleged significant price suppression. None of the factors considered by the original panel in reaching its conclusion regarding the discernible temporal coincidence between US subsidies and significant price suppression supports such a finding with respect to the marketing loan and counter-cyclical programmes now. *First*, US planted acreage has been stable for the entire period that the FSRI Act has been in effect and is now substantially lower than during the period examined by the original panel. The fact that production in MY 2005 was larger than in MY 1999 and MY 2001, even though producers actually planted fewer acres in MY 2005, reflects the dramatic improvements in yields. *Second*, over the period of the FSRI Act the US share of world production has remained stable. *Third*, prices received by US upland cotton producers have not decreased since the FSRI Act came into effect. *Fourth*, the fact that the A-Index in MY 2002-MY 2005 was an average of 16 per cent lower than the 1980-2001 average says nothing about whether the marketing loan and counter-cyclical payments programmes are causing present significant price suppression as a decline in prices does not establish price suppression. Moreover, the fact the A-Index has trended downward for more than 25 years and has gone up from the levels prevailing before the entry into effect of the FSRI Act suggests that if there is price suppression, it is not the effect of the marketing loan and counter-cyclical payment programmes. *Fifth*, the share of the United States in world exports has not increased over the period of the FSRI Act and has even declined in MY 2002. Finally, the low level of imports of upland cotton has little to do with the marketing loan and counter-cyclical payments as US imports of

[404] Brazil's First Written Submission, paras. 153-154; Brazil's Rebuttal Submission, para. 233.

upland cotton have been at low levels for many decades and as US demand for cotton generally has declined as the textile industry shrunk.[405]

(b) Evaluation by the Panel

10.130 In support of its finding of a causal link between certain of the challenged US subsidies and the significant price suppression in the world market for upland cotton, the original panel relied upon the existence of "a discernible temporal coincidence" of suppressed world market prices and the price-contingent US subsidies.

10.131 The original panel explained its finding as to the existence of this discernible temporal coincidence as follows:

> "Third, there is a discernable temporal coincidence of suppressed world market prices and the price-contingent United States subsidies. Looking at the period, we see the following:
>
> - United States production of upland cotton increased from MY 1998 to MY 2001 and, while production dropped in MY 2002, there was still an overall increase in MY 2002 compared to MY 1998;
> - the United States' share of world upland cotton production increased to and remained at a level of approximately 20 per cent;
> - United States prices received by United States upland cotton producers decreased by 34 per cent between MY 1998 and MY 2001;
> - the A-Index in MY 1999 – MY 2002 was, on average, 29.5 per cent below its 1980-1998 average;
> - United States exports increased by approximately 160 per cent from MY 1998 to MY 2001 and by an even greater percentage from MY 1998-MY 2002;
> - United States share of world exports of upland cotton increased; and
> - United States imports of upland cotton remained at comparatively low levels.
>
> These data reveal that, over the same period that the subsidies in question were being granted, the United States market generated large supplies of upland cotton. Over this same time period, market revenue of United States upland cotton producers decreased. So did world market prices. There was also a marked increase in United States exports, both absolute and in terms of relative share of world exports. Even taking into account that in 1998, production may have been driven downward by drought and high levels of crop abandonment and that, in 2001, production may have been driven upward by high yields, we see a strong temporal coincidence between the United States subsidies and the drop in United States prices, the drop in – and suppression of – world market prices, the increase in United States exports."[406] (footnotes omitted)

10.132 The Appellate Body addressed this finding of the original panel as follows:

[405] US First Written Submission, paras. 288-290; US Rebuttal Submission, para. 316.
[406] Panel Report, *US – Upland Cotton*, paras. 7.1351-7.1352.

> "The third reason the Panel provided for finding a 'causal link' was that 'there is a discern[i]ble temporal coincidence of suppressed world market prices' and the price-contingent subsidies. The United States describes this as 'an exercise in spurious correlation'. However, in our view, one would normally expect a discernible correlation between significantly suppressed prices and the challenged subsidies if the effect of these subsidies is significant price suppression. Accordingly, this is an important factor in any analysis of whether the effect of a subsidy is significant price suppression within the meaning of Article 6.3(c). However, we recognize that mere correlation between payment of subsidies and significantly suppressed prices would be insufficient, without more, to prove that the effect of the subsidies is significant price suppression."[407]

10.133 In light of these comments of the Appellate Body, the Panel considers that the existence of a correlation between a subsidy and a particular level of prices is not in and of itself sufficient to establish that the subsidy causes significant price suppression.[408] Moreover, the data before the Panel indicates that with respect to several key factors relied upon by the original panel in finding "a discernible temporal coincidence" of suppressed world market prices and the price-contingent US subsidies, the current situation is significantly different from the situation considered by the original panel.

10.134 Regarding the evolution of prices of upland cotton, the original panel found that there had been a 34 per cent decrease in prices received by US upland cotton producers between MY 1998 and MY 2001. With respect to exports, the original panel found that there had been "a marked increase in United States exports, both absolute and in terms of relative share of world exports". From MY 1998 to MY 2002, US exports had increased by more than 160 per cent and the share of the United States in world exports had increased from 23.5 per cent in MY 1999 to 39.9 per cent in MY 2002.

10.135 For the period MY 2002 to MY 2005, we are unable to detect a similar "strong discernable coincidence" between the US subsidies, the increase in US cotton exports and the drop in world market prices. Instead, what could be discerned is the continuing and sharp rise in volumes of US production and exports. However, these increases in volumes did not translate into a higher share of US cotton in world production or world exports. Nor have the absolute increases in US cotton production and exports been associated with a "broad decline" in cotton prices.

10.136 We shall first examine the pattern of US subsidy payments using data from Tables 1 and 2A above[409], relating them to the behaviour of the world market price of cotton. Except for MY 2003, when cotton prices saw a sharp increase, the sum of marketing loan and counter-cyclical payments averaged more than US$2 billion dollars annually. Over this four-year period, marketing loan payments made up more than 60 per cent of total payments to cotton producers. The amount of subsidy payments varied inversely with cotton prices. When cotton prices were low, as in MY 2002, 2004 and 2005, significant marketing loan and counter-cyclical payments were triggered. When cotton prices were high, as in MY 2003, both marketing loan and counter-cyclical payments were substantially reduced. This pattern of subsidy payments results in a stabilization of US cotton producers' revenues. Figure 1 below illustrates this inverse relationship of subsidy payments and the A-index for MY 2002-2005.

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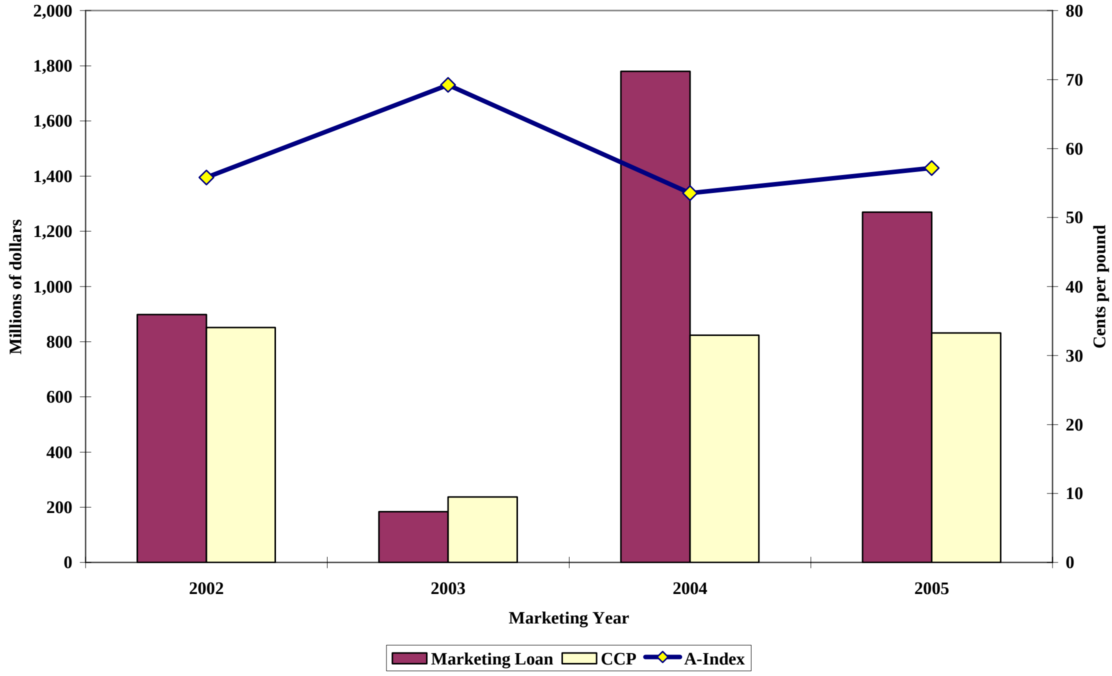
[407] Appellate Body Report, *US – Upland Cotton*, para. 451.

[408] We also recall our observations (*supra*, paras. 10.45-10.49) on the concept of price suppression and on the need for a counterfactual analysis in determining whether price suppression is the effect of a subsidy.

[409] *Supra*, paras. 10.24 and 10.32.

Figure 1: Subsidy (Marketing Loan and Counter-Cyclical) Payments and World Cotton Prices, MY 2002-2005



Sources: The A-Index is from Exhibit US-25. Total marketing loan payments are taken from rows 2 and 3 of Table 1 above. Counter-cyclical payments are taken from row 3 of Table 2A above.

10.137 During the period MY 2002-2005, when these large marketing loan and counter-cyclical payments continued to be made by the United States, the absolute level of US cotton production increased by 38.8 per cent with a much bigger increase in the absolute level of US cotton exports of 51.6 per cent. Cotton production and exports in MY 2005 were at the highest levels ever achieved by the United States. However, these increases in US production and exports did not translate into an increase in the US share of the world cotton market. As can be observed in Table 3 above, the US shares of world exports and world production have stayed at about 40 per cent and 20 per cent, respectively, during the period analyzed. This means that cotton producers and exporters in the rest of the world were increasing their levels of production and exports at the same time. The increases were to such an extent that, collectively, the foreign producers and exporters maintained their share of the world market.

10.138 Also, unlike the situation found by the original panel, these increases in the absolute levels of US production and exports did not take place during a period when the market price of US upland cotton producers was declining. The original panel noted that prices received by US upland cotton producers decreased by 34 per cent between MY 1998 and MY 2001. The implication was that US subsidy payments could explain why US cotton production was increasing despite declining market revenues. Our examination of the prices received by US cotton producers in the more recent period does not show an equally dramatic decline. Instead, the average US farm price during the period MY 2002-2005 was 14.3 per cent higher than the average US farm price during the period MY 1999-2002.[410] In the case of upland cotton spot market prices, the average for MY 2002-2005 was 9.6 per cent higher than the average for MY 1999-2002. No doubt this higher average price of cotton in MY 2002-2005 has been driven by the spike in MY 2003.

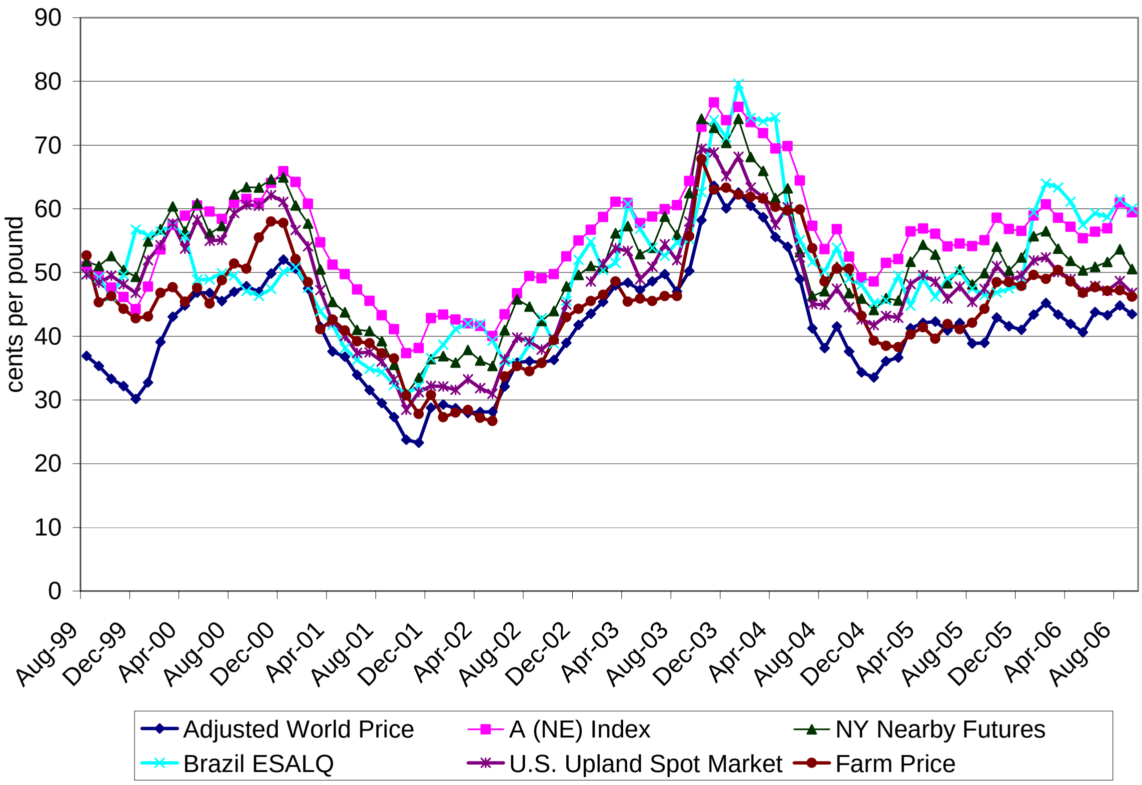
[410] This is based on the unweighted marketing year averages of US farm and spot market prices compiled by Brazil in Exhibit Bra-452.

10.139 Nevertheless, these two factors – first, that other major cotton producers were increasing their production and exports at the same time as US producers and second, that prices received by US cotton producers were not declining dramatically during this period – make it more difficult to discern a pronounced temporal coincidence between the US subsidies, the increase in US cotton exports and the drop in world market prices.

10.140 With respect to the trend in world cotton prices, the original panel found "a broad decline in the overall level of these price trends from 1996 through the beginning of calendar year 2002, with intermittent peaks and valleys".[411] The original panel qualified this observation of price trends by noting that this is not, in and of itself, conclusive for a determination of price suppression. However, in the panel's causality analysis, the decline in world cotton prices was one of the elements it relied on in finding a temporal coincidence of suppressed world market prices and the price-contingent US subsidies.

10.141 An examination of recent world price trends does not show a similar broad decline. Instead, over the period MY 2002-2005, there have been intermittent peaks and troughs. Prices rose strongly from MY 2002 onwards with the A-index reaching a peak of 76.7 cents per lb in November 2003.[412] Prices started a sharp decline thereafter with the A-index falling to a low of 48.6 cents per lb. in December 2004. Prices have since climbed with the A-index reaching about 60 cents per lb. at the start of MY 2006. The absence of a broad decline in prices persists even if one takes a slightly longer period of analysis – from MY 1999-2005 – as Brazil does in its Submission (see Figure 2).

Figure 2: Monthly US and World Upland Cotton Prices



Source: Brazil's First Written Submission, Figure 4.

[411] Panel Report, *US – Upland Cotton*, para. 7.1288.
[412] The price data is from Exhibit Bra-452.

10.142 In its analysis of price trends, the original panel noted that the world price (the A-Index) during MY 1999-2002 was, on average, 29.5 per cent below its 1980-1998 average. In the current dispute, Brazil extends the price comparison to the MY 2002-2005 period and notes that the A-index remains well below historic price levels. The average A-Index price during MY 1980-1998 was 73.36 cents per pound, while the average during MY 2002-2005 was 58.92 cents per pound.[413] However, this historical comparison is subject to an important objection. The United States has argued that the A-Index has trended downwards for more than a quarter of a century, well before the FSRI Act came into effect.[414] The long-term decline in non-oil commodity prices is in fact one of the recurring themes of development and international economics. Thus, it is not clear to us that the comparison between the average price during the 1980-1998 period and the average price afterwards is as important as Brazil makes it out to be.

10.143 Therefore, while the original panel appears to have attached particular significance to the coincidence of a substantial increase in the US share of world exports and the decline in world market price of upland cotton[415], such a coincidence is not clearly discernible from the data for the years since the period considered by the panel.

10.144 Brazil attempts to discount some of these facts by arguing that the very fact that the level of planted acreage is stable and that the United States has a consistently high share of world production and of world exports is evidence of a coincidence of subsidies and price suppression because, but for those subsidies, these shares of world production and exports would be significantly lower. Similarly, Brazil argues that the increase in absolute volume of production and exports is evidence of a coincidence between subsidies and price suppression because, absent the subsidies, this increase would not have occurred.[416]

10.145 The question before the Panel is whether, as argued by Brazil, "a discernible temporal coincidence" of subsidies and significantly suppressed prices exists that supports a finding of a causal relationship between subsidies and significant price suppression. To posit that where prices and US shares of production and exports have not increased but remained relatively stable this is the result of the effect of subsidies is to assume the very conclusion that must be demonstrated. The fact that stable shares of world production and exports coincide with the payment of subsidies cannot in and of itself establish the existence of a causal relationship between the subsidies and significant price suppression.

10.146 The Panel concludes from its analysis of developments during the period MY 2002-2006 concerning the factors relied upon by the original panel in reaching its conclusion regarding the existence of a temporal coincidence between subsidies and significantly suppressed world market prices for upland cotton, that it is more difficult to find support in these factors for a finding that the effect of the subsidies is significant price suppression under current conditions than at the time of the

[413] Brazil's First Written Submission, para. 101.
[414] US First Written Submission, para. 287.
[415] Panel Report, *US – Upland Cotton*, para. 7.1352:

"Even taking into account that in 1998, production may have been driven downward by drought and high levels of crop abandonment and that, in 2001, production may have been driven upward by high yields, *we see a strong temporal coincidence between the United States subsidies and the drop in United States prices, the drop in – and suppression of – world market prices, the increase in United States exports*." (emphasis added)

We also note the panel's statement in paragraph 7.1303 of its report that "[t]he effects of these three price-contingent subsidies are, in our view manifest in the movements in upland cotton prices in the same world market during the reference period."
[416] Brazil's Rebuttal Submission, paras. 202-203.

original panel's analysis. At the same time, the Panel recalls that the purpose of its inquiry under Article 6.3(c) of the *SCM Agreement* is to determine whether, but for the subsidies at issue, the world market price for upland cotton "would have increased [significantly], or would have increased by [significantly] more than was in fact the case".[417] The fact that recent years have not witnessed the sharp decline in the world market price for upland cotton that occurred during the period considered by the original panel does not necessarily mean that there is currently no price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*.

9. Alleged gap between long-term costs of production and market revenues of US upland cotton producers

(a) Main arguments of the parties

10.147 **Brazil** submits that the widening gap between the total long-term costs of production and the market revenue of US upland cotton producers demonstrates that much of US upland cotton production would not be economically viable without the marketing loan and counter-cyclical payments. During the period MY 2000-2005 US upland cotton producers would have lost US$663 per planted acre, or US$9.84 billion in aggregate, without the marketing loan and counter-cyclical payments.[418] Brazil also argues that a survey conducted by the International Cotton Advisory Committee (ICAC) shows that the United States is a high-cost producer relative to other countries producing upland cotton. Brazil considers that the data on costs of production of US upland cotton producers shows that, in the absence of the marketing loan and counter-cyclical payments, many US upland cotton producers would have had to discontinue growing upland cotton and switch to alternative crops. US supply would have been, on average, 15-16 per cent lower in the absence of marketing loan and counter-cyclical payments over the period MY 2000-2005.[419]

10.148 Brazil submits that the United States cannot sidestep the gap between upland cotton revenue and total costs of production by reference to whole-farm or off-farm revenues. Brazil recalls that the United States made a similar argument in the original proceeding and submits that, like the original panel, this Panel should reject the argument of the United States that whole-farm costs and income, including off-farm income, are relevant to an assessment of the effects of the marketing loan and counter-cyclical payments.[420] The United States has not answered the question why a farmer would cross-subsidize the production of upland cotton. The fact that US upland cotton producers supplement their income with off-farm work is irrelevant to an examination of costs and returns in respect of upland cotton.[421]

10.149 Brazil also submits that while variable costs of production may play a role in the short-term, US upland cotton producers must meet both short-term variable costs of production and long-term

[417] *Supra*, para. 10.49. The Panel also recalls the observation of the original panel that "[t]he fact that prices dropped from 1996 through the beginning of 2002 is relevant. However, it is not, in and of itself, conclusive for a determination of price suppression. Nor is the increase from 2002 conclusive that a determination that any price suppression necessarily ceased at that point. We must examine whether these prices were suppressed, that is, lower than they would have been without the United States subsidies in respect of upland cotton". Panel Report, *US – Upland Cotton*, para. 7.1288.

[418] The data and calculations provided by Brazil in support of this assertion are contained in Exhibit Bra-477. Brazil illustrates this widening gap in a graph in Figure 13 of its First Written Submission. Brazil argues that without the Step 2 programme, the effect of which was to raise the domestic price of upland cotton, this gap between costs and revenues would have been even larger. Brazil's First Written Submission, para. 161.

[419] Brazil's First Written Submission, paras. 156-164.

[420] Brazil's Rebuttal Submission, paras. 249-253; Brazil's Oral Statement, para. 83.

[421] Brazil's Comments on US Response to Panel Question 59, para. 141.

total costs of production to be economically viable and continue upland cotton farming.[422] Therefore the evidence provided by Brazil, which shows that US upland cotton producers do not cover their long-term costs of production, is sufficient to establish a causal relationship between the subsidies at issue in this proceeding and significant price suppression. Brazil also submits that the United States mischaracterizes certain cost items – land, labour and capital recovery costs – as fixed costs when these costs, which vary with the amount of production in any given year, are in fact variable costs. If these items are correctly treated as variable costs, a significant number of US upland cotton producers are not able to cover their variable costs of production, nor do they expect to be able to cover their variable costs of production.[423] [424]

10.150 Based on a comparison of expected returns and total costs of growing cotton, corn or soybeans on a base acre of cotton in MY 2005, Brazil submits that without marketing loan and counter-cyclical payments US upland cotton producers would have had every incentive to switch to production of the other two crops. Similarly, a comparison of expected returns and total costs of growing cotton, corn or soybeans on a base acre of cotton in MY 2007 shows that the effect of the marketing loan and counter-cyclical payments is to mute significantly the incentives that would otherwise exist for upland cotton producers to switch to production of soybeans and corn. A comparison of average returns and total costs associated with planting cotton, corn or soybeans on a cotton base acre in MY 2002-2006 indicates that only US subsidies made growing cotton during MY 2002-2006 economically rational and very profitable and that in the absence of cotton marketing loan and counter-cyclical payments, cotton farmers would have sustained significant losses whereas growing corn or soybeans would have been profitable.[425] Brazil argues that the conclusion that in the absence of the marketing loan and counter-cyclical payments it would be far more profitable for US upland cotton farmers to switch to production of corn and soybeans holds even if one makes a comparison of expected and actual returns with cash costs or with variable costs.[426]

10.151 Brazil submits that the cost data relied upon by the United States in support of the proposition that most US cotton producers are able to cover both variable and total costs of production is based on MY 2003 when prices were at their highest level in the past ten years. The fact that even with these high prices eight per cent of US production did not cover variable and total costs of production suggests that in MY 2004 and MY 2005, when prices were much lower, a far greater percentage of US producers were unable to cover variable and total costs of production. Brazil refers in this regard to data on losses made by US upland cotton producers in MY 2004-2005 and to projections of lower yields and increased costs for MY 2006. In any event, instead of breaking cotton farms into arbitrary

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[422] Brazil considers that long-term total costs are highly relevant to an assessment of the effects of the marketing loan and counter-cyclical payments even if the Panel uses only MY 2005 as a reference period. Brazil's Response to Panel Question 71.

[423] Brazil's Rebuttal Submission, paras. 257-277 and Figure 10. Brazil submits in this respect that US variable costs of production are expected to be significantly higher in MY 2006-2008 than in MY 2003-2005 and that expected variable costs are projected to exceed expected market revenue in MY 2006-2008. Brazil's Rebuttal Submission, paras. 276-277. See also Brazil's Oral Statement, paras. 87-89.

[424] In addition, Brazil considers that the United States has provided a misleading presentation of costs of production data insofar as certain data offered by the United States excludes the costs of ginning and the revenues associated with cottonseed. USDA costs of production shows that the costs associated with ginning are far higher than the market value of cottonseed. The USDA data also does not make a distinction between costs associated with producing upland cotton lint and costs associated with cottonseed. Nor did the original panel make such a distinction. Brazil's Rebuttal Submission, paras. 279-281.

[425] Brazil's Oral Statement, paras. 63-78, Figures 1-6 and Exhibits Bra-634 and Bra-648.

[426] Brazil's Comments on US Oral Statement, paras 15-17, Figures 7-12, Exhibit Bra-667 and Exhibit Bra-668.

cost groups, the Panel should adopt the same approach as the original panel and rely upon national average cost of production data.[427]

10.152 Brazil considers that in criticizing the use made by Brazil of the total cost of production data published by USDA the United States makes an argument that was already rejected by the original panel. The argument that total cost data is not an appropriate indicator of the financial viability of upland cotton farmers because of the inclusion of non-cash costs is in contradiction with basic economic and accounting principles. As explained by USDA, non-cash costs are real economic costs and are part of the total costs that are taken into account by farmers when making their production decisions. The criticism by the United States also ignores the fact that the USDA total cost data reflects valuation methodologies that were conceived by the American Agricultural Economics Association and implemented by USDA.[428]

10.153 Brazil also submits that the evidence does not support the US argument that low-cost producers would expand production and thus offset the decline of production caused by the exit of high-cost producers.[429]

10.154 The **United States** argues that Brazil does not demonstrate that US producers would switch to alternative crops in the absence of payments under the marketing loan and counter-cyclical payment programmes. The gap between total costs and revenues of growing cotton does not support the argument that cotton plantings and production would have been lower but for the marketing loan and counter-cyclical payments. *First*, total costs and returns of growing cotton do not explain short-term planting decisions and do not alone explain long-term farming decisions. Short-term decisions on whether to plant cotton or an alternative crop are not made by reference to long-term costs of production but by reference to variable costs of production. While in the long run total costs may be relevant to decisions on whether to continue cotton farming, such decisions are made taking into consideration whole-farm costs and revenues, including off-farm revenues, and are not based only on the costs of producing cotton.[430] *Second*, US cotton producers have not only covered their variable costs of production but also a substantial portion of their total costs from cotton revenues in MY 2002-2005.[431] The evidence also shows that over the period of the FSRI Act of 2002, costs per pound of cotton have declined steadily.[432]

10.155 The United States submits that Brazil has not shown that US upland cotton producers are unable to meet their variable costs of production without marketing loan and counter-cyclical

[427] Brazil's Oral Statement, para. 84; Brazil's Comments on US Response to Panel Question 59, paras. 142-149.

[428] Brazil's Comments on US Response to Panel Question 59, paras. 150-160.

[429] Brazil's Oral Statement, para. 85.

[430] The United States asserts that Brazil also fails to take into account the diversity of US cotton producers and the possibility that any exit of high-cost producers would be offset by the expansion of more efficient low-cost producers. US First Written Submission, para. 298.

[431] US First Written Submission and Exhibit US-47. The United States explains that the graph in paragraph 300 of its First Written Submission presents costs of production in two ways:

> "For both variable and total costs, the upper line is the cost for *both* cotton and cottonseed (i.e. for 'raw ' or seedcotton). The farm price shown above, however, is the price for cotton *lint*, which is the product at issue here. To calculate costs for cotton lint only that can properly be compared to the upland cotton farm price, the United States has subtracted ginning costs from variable costs of production. This is consistent with the practice in the United States of ginning costs being paid for out of the proceeds gained by the gin from sale of the cottonseed that is separated out in the ginning process. The bottom line for both variable and total costs shows costs net of ginning." US First Written Submission, para. 301 (original emphasis)

[432] US First Written Submission, paras. 302.

payments programmes. *First*, the economic literature does not support Brazil's argument that the opportunity costs of unpaid labour, land costs and capital recovery costs should be treated as variable cash costs.[433] *Second*, prices were sufficiently high to cover variable costs of production and, in many cases, total costs of production both on a national and a regional basis. A comparison of upland cotton lint costs and returns shows that even classifying paid labour as a variable cost, US upland cotton producers have been able to more than cover their operating costs and much of their overhead costs over the period 1999-2005.[434] In addition, US producers are forecast to more than cover operating costs as well as a large share of total costs.[435] Contrary to Brazil's argument, the fact that the cost of production data represents averages understates the cost effectiveness of US producers because, as shown by data for 2003, the overwhelming majority of US production took place on farms that not only met their variable costs but also their total costs and only high-cost producers, accounting for approximately 8 per cent of US production, did not cover their operating costs.[436] *Third*, ginning costs are appropriately excluded from the calculation of costs of production for US upland cotton lint in light of the common practice in the United States of ginning costs being paid out of the proceeds gained by the gin from the sale of the cotton seed separated out in the ginning process.[437]

10.156 The United States argues that Brazil has no basis to contest the economic literature showing that long-term decisions about upland cotton production take total costs of producing upland cotton into account as one of many other factors including off-farm income and income from other sources. Brazil's argument that income from other sources is not legally or factually relevant to an analysis of US upland cotton production costs and returns misses the point because the question before the Panel is not one regarding the balance of upland cotton costs of production and returns. The question before the Panel is whether the marketing loan and counter-cyclical payments are causing significant price suppression of the world market price for upland cotton. An analysis, such as Brazil's, that purports to show that US producers would make different long-term production decisions affecting price in the absence of marketing and counter-cyclical payments is not valid if it disregards how US producers actually make these decisions.[438]

10.157 The United States also submits that Brazil has yet to provide evidence that even if some US upland cotton producers were to decide to exit cotton farming in the absence of marketing loan and counter-cyclical payments, this would necessarily result in any significant decline in US cotton plantings.[439]

10.158 With respect to the comparisons offered by Brazil of expected market revenue and total costs of production of growing cotton, corn or soybeans in MY 2005 and MY 2007 and of the average market revenue and total costs of production in MY 2002-2006, the United States submits, *first*, that variable costs, not total costs of production, are the relevant measure in assessing year-to-year

[433] US Rebuttal Submission, paras. 326-332.
[434] US Rebuttal Submission, paras. 334-335 and Exhibits US-89 and US-90.
[435] US Rebuttal Submission para. 336 and Exhibits Bra-575 and Bra-479.
[436] US Rebuttal Submission, para. 337. As part of its Opening Statement, the United States submitted a table that contains figures slightly revised from the original table in paragraph 337 of the US Rebuttal Submission due to a calculation error. US Opening Statement para. 72 and Exhibit US-119. The United States submits in this respect that with respect to 92 per cent of US production of upland cotton Brazil's theory of a gap between costs and revenues fails as a matter of fact.
[437] US Rebuttal Submission, paras. 338-343.
[438] US Rebuttal Submission, paras. 344-347. See also US Response to Panel Question 59, para. 136: "The fact that US upland cotton farmers actually make their decisions about whether or not to close their operations based on the total costs and revenues *for the farm* as a whole – including revenue from *all* crops as well as from off-farm sources – is necessarily a relevant and important consideration." (emphasis original)
[439] US Rebuttal Submission, para. 348.

planting decisions.[440] *Second*, for the entire period MY 2002-2007 US cotton farmers expected to meet or exceed their variable costs of planting cotton, corn or soybeans, and in terms of the expected market revenues above variable costs, cotton was the most attractive option in at least three of these years.[441] *Third*, while total costs may be a relevant consideration in long-run decisions, Brazil's analysis of total costs is flawed in that Brazil regards total costs of growing cotton as the only consideration for a farmer in deciding whether to continue or to exit farming altogether and in that Brazil includes imputed opportunity costs in its assessment of total costs. In most years under the FSRI Act of 2002 US farmers actually met and exceeded variable costs and even total cash costs. Examining the cost data properly, the cumulative returns over the period 2000-2005 were a positive return of US$161 per acre instead of the cumulative US$663 deficit alleged by Brazil. For the period MY 2000-2006, the cumulative returns were a positive US$131 per acre instead of the US$837 deficit per acre alleged by Brazil.[442]

10.159 The United States considers that the use of total cost data published by USDA is not an appropriate means of assessing the financial viability of farms, let alone of an entire agricultural sector. *First* the total cost data is an average that obscures the fact that the vast majority of US production occurs on farms that are highly profitable.[443] *Second*, even with respect to the small fraction of US production that is not profitable Brazil's argument is not conceptually sound. Crop-specific data published by USDA cannot be used to reach conclusions on the financial viability of cotton farmers who rely on many sources of income and incur various kinds of costs.[444] Moreover, USDA data includes imputed opportunity costs, which are not necessarily costs which farmers must pay off in order to avoid having to close down their businesses.[445]

(b) Evaluation by the Panel

10.160 The question before the Panel is whether a comparison of costs of production of upland cotton and market revenues of US cotton producers supports a finding that marketing loan and counter-cyclical payments are causing significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement.* Brazil argues, in this regard, that because of the widening gap between the costs of production and the market revenues of US upland cotton producers much of US upland cotton production would not be economically viable without marketing loan and counter-cyclical payments. The United States considers that Brazil's cost of production analysis is fundamentally flawed and that a proper examination of the data supports the argument of the United States that marketing loan and counter-cyclical payments are not having any significant price suppressing effect.[446]

10.161 The Panel considers that the principal issues on which the parties disagree include the following. *First*, whether variable costs or total costs should be used to measure the gap between the

[440] US Comments on Brazil's Oral Statement, paras. 60-65.

[441] US Comments on Brazil's Oral Statement, paras. 66-72, Annex I and Exhibit US-139.

[442] US Comments on Brazil's Oral Statement, paras. 73-77 and Exhibit US-124.

[443] US Response to Panel Question 59, paras. 140-141. The United States refers in this respect to the USDA survey data for MY 2003 which shows that 92 per cent of US production was on farms on which total revenue exceeded total costs, including the items of economic opportunity cost published by USDA. The United States asserts that, in view of the substantial spread between the total cost figures and the market revenue figures for low- and mid-cost producers, the fact that prices were lower in MY 2004 and 2005 than in MY 2003 does not undermine the conclusion that 92 per cent of US upland cotton production occurs on farms that are profitable.

[444] US Response to Panel Question 59, paras. 143-146.

[445] US Response to Panel Question 59, paras. 148-149.

[446] As noted above, Brazil submits that in the period MY2000-2005 US upland cotton producers would have lost US$663 per acre without marketing loan and counter-cyclical payments. The United States argues that the cumulative returns were a positive US$161 per acre instead of the cumulative US$663 deficit alleged by Brazil.

market revenues of US cotton producers and their costs of production. *Second*, whether the examination of total costs relevant to long term decisions, such as whether to exit cotton farming, should be limited to cotton-specific costs or whether account should also be taken of whole-farm costs and revenues. There are, in addition, disagreements between the parties about the composition of variable costs, i.e. whether certain items (land, unpaid labour and capital recovery costs) should be included as variable costs and whether total costs should include imputed values for opportunity costs or whether they should be limited to cash costs. The United States also claims that US cotton producers have not only covered their variable costs but also a substantial portion of their total costs from cotton revenues in MY 2002-2005.

(i) Description of the data on commodity cost and returns

10.162 We begin our analysis with a description of the data that has been provided to the Panel. Data on cotton production cost and returns on a per acre basis covering MY 2002-2005 has been provided by both Brazil and the United States. The data is from the Commodity Costs and Returns estimates of the Economic Research Service (ERS) of USDA. The ERS describes these costs and returns estimates as: [447]

> "These cost and return accounts are 'historical' accounts based on the actual costs incurred by producers. The costs and returns estimation program uses surveys conducted about every 4-8 years for each commodity as part of the annual Agricultural Resource Management Survey (ARMS), and methods that conform to standards recommended by the American Agricultural Economics Association (AAEA)."

These standards or recommendations are contained in the Commodity Costs and Returns Estimation Handbook authored by the AAEA Task Force on Commodity Costs and Returns.[448]

10.163 One difficulty with this data is that it decomposes costs of production into "allocated overhead" and "operating" costs rather than into the economic concepts of fixed and variable costs. This stems from the difficulty, which the AAEA Task Force recognizes, in labelling costs as fixed or variable. Instead, the AAEA Task Force recommends that costs should be categorized according to whether they are associated with expendable factors or the services of capital assets. The AAEA Task Force also recommends that all the costs of expendables be allocated to "operating costs" and that all other costs be included in "allocated overhead".[449] These recommendations appear to have been followed in the ERS methodology for estimating commodity costs and returns.[450]

10.164 In their analysis of these Commodity Costs and Returns estimates of the ERS, both Brazil and the United States use "operating" and "variable" costs interchangeably. They also use "overhead" and "fixed" costs interchangeably. While much of the debate between the parties is about the relevance of variable and total costs (the sum of variable and fixed costs) to the planting decision by farmers, the cost data that is relied upon by both parties is actually classified as "operating" and "overhead".

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[447] Description from the USDA's Economic Research Service website: http://www.ers.usda.gov/Data/CostsAndReturns/.

[448] Exhibit US-88.

[449] Commodity Costs and Returns Estimation Handbook, pages 1-4 and 1-5.

[450] US Response to Panel Question 58, para. 126. The United States explains that the US categorization of "operating" (or "variable") costs differs in some ways from that used by ERS. *First*, the United States, to be more conservative, includes hired labour as an operating cost. *Second*, the United States adjusts both ginning costs and cottonseed revenue to isolate the costs and revenues for the "subsidized" product. See US Response to Panel Question 58, para. 129.

(ii) Whether certain items (land, unpaid labour and capital recovery costs) should be included as variable costs

10.165 Brazil disputes the inclusion of land, labour and capital recovery costs in fixed costs and argues that these costs are variable costs.[451] The United States argues that it is the long-standing practice of USDA and agricultural economists to treat land, labour, and capital recovery costs as fixed costs.[452] The United States considers that there is no basis in the economics literature for Brazil's assertion that an imputed value for the opportunity cost of unpaid labour should be treated as a variable cash outlay.[453] Following the AAEA Task Force guidelines, the United States maintains that a determinative factor as to whether an input cost can be classified as a fixed or a variable cost is whether the input is an expendable or a capital input. Since land is clearly a capital input, it should be classified under fixed costs.[454] The United States adopts a similar approach to the treatment of capital recovery costs.[455]

10.166 The Panel notes the difficulty highlighted by the AAEA Task Force in classifying the many elements of commodity production costs into variable and fixed costs. While variable and fixed costs are the economically relevant cost concepts in this dispute, there appears to be no unambiguous way of arriving at such a classification. The AAEA Task Force has chosen to take a less difficult tack, which is to classify costs according to whether they are associated with expendable factors or the services of capital assets. While this classification of costs is unlikely to fully coincide with the economic concepts of variable and fixed costs, it is the classification that the agricultural economics profession has recommended. Accordingly, it is the method that has been used by the ERS in its collection of commodity costs and returns data. We therefore consider the inclusion of land, labour and capital recovery costs in fixed (overhead) costs as appropriate, being in accordance with the methodology recommended by the AAEA Task Force.

(iii) Cash or opportunity costs

10.167 The United States raises the issue of cash costs and their role in determining whether farmers have to "close down their businesses". Specifically, the United States argues that in the long run, the relevant comparison to make is between market return or revenue and total cash costs. The opportunity cost of factors of production for which no cash payments are made, such as land that the farmer owns, his own labour or his family's labour, are not like cash costs, which must be paid off in

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[451] Brazil submits that hired and unpaid labour vary with the amount of upland cotton planted and produced. If an upland cotton farmer grows nothing at all, he or she will not hire labour. If the farmer decides to plant upland cotton, he or she will hire labour. If he plants crops, he may well have less time to dedicate to off-farm employment the more acreage he chooses to plant. Thus, both the cost of hired labour and the imputed cost of unpaid labour vary with the amount of production. So does the cost of land, whether rented or owned by a farm operator, vary with the amount of upland cotton produced. Finally, the rate of depreciation depends on the intensity of use. Machinery and equipment that is used intensively will depreciate much more rapidly than machinery and equipment that is used less intensively. Furthermore, certain equipment used in upland cotton production, especially harvesting and ginning equipment, can be rented to other producers. Thus, the cost of capital recovery of machinery and equipment is also not entirely fixed; it can vary as a function of the farmer's production decisions. A farmer will, therefore, consider the variable costs associated with capital recovery when deciding whether or not to produce upland cotton. Brazil's Rebuttal Submission, paras. 262-266.

[452] US Rebuttal Submission, para. 326.

[453] US Rebuttal Submission, para. 327.

[454] US Rebuttal Submission, para. 328.

[455] Quoting directly from the Commodity Cost and Returns Handbook, the United States notes that capital assets are factors of production that are not used up during a single production period, provide services over time, and retain a unique identity. The term durable asset is often used to describe physical capital because the word durable denotes not temporary or long-lived. It is common in preparing cost of production estimates to assume that durables such as machinery and buildings provide a constant quality of service over their lifetime with regular maintenance. US Rebuttal Submission, para. 331.

order for farmers to avoid having to "close down their businesses". It would appear that the United States is arguing that only when total cash cost exceeds market returns would farmers "close down their businesses".[456] In addition, the United States points to the inherent difficulties involved in valuing items (such as land that the farmer owns, his own labour or his family's labour) for which there is no market transaction or cash outlay.

10.168 Brazil has clarified that the claim that it is making is that, in the long-term, if total costs incurred in producing cotton exceed market revenues from the sales of cotton, then the cotton farmer would exit cotton farming, not necessarily farming altogether.[457] Brazil considers that the argument of the United States with respect to non-cash costs squarely contradicts basic economic and accounting principles. Brazil asserts that the opportunity cost of factors of production for which no cash payments are made are nevertheless real costs.[458]

10.169 The Panel agrees with the United States that imputing values to resources for which there are no market transactions is not as reliable as direct market valuation. It is also true, however, that the methodology used by the USDA conforms to standards recommended by the AAEA, and the application of that methodology probably produces the best estimates that can be achieved. Thus, it is our view that such difficulties in imputation do not pose a problem in using the cost data from USDA to determine whether US farmers were generating enough returns from the market to make it economically worthwhile to continue planting cotton.

10.170 The Panel concurs with Brazil that the argument of the United States about total cash costs guiding cotton production decisions is not consistent with basic economic principles. The principle that resource allocation is guided by opportunity cost is a fundamental principle of economics. All resources that a farmer uses to produce cotton have a cost – which is the value that they can obtain when employed in the next best alternative. It does not matter whether the factor must be paid for in cash or not. Unless those resources used in cotton farming fetch a market return that matches their next best use, the farmer is foregoing opportunities to make better returns and would do better by moving to the next best alternative ("exiting cotton farming"). If the next best alternative is another agricultural crop like soybean or corn, exiting cotton farming will not involve moving away from farming altogether. The Panel therefore considers that opportunity costs should be included in the calculation of total costs of production.

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[456] See, e.g. US Comments on Brazil's Oral Statement, para. 75.

[457] Brazil's Comments on US Response to Panel Question 59, para. 139.

[458] Brazil quotes the following explanation from the Commodity Costs and Returns Estimation Handbook:

> "[c]ommodity costs and returns include estimates of both cash expenditures and noncash costs. Cash expenditures are incurred when factors of production are purchased or rented. Noncash costs occur when factors are owned. For example, if a farmer fully owns the land used to produce corn, he/she would have no expenditure for land rental or for loans to pay for the purchase of land. Yet, an economic cost arises. By owning the land and using it to grow corn, the farmer foregoes income from other uses of the land, such as renting it to another producer. These costs come about because production resources are limited and have alternative uses. If a farmer uses savings to pay for operating inputs, such as seed, fertilizer, chemicals, and fuel, and thus pays no interest on operating loans, the farmer still incurs an economic cost because the savings could have earned a return in another use. Likewise, the farmer has an opportunity cost of his/her labour used in the production of the commodity because it could have been used on another farm or in off-farm employment."

Brazil's Comments on US Response to Panel Question 59, para. 152.

(iv) Total or variable costs of production

10.171 Brazil submits that the widening gap between United States upland cotton producers' total long-term costs of production and market revenue over the period MY 2002-2005 demonstrates that much of US production would not be economically viable without the marketing loan and counter-cyclical payments.[459] The United States argues that total costs do not explain short-term planting decisions. Short-term decisions on whether to plant cotton or an alternative crop are not made by reference to long-term costs of production but by reference to variable costs of production.[460]

10.172 We note that both parties agree that in the short-term variable costs play a role in cotton producers' decision whether to plant cotton or not.[461] Both parties also agree that in the long-term, market revenues should be able to cover total costs of production if farmers are to continue to plant cotton.[462] It should be noted that the relevance of variable costs to production decisions in the short-term and of total costs to production decisions in the long-run is consistent with the economic literature. Given these points of agreement, the dispute between the parties is whether the question of a causal relationship between US subsidies and significant price suppression is best answered on the basis of long-run production decisions by cotton farmers or on the basis of short-run (year-to-year) planting decisions.

10.173 On this question, we recall that the original panel considered that "a medium- to longer-term examination of developments in the United States upland cotton industry" was appropriate.[463] It therefore relied upon "the divergence between United States producers' total costs of production and revenue from sales of upland cotton since 1997" as one factor supporting a finding of a causal relationship between certain price-contingent subsidies and significant price suppression:

> "Fourth, we find credible evidence on the record concerning the divergence between United States producers' total costs of production and revenue from sales of upland cotton since 1997. This supports the proposition that United States upland cotton producers would not have been economically capable of remaining in the production of upland cotton had it not been for the United States subsidies at issue and that the effect of the subsidies was to allow United States producers to sell upland cotton at a price lower than would otherwise have been necessary to cover their total costs.
>
> If market revenue alone is compared to United States upland cotton producers' total costs of production, the information before us reveals that United States upland cotton producers would on average have lost money for each planted acre in every year since MY 1998, and made a small profit in MY 1997. We do not believe the utility of the record data is fundamentally undermined by any of the criticisms levied by the United States for the purposes of this dispute, particularly as the data are calculated in accordance with a methodology which the USDA itself has deemed to be a sufficiently reliable reflection of United States upland cotton producers' costs and revenues. That the figures before us are cumulated to show a result over the six-year period from 1997-2002 also lends itself to an assessment of the medium- to longer-term examination of developments in the United States upland cotton industry. We believe that the existence of this gap between upland cotton producers' total production costs and market revenue, on the one hand, and the effect of the subsidies,

[459] Brazil's First Written Submission, paras. 156-161.
[460] US First Written Submission, paras. 293-294.
[461] US First Written Submission, paras 293-294, and Brazil's Rebuttal Submission, para. 255.
[462] US First Written Submission, para. 295, and Brazil's Rebuttal Submission, para. 255.
[463] Panel Report, *US – Upland Cotton*, para. 7.1354.

> on the other hand, was to sustain a higher level of output than would have occurred in the absence of the United States subsidies at issue."[464] (footnotes omitted)

10.174 The original panel relied on total costs of production, notwithstanding that the United States had argued that the use of an average total cost of production figure was not appropriate for constructing an annual revenue gap.[465] The panel explained its approach as follows:

> "We believe that not only coverage of variable costs, but also of fixed costs, would be necessary, at least over the medium to longer term, in order for United States upland cotton producers rationally to opt to remain United States upland cotton producers. We find support for this proposition in Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 87, 88. Only an analysis of the total cost of production takes account of the economic resources the producer invests in the product. Fixed and variable costs are the total amount which the producer incurs in order to produce the product and the total amount it must recoup, in the long-term, to avoid making losses. To the extent that the producer charges prices that do not recoup the total cost of production, over time, it sustains a loss which must be financed from some other source, or else the producer simply has to close down his business."[466]

10.175 The United States appealed the panel's decision to use total costs rather than variable costs of production.[467] The Appellate Body discussed the panel's approach to the consideration of total costs of production as follows:

> "We agree with the general proposition of the United States that variable costs may play a role in farmers' decision-making as to whether to plant upland cotton or some alternative crop, and how much of each crop to plant. From a short-term perspective, variable costs may be particularly important. However, from a longer-term perspective, total costs may be relevant. Based on the evidence before it regarding upland cotton production in the United States, the Panel concluded that 'the six-year period from 1997-2002 ... lends itself to an assessment of the medium- to longer-term examination of developments in the United States upland cotton industry'. The Panel found that 'the effect of the subsidies was to allow United States producers to sell upland cotton at a price lower than would otherwise have been necessary to cover their total costs'. In the circumstances of this dispute, we do not consider that the Panel's reliance on total rather than variable costs of production amounts to an error vitiating the Panel's analysis under Article 6.3(c)."[468] (footnotes omitted)

10.176 In comparing cotton costs and returns, the original panel considered it essential that this be done on the basis of the medium- to longer- term developments in the US upland cotton industry. We concur with this approach. Under the FSRI Act of 2002, the price-contingent marketing loan and counter-cyclical payments will be available over the lifetime of the legislation, which only lapses in MY 2007. Thus, it appears to us that the effect of the marketing loan and counter-cyclical payments on cotton farmers' production decisions could be best assessed on the basis of data covering the lifetime of the Act. Where this is not possible because a claim of "present" serious prejudice was brought before the end of the Act, the assessment of cost and return will have to be made on the basis of data covering as much of the lifetime of the FSRI Act as possible, in this instance MY 2002-2005

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[464] Panel Report, *US – Upland Cotton*, paras. 7.1353-7.1354.
[465] See e.g. Further Rebuttal Submission of the United States, (18 November 2003), paras. 116-135.
[466] Panel Report, *US – Upland Cotton*, footnote 1465.
[467] Appellate Body Report, *US – Upland Cotton*, paras. 40 and 452.
[468] Appellate Body Report, *US – Upland Cotton*, para. 453.

including projections for MY 2006. This period of time is of sufficient length to require a medium to long-term analysis. Thus, a comparison of market returns with total costs, rather than only with variable costs, is the appropriate benchmark for assessing the effects of the subsidies.

(v) The role of off-farm income

10.177 While the United States accepts that total costs may be relevant to the long-term decision as to whether to continue or to exit cotton farming, it argues that this decision is not made on the basis of a cotton-only analysis of costs and returns. Rather, whole-farm decisions will be made taking into consideration whole-farm costs and returns, including off-farm revenues.[469] The United States considers that the question of "off-farm income" is important because it bears on Brazil's ability to prove that without marketing loan and counter-cyclical payments, US producers would exit the business of upland cotton farming altogether.

10.178 The United States points to two studies that note the increased prevalence of off-farm employment and off-farm income for farm households in the United States.[470] Brazil does not dispute these studies or this trend for US agriculture as a whole. However, Brazil points out that the studies submitted by the United States suggest that off-farm income is of particular importance for small farms. Moreover, according to some studies, larger farms account for most US agricultural production.[471] Finally, Brazil refers to the original panel's conclusion that off-farm income or income from growing other crops is not relevant to the dispute.

10.179 In addressing the argument of the United States concerning the relevance of what it termed "off farm income", the original panel stated:

> "We disagree with the United States that an examination of United States upland cotton producers' 'off farm income' may be a legally relevant consideration in the examination before us. We are considering costs and market revenues in respect of upland cotton. Our examination is one of the upland cotton industry. We find support for this proposition in the references to 'subsidized product' and 'like product' in Article 6.3(c) of the *SCM Agreement*, and contextual support in such references in Article 15 of the *SCM Agreement*. We are inquiring into whether, in respect of upland cotton production, United States producers' revenues in respect of upland cotton were insufficient to sustain their total costs incurred. We are not looking into the possibility of cross-subsidization or cross-financing of insufficient market revenues for upland cotton that may have come from other United States industries. Indeed, the very fact that the United States relies on such cross-subsidization as a possible source of revenue would tend to support the proposition that upland cotton producers would have lost money over the longer term if they were involved in upland cotton production alone. If the infrastructure of United States upland cotton production supports the 'off farm income' then the subsidies are supportive of that income as well. If the infrastructure of United States upland cotton production does not support 'off farm income', the producer need not produce upland cotton. However, we have seen, as a factual matter, that United States producers continue to produce upland cotton, and still receive subsidies in relation to production."[472]

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[469] US First Written Submission, para. 295.

[470] Dimitri, Carolyn et. al., "The 20th Century Transformation of US Agriculture" and Hoppe, Robert A. and Korb, Penni, "Understanding US Farm Exits. Economic Research Report 21" June 2006, p. 20 (Exhibit US-46).

[471] Brazil's Comments on US Response to Panel Question 59, para. 141.

[472] Panel Report, *US – Upland Cotton*, footnote 1470.

10.180 For our part, we have turned to the two studies cited by the United States. The United States describes one of the studies (Dimitri, et al.) as an analysis of changes in US farm structure over the 20th century, and quotes a specific section of it:[473]

> "[A]bout a third of farm operators worked off the farm for at least 100 days in 1930. ... By 1970, more than half of farms had off-farm income, and by 2000, 93 per cent of farms earned off-farm income. Off-farm work has played a key role in increased farm household income; while farm household income was once below the national average, in 2002 it exceeded the national average by nearly US$8,000."

The United States uses this quotation to substantiate its argument about the growing importance of off-farm income in US farm operators' income.

10.181 The second study cited by the United States (Hoppe and Korb) looks at the link between off-farm income and the decision to exit from farming. The United States quotes the following passage from the study (to be found on page 20) and underscores the last sentence:[474]

> "Off-farm work has become important to farm operators. About one-third of farmers have worked off the farm at least 200 days per year—essentially fulltime— since 1978. Off-farm work could hypothetically affect exits in two ways. First, off-farm work may be the first step in an exit from farming, which would be reflected in higher exits for farms the operators of which work off-farm. Second, off-farm work might lower the probability of exit by providing farm operator households with another source of income."

10.182 In the Panel's assessment, the study cited by the United States appears ambivalent about the role of off-farm income in farm exit. On the one hand, having a source of off-farm income could be a factor that reduces the likelihood of exit from farming. Alternatively, finding off-farm work may be the first step to exit from farming. In other words, the increasing importance of off-farm income in the US agricultural sector may just be reflecting the long-term exit of workers from that sector.

10.183 The Panel finds stronger evidence of this ambivalence in the very next paragraph of the study in which the authors explain that the econometric model they used to estimate the impact of off-farm income on the likelihood of farm exit supports both hypotheses.[475]

> "The days-of-work model supports both hypotheses (table 8). On the one hand, working full-time off-farm is associated with a slightly higher exit probability than either of the alternatives (hypothesis 1). On the other hand, combining some off-farm work (1-199 days) with farm work leads to lower exits than working full-time on or off the farm (hypothesis 2). Note, however, that the range in exit probabilities is fairly narrow, about 2 percentage points, for any sales-age category." (footnote omitted)

10.184 Thus, while the Panel is convinced that off-farm income has grown in importance in farm operators' income, there is ample room for debate as to the implications of this for the likelihood to exit from farming. The United States emphasizes one possible implication – off-farm work might lower the probability of exit by providing farm operator households with another source of income – for which the study finds some empirical support. But to our mind, a fair reading of the study also requires us not to neglect the alternative interpretation – off-farm work may be the first step in exiting

[473] US First Written Submission, para. 295.
[474] US First Written Submission, para. 296.
[475] Exhibit US-46, p. 21.

from farming – for which the study finds equally convincing empirical support. Taking this ambivalence of the results into account, the Panel does not think that the issue of off-farm income bears as negatively as the United States believes against Brazil's ability to prove that without marketing loan and counter-cyclical payments, US producers would exit the business of upland cotton farming.

(vi) US upland cotton producers' long-term costs of production and market revenues

10.185 The Panel has relied on USDA cost of production surveys which combine total costs and total returns from upland cotton lint and cottonseed. This was the type of cost data relied upon by the original panel in making its findings about the US cost of production, "as the data are calculated in accordance with a methodology which the USDA itself has deemed to be a sufficiently reliable reflection of United States upland cotton producers' costs and revenues."[476] In this cost of production data, ginning costs were included as part of operating costs.[477]

10.186 In the present dispute, the United States asserts that market revenues should only include revenues from cotton lint and exclude returns from the sale of cottonseed. The reason for this, according to the United States, is that cotton lint is the product at issue in this dispute.[478] As a consequence of this focus on cotton lint, the United States argues that ginning costs should be excluded from the calculation of the costs of production. It claims that "this is consistent with the practice in the United States of ginning costs being paid for out of the proceeds gained by the gin from sale of the cottonseed that is separated out in the ginning process."[479]

10.187 Brazil disputes this statement, arguing that the United States has not presented any basis for this assertion that ginning costs are paid for out of the proceeds gained by the gin from sale of the cottonseed.[480] In response to Brazil's criticism, the United States submits an exhibit containing an annual survey of eight gins in the mid-south region conducted by a certified accounting firm which includes data on revenue from cottonseed sales, warehouse rebates, gain/loss on the sale of assets, mote sales, interest and other income but no category for producer fees.[481] In the view of the United States, this shows that ginning costs are not paid separately by cotton producers.[482]

10.188 While the Panel is of the view that the cost data relied upon by the original panel is a sufficiently reliable reflection of US upland cotton producers' costs and revenues, the Panel has chosen to consider the cost and revenue data in both forms. Firstly, in the form proposed by Brazil and considered sufficiently reliable by the original panel, where revenue from cottonseed and costs from ginning are both included (see Table 6A). Secondly, in the form which the United States proposes, where only revenues from cotton lint are included and the costs of ginning are excluded (see Table 6B).

10.189 Table 6A shows market revenue and total costs in the form analyzed by the original panel. Over the MY 2002-2006 period, US cotton producers' market revenue exceeded total costs of production only once, in MY 2003, when cotton prices were at their highest since MY 1997. In all other marketing years, total costs of production exceeded market revenue, sometimes by very significant margins. In MY 2002, for example, total costs exceeded market revenue by 72 per cent. Data provided by Brazil for MY 2006 suggests that total costs will continue to exceed market

[476] Panel Report, *US – Upland Cotton*, para. 7.1354.
[477] Panel Report, *US – Upland Cotton*, footnote 1468.
[478] US First Written Submission, para. 301.
[479] US First Written Submission, para. 301.
[480] Brazil's Rebuttal Submission, para. 279.
[481] Exhibit US-94.
[482] US Rebuttal Submission, para. 340.

revenue. The gap is expected to be about 115.76 dollar per acre, which would be equivalent to more than a quarter of US cotton producers' market revenue.

Table 6A: Cotton Production Costs and Returns, MY2002-2006

(US$ per acre)

Item	MY 2002	MY 2003	MY 2004	MY 2005	MY 2006
1. Market Revenue	307.83	561.72	483.49	456.69	450.29
2. Total Costs	529.02	496.74	501.51	544.23	566.05
a. Operating Costs	278.00	304.29	315.35	349.26	362.18
b. Overhead Costs	251.02	192.45	186.16	194.97	203.87
3. Revenue less Total Costs	-221.19	64.98	-18.02	-87.54	-115.76
Gap between revenue and total costs as share of market revenue	-71.9%	11.6%	-3.7%	-19.2%	-25.7%

Source: Exhibits Bra-648 and US-47.

10.190 Table 6B shows market revenue from cotton lint, total costs (*less* ginning costs) and the difference between market revenue and total costs on a per acre basis in MY 2002-2006. Over the period examined, US cotton producers' market revenue exceeded total costs of production twice, in MY 2003, when cotton prices were at their highest since MY 1997, and also in the year immediately following that. In other marketing years, total costs of production exceeded market revenue, at times by very huge margins. In MY 2002, for example, total costs exceeded market revenue by 84 per cent. Data provided by Brazil for MY 2006 suggests that total costs will continue to exceed market revenue. The gap is expected to be about 56.25 dollar per acre, which would be equivalent to about 14.7 percent of US cotton producers' market revenue in that marketing year. Cumulated over the five marketing years 2002-2006, US cotton farmers' costs of production have exceeded market revenues by an average of 227.49 dollars per acre.

Table 6B: Cotton Production Costs And Returns

(US$ per acre)

Item	MY 2002	MY 2003	MY 2004	MY 2005	MY 2006
1. Market Revenue (Cotton Lint)	257.88	489.72	414.12	392.16	381.65
2. Total Costs	473.41	408.41	403.08	440.22	437.90
a. Operating Costs (W/out ginning costs)	222.39	215.96	216.92	245.25	234.03[483]
b. Overhead Costs	251.02	192.45	186.16	194.97	203.87
3. Revenue less Total Costs	-215.53	81.31	11.04	-48.06	-56.25
Gap between revenue and total costs as share of market revenue	-83.6%	16.6%	2.7%	-12.3%	-14.7%

Source: Exhibits Bra-648 and US-47.

10.191 Thus, in both tables a significant gap exists between market revenues and total costs of production. The Panel believes that the existence of this gap between upland cotton producers' total production costs and market revenue is telling. The Panel concurs with Brazil that this data provides further evidence of the essential role played by marketing loan and counter-cyclical payments in covering US upland cotton producers' long-term total costs of production and that this data provides support for Brazil's argument that, but for these subsidies, many upland cotton producers would not have been able to continue growing upland cotton and would have had to switch to alternative crops.[484]

(vii) Other arguments

10.192 The United States makes several other arguments with respect to costs and revenue in cotton. *First*, the United States argues that US cotton producers have covered their variable costs in MY 2002-2005. *Second*, the United States submits that in almost all years they have covered most if not all of their total costs of growing cotton.[485] *Third*, the United States contends that the overwhelming majority of US production took place on farms that not only met their variable (operating) costs but also their total costs.[486]

[483] Exhibit Bra-648 does not provide an estimate of ginning costs. Two alternative estimates were calculated for this purpose: (i) the average ginning costs during MY 2002-2005 and (ii) the result of applying the compound growth rate of ginning costs over the MY 2002-2005 period. The second method yielded a higher estimate of ginning costs for MY 2006 ($128.15 per acre) compared to the first approach ($86.60 per acre). But whichever estimate is used still yields the same result that total costs (without ginning costs) exceed market revenues (cotton lint only) in MY 2006. The operating costs of $234.03 per acre shown in Table 6B are the result of removing the higher estimate of ginning costs from variable costs.

[484] Brazil's First Written Submission, para. 163.

[485] US First Written Submission, para. 300.

[486] US Rebuttal Submission, para. 337.

10.193 The first argument of the United States is certainly borne out by the data in Tables 6A and 6B. Market revenue exceeded variable costs in all five marketing years. The second argument of the United States is somewhat imprecise because the United States offers no benchmark for judging what it means by "most". What must be clear from the outset is that, on average, cotton farming operated at a loss in four of the five marketing years shown in Table 6A and three of the five marketing years shown in Table 6B. Thus, we interpret the second argument of the United States as an attempt to describe how large these losses were in those years. Table 7 attempts to be more precise about the import of this second argument of the United States. It is based on the information in Table 6A above.[487] The second row gives market revenue less operating costs, i.e. whatever is left over after paying variable costs. The third row is overhead costs. The last row gives the percentage of overhead costs that could be covered by market revenue after deducting variable costs. The second argument of the United States accurately describes what occurred in MY 2003 and MY 2004 but not what transpired in MY 2002. In MY 2005, market revenue net of operating costs is able to cover a little over half of overhead costs.

Table 7: US Overhead Costs Covered By Market Revenue, MY 2002-2006

(US$ per acre)

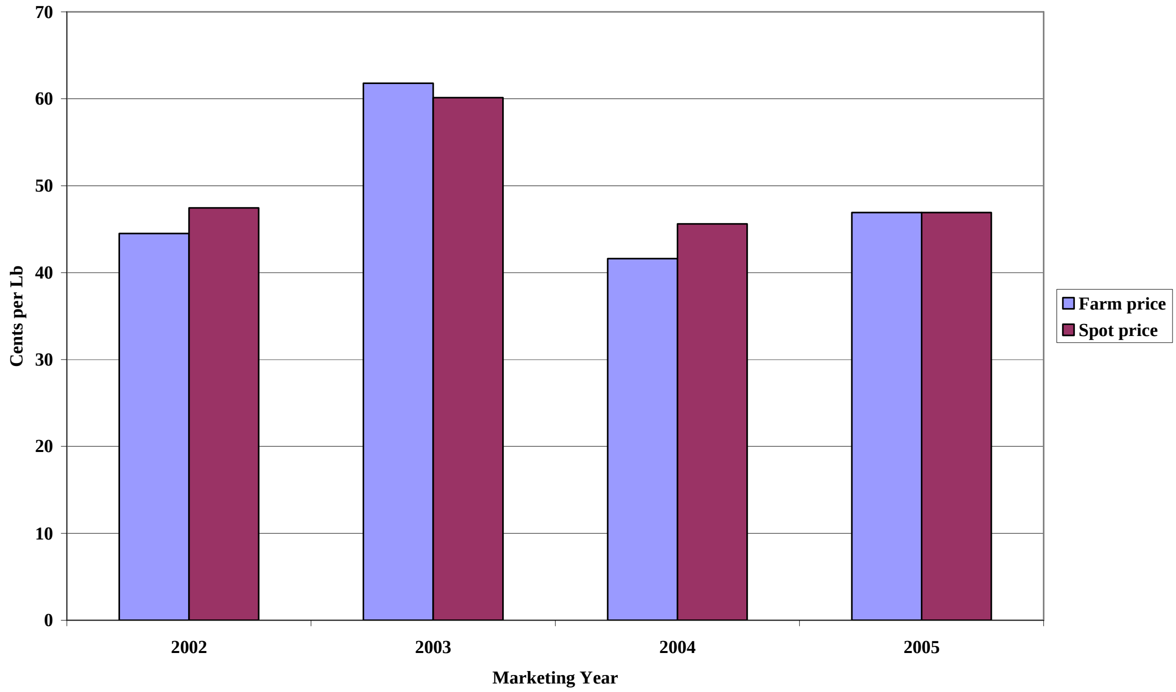
Item	MY 2002	MY 2003	MY 2004	MY 2005	MY 2006
Market Revenue (less operating costs)	29.83	257.43	168.14	107.43	88.11
Overhead Costs	251.02	192.45	186.16	194.97	203.87
Part of overhead costs covered	**11.9%**	**133.8%**	**90.3%**	**55.1%**	**43.2%**

Source: Exhibits Bra-648 and US-47.

10.194 To support its third argument, the United States points to data on the costs of cotton production, by cost group, which shows that only high-cost producers, accounting for approximately 8 per cent of US production, did not cover their total costs in MY 2003. Unfortunately, the United States does not have a similar breakdown by cost group for other marketing years. MY 2003 was the last year in which the USDA conducted a complete cost survey for upland cotton production. It is not clear how representative the results obtained for MY 2003 are since cotton prices were at their highest that year since MY 1997. To provide some perspective on how high cotton prices were in MY 2003, Figure 3 shows average farm and spot prices (taken from Exhibit US-83) from MY 2002 to MY 2005. The farm price in MY 2003 was 39 per cent, 49 per cent and 32 per cent higher than in MY 2002, MY 2004 and MY 2005 respectively. The spot price in MY 2003 was 27 per cent, 32 per cent and 28 per cent higher than in MY 2002, MY 2004 and MY 2005 respectively. Thus, it is reasonable to expect that the proportion of farmers who did not cover their total costs would be significantly higher in those years.

[487] If we use Table 6B, the portion of overhead costs covered by market revenues (less operating costs) are 14.1%, 142.2%, 105.9%, 75.4% and 72.4% for MY 2002, 2003, 2004, 2005 and 2006 respectively. The second argument of the United States accurately describes what occurred in all marketing years except in MY 2002 where only 14.1% of overhead costs were covered. In other marketing years, overhead costs were either fully covered (as in MY 2003 and MY 2004) or about three-fourths were covered (as in MY 2005 and MY 2006).

Figure 3: Average Farm and Spot Prices, MY 2002-2005



Source: Exhibit US-83.

10.195 The Panel considers, however, that these additional arguments skirt around the main issue. The Panel is making an assessment involving the medium to long-term developments in the upland cotton industry. This requires the Panel to compare market revenue not only with variable costs but with total costs. And the picture that emerges from this medium- to long-term analysis is of total costs exceeding market revenue in three of the four marketing years for which we have final data if we use Table 6A and in two of the four marketing years for which we have final data if we use Table 6B. In the Panel's view, it is likely that the total costs of production will continue to exceed market revenue in MY 2006, irrespective of whether ginning costs are excluded or not.

10.196 In conclusion, the Panel finds that there exists a significant gap between the total costs of production of US upland cotton producers and their market revenue. The Panel considers that this gap between costs and revenue, when analyzed in conjunction with the magnitude of the marketing loan and counter-cyclical subsidies and their importance as a share of the revenue of US cotton producers[488], supports the proposition that the marketing loan and counter-cyclical payments are an important factor affecting the economic viability of US upland cotton farming. The Panel therefore also considers that without these subsidies the level of US upland cotton acreage and production would be considerably lower.[489]

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[488] *Supra*, para. 10.111.

[489] Thus, based on the evidence before us, we arrive at the same conclusion as the original panel, which found that "United States upland cotton producers would not have been economically capable of remaining in the production of upland cotton had it not been for the United States subsidies at issue" and that the subsidies at issue sustained a higher level of output than would have occurred in the absence of the subsidies. *US – Upland Cotton*, paras. 7.1353 and 7.1355.

10. The economic simulation model submitted by Brazil in this proceeding

(a) Introduction

10.197 Brazil submits an economic model to simulate the effects of US subsidies on the world market for upland cotton. Brazil includes the model as part of a set of economic studies which it claims support a finding that marketing loan and counter-cyclical payments continue to cause significant price suppression. The Panel understands that the model is intended to quantify the price suppression that Brazil claims is caused by US subsidy payments. In the original dispute, an economic model was also presented by Brazil. With respect to that model, the original panel stated that:

> "we have taken [Professor Sumner's] analysis … into account where relevant to our analysis of the existence and nature of the subsidies in question, and their effects, under the relevant provision of the *SCM Agreement*, and have attributed to them the evidentiary weight we deemed appropriate."[490]

10.198 In this case, we have taken the analysis of the model one step further by considering in some detail the arguments made by the parties about the model, its assumptions and results.[491] To the extent possible, we have provided our assessment of these arguments, and based on that arrived at an overall conclusion about the simulation results.

10.199 Brazil's model is a demand and supply model in log (natural logarithm) difference form which calculates changes from an initial equilibrium where US subsidy payments are in place. The model has just two regions, the US and the rest of the world. The model simulates a counterfactual scenario: how much would be the changes to the world price, cotton production in the US and rest of the world, and cotton exports/imports of the US and the rest of the world if US subsidy payments – principally the marketing loan and counter-cyclical payments – were eliminated?

10.200 The model is simulated over the period MY 1999-2008. In order to run this simulation, assumptions have to be made about a number of parameters: the US and foreign elasticities of supply and demand and the coupling factor for marketing loan and counter-cyclical payments. Further, given that expectations about prices drive production decisions, the expected prices have to be determined as well. Three alternative assumptions are made about how farmers form price expectations: (i) the expected price is a one-year lag of actual prices and subsidy amounts, (ii) the expected price is the harvest period futures prices at the time of planting, and (iii) the expected price is equal to the FAPRI commodity outlook that is developed at the same time that growers are forming their expectations and projections.

(b) Main arguments of the parties

10.201 Using the results of the simulation model, **Brazil** asserts that were it not for the marketing loan and counter-cyclical payments, the world price of cotton would have been higher and US upland cotton production and exports would have been substantially lower. For the period MY 2002-2005, the world price would have been higher on average by 8.2 to 8.9 per cent and US cotton production and exports would have been lower on average by 15 to 16.2 per cent and 20.8 to 22.5 per cent

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[490] Panel Report, *US – Upland Cotton*, para. 7.1209 (footnote omitted).

[491] The Panel notes the transparency of the model. The full set of equations is explicitly written out and an electronic version of the simulation model, in the form of an Excel spreadsheet, has been provided to the United States and to the Panel. This gives all parties to the dispute and the Panel full access to the model, its assumptions and the results. In fact, the United States has used the Excel spreadsheet provided by Brazil to conduct alternative simulations using a different set of parameter assumptions.

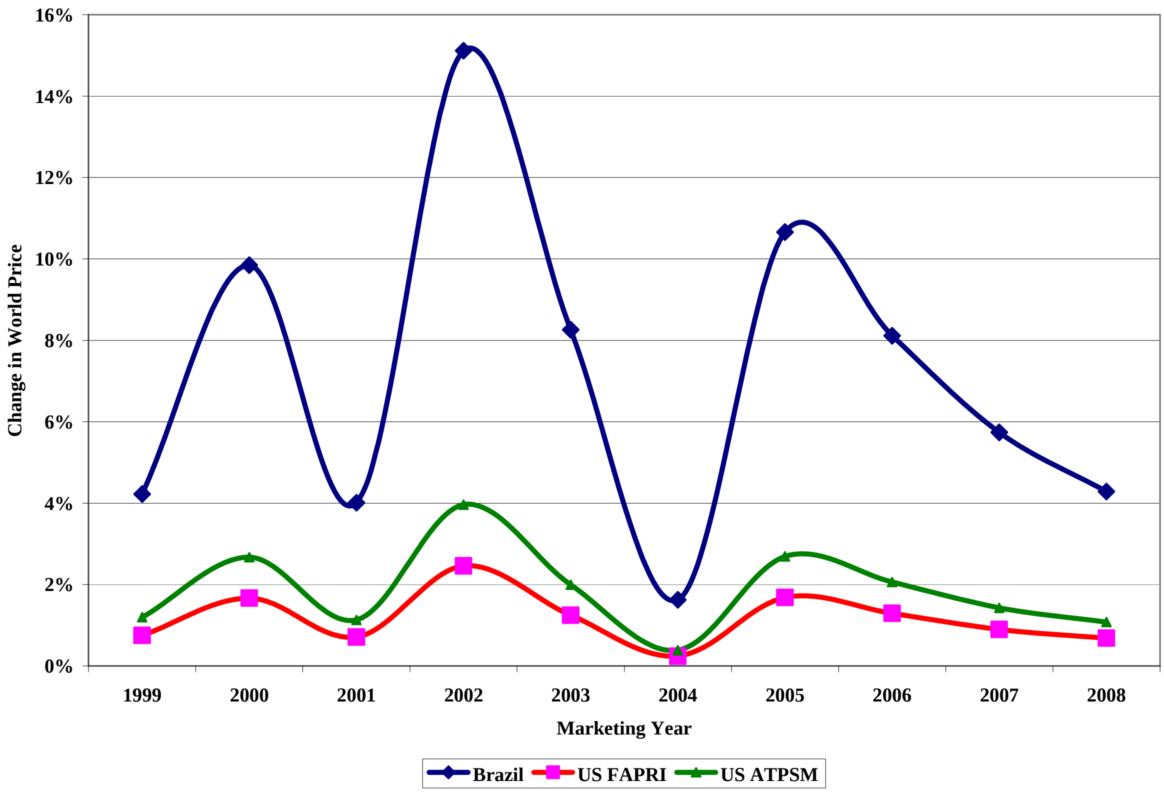
respectively, depending on the assumption made about price expectations.[492] For marketing year 2005 alone, Brazil estimates that the removal of marketing loan and counter-cyclical payments increases the world price of cotton by 9.3 to 10.7 per cent, decreases US cotton production by 16.9 to 19.4 per cent and decreases US exports by 23.5 to 26.9 per cent, depending on the proxy used for deriving revenue expectations.[493] For MY 2006-2008, Brazil projects a price increase of between 4.44 per cent and 6.05 per cent if both marketing loan and counter-cyclical payments were to be eliminated.[494]

10.202 The **United States** strongly contests these results. Utilizing the same model provided by Brazil, the United States has carried out its own simulations using a different set of parameter values derived from the US and world cotton models developed by the FAPRI as well as another set of parameter values taken from the UNCTAD-FAO Agricultural Trade Policy Simulation Model (ATPSM). Using parameter values from the FAPRI cotton model, and assuming that the expected price is a one-year lag of actual prices, the removal of marketing loan and counter-cyclical payment programmes is projected to increase the world price by only 1.41 per cent over the period MY 2002-2005 and 0.96 per cent over the period MY 2006-2008. Using the supply and demand elasticities from the ATPSM model, and assuming that the expected price is a one-year lag of actual prices, removal of marketing loan and counter-cyclical payment programmes is projected to lead to an increase in the world price of 2.26 per cent over the period MY 2002-2005 and 1.52 per cent over the period MY2006-2008.[495] The United States argues that the results for the other price expectation models are similar to that obtained from the lagged price model.

10.203 A comparison of the impact on world prices of the simulations performed by Brazil and the United States, using the one-year price lag assumption, is shown in Figure 4 below. Brazil's simulation results are shown by the top curve. The results of two US simulations are shown: the bottom curve is the outcome from using FAPRI elasticities while the middle curve shows the projected increase in the world price using the ATPSM elasticities.

[492] Brazil's First Written Submission, Annex I, para. 82.
[493] Brazil's First Written Submission, Annex I, para. 81.
[494] These are the simple averages derived from Tables 2.A.1 and 2.A.3 of Brazil's First Written Submission, Annex I.
[495] US First Written Submission, Annex 1, paras. 3-4.

Figure 4: Simulation Results Using Different Parameter Assumptions



10.204 The disagreement between the parties relates to two issues. The first issue has to do with adequacy of the model itself. The second issue has to do with the appropriate choice of parameter values – primarily demand and supply elasticities. Although we have tried to treat each issue separately, it is important to note that the two issues are closely related.

(i) *Structure of the model*

10.205 There appear to be several criticisms by the United States against the model submitted by Brazil. *First*, the model is based on a simpler and more reduced formulation than the FAPRI model and abandons critical FAPRI parameters.[496] The United States notes, in this respect, that in the original proceeding, in which Brazil also submitted a model, Brazil emphasized the similarity of its model with the FAPRI model. *Second*, as a consequence of this more simple and reduced formulation, the model is unable to take cross-commodity impacts and cross-price elasticities into account, potentially leading to biased price effects.[497] *Third*, Brazil's model does not allow for changes in cotton stock levels and has no stock equation, which is another problem with the model that will tend to accentuate price changes.[498] *Fourth*, the United States also objects to the way in

[496] US Rebuttal Submission, Annex I, para. 4.
[497] US Rebuttal Submission, Annex I, para. 4. See also Statement of Dr. Joseph W. Glauber, paras. 3-4.
[498] US Rebuttal Submission, Annex I, para. 4.

which different types of government payments are modelled differently, although they operate in the same way, or are directly incorporated in the revenues of the producers.[499]

10.206 Brazil's defence is that the far more straightforward model it has used can be readily focused specifically on effects in cotton markets and the removal of cotton subsidies alone.[500] Brazil explains that this approach would make the analysis more accessible to other parties and to the Panel. This single purpose use of the model – to address the question of significant price suppression of US subsidies – also explains its use of parameters that were more applicable to the case at hand rather than "all-purpose—one size fits all" parameters that are imbedded in the FAPRI system.[501]

(ii) Parameters of the model

10.207 The United States argues that many of the parameter values chosen by Brazil are "inappropriate" and "bias" the effects of the removal of US cotton subsidies on world market prices.[502] The United States contends that the parameter values chosen by Brazil differ substantially from the parameter values used in the model ("Sumner I") submitted in the original dispute and with the parameters used in the FAPRI cotton models. Further, it criticizes Brazil for not providing any statistical evidence or validation for its choice of elasticities.[503]

10.208 Brazil argues that the parameters it has chosen are more applicable to the case at hand rather than the "all-purpose—one size fits all" parameters that are imbedded in the FAPRI system. It claims that the "cumbersome nature" of the FAPRI modeling system means that it is difficult to recognize in the parameterization that different degrees of response would be expected under different policy circumstances.[504]

US Supply Elasticity

10.209 The parties disagree about the size of the US supply elasticity with Brazil claiming a larger value (0.8) than the United States (0.21).

10.210 Brazil explains that the use of a higher supply elasticity is justified by the nature of the policy experiment being contemplated, a large and permanent reduction in per unit revenue, entailed by the elimination of the marketing loan and counter-cyclical programmes.[505] Brazil cites empirical studies which suggest that by eliminating the constraints which exist under US subsidy programmes, US farmers' supply response will become substantially larger.[506] Brazil claims that what it uses is a general equilibrium supply elasticity reflecting the endogenous changes in the prices of other crops.[507] Brazil also expresses doubts about the accuracy and applicability of the estimates of regional supply elasticities that the United States uses to come up with a national estimate of the US supply elasticity.[508]

10.211 The United States has used the FAPRI regional acreage equations to calculate a weighted average cotton supply elasticity for the country as a whole. This produced a considerably lower

[499] US Rebuttal Submission, Annex I, para. 4.
[500] Brazil's Rebuttal Submission, Annex I, para. 4.
[501] Brazil's Rebuttal Submission, Annex I, para. 6.
[502] US First Written Submission, Annex 1, para. 1.
[503] US Rebuttal Submission, Annex I, para. 12.
[504] Brazil's Rebuttal Submission, Annex I, para. 6.
[505] Brazil's Rebuttal Submission, Annex I, para. 8.
[506] Brazil's Rebuttal Submission, Annex I, para. 10.
[507] Brazil's Rebuttal Submission, Annex I, para. 14.
[508] Brazil's Rebuttal Submission, Annex I, para. 18.

estimate than that obtained by Brazil.[509] The United States counters Brazil's explanation about the high US supply elasticity by pointing to equally ambitious policy scenarios that have been simulated by the FAPRI cotton model which were conducted without modifying the size of the supply elasticity.[510] The United States questions the relevance of the empirical literature cited by Brazil since this literature analyzed the acreage response of producers during the early 1990s when cotton producers were allowed only limited planting flexibility under the 1990 farm bill.[511] The United States also alleges that the magnitude of the elasticity chosen by Brazil suggests a neglect of cross-commodity price impacts.[512]

Foreign Supply Elasticity

10.212 Brazil's model assumes a foreign supply elasticity of 0.2. The United States criticizes this choice as being too low and gives an alternative value of 0.33.

10.213 Brazil gives several reasons for why the foreign supply elasticity should be small. The incentive to change production faced by foreign producers is indirect, relatively small compared to the revenue loss faced by US producers, and in the opposite direction from that faced by US producers.[513] Further, the transmission of world price changes to local prices occurs with a lag and, for some countries, only partially, due to trade barriers, institutional constraints, transportation costs, and costly information, among others factors.[514]

10.214 The United States obtains its value of the foreign supply elasticity from the FAPRI international cotton model.[515] It objects to Brazil's explanation about the incentive to change production faced by foreign producers being indirect and relatively small since the foreign supply elasticity measures the responsiveness of foreign supply to changes in foreign producer revenue (not US producer revenue).[516] While the United States agrees that the factors mentioned by Brazil, such as trade barriers, institutional constraints, transportation costs, and costly information can have an impact on local cash prices, it believes that these impacts are captured in the FAPRI's international cotton model's estimation of detailed supply-response equations for the major cotton-producing countries.[517]

US and Foreign Demand Elasticities

10.215 Brazil assumes identical US and foreign demand elasticities of -0.2. The United States assumes a US demand elasticity of -0.822 and a foreign demand elasticity of -0.39.

10.216 The United States criticizes the absence of a stock or inventory adjustment in Brazil's model. Shocks to supply and demand have to be absorbed only through price changes as there is no scope for absorption through stockholding behaviour.[518] To account for stocks in their analysis, the United States considers a total demand elasticity for mill use and ending stocks based on MY 2003-2005 mill use and ending stock levels and the estimated mill use and stock demand equations from the FAPRI model.[519]

[509] US First Written Submission, Annex I, para. 19.
[510] US First Written Submission, Annex I, para. 13.
[511] US Rebuttal Submission, Annex I, para. 14.
[512] US First Written Submission, Annex I, para. 15.
[513] Brazil's Rebuttal Submission, Annex I, para. 21.
[514] Brazil's Rebuttal Submission, Annex I, para. 23.
[515] US First Written Submission, Annex I, para. 23.
[516] US Rebuttal Submission, Annex I, para. 20.
[517] US Rebuttal Submission, Annex I, para. 21.
[518] US First Writtten Submission, Annex 1, para. 25.
[519] US First Written Submission, Annex 1, para. 27.

10.217 Brazil explains that the lack of stock adjustment in its model is a consequence of the counterfactual scenario that is being simulated. The counterfactual involves an expected and permanent change in the overall market price level of cotton. In Brazil's view, such temporary increases or decreases in stocks in response to fluctuations in market prices are irrelevant to the demand response to the anticipated and permanent policy changes being examined in this proceeding.[520]

CCP Coupling Factor

10.218 Finally, Brazil and the United States disagree on the appropriate value to assign to the "coupling factor" linking counter-cyclical payments to market price. This coupling factor provides some measure of the production-enhancing effect of subsidies. Brazil uses a coupling factor of 0.4 for counter-cyclical payments while the United States argues that the correct coupling factor is 0.25, which is that assumed in the FAPRI model.

(c) Evaluation by the Panel

10.219 The Panel notes the advantage of the modeling approach that Brazil has chosen to adopt. A simpler and more accessible model can be readily focused on the specific issue at hand. It should include only the relevant economic features that are crucial to a determination whether certain US Government payments led to significant price suppression.

10.220 However, the Panel is also mindful of the criticism by the United States that Brazil's model "has no foundation within economic circles".[521] The model has been submitted for the first time to this dispute. This means that the model needs to earn the confidence of this Panel.

10.221 Furthermore, the magnitude of the impact of US subsidies on the world price depends on the parameter values assumed for Brazil's model. Each party has presented us with arguments why the parameter values it has chosen in the simulation are better than those used by the other party. The Panel does not take a position on whether the FAPRI or ATPSM parameters are better than those chosen by Brazil. Thus, the Panel is not in a position to judge the claims of the parties about the exact magnitude by which the world price would rise were marketing loan and counter-cyclical payments to cease entirely.

10.222 While the Panel has refrained from making a determination about the magnitude of the impact of the US subsidies on the world price, the Panel nevertheless finds that all the simulations conducted by the parties support the view that US marketing loan and counter-cyclical payments have led to an increase in US production and exports of cotton that have then suppressed world prices. The Panel takes note of the fact that price suppression has been the outcome of all the simulation results whether one uses the parameter values proposed by Brazil or the FAPRI and ATPSM parameter values proposed by the United States.

11. Impact of the elimination of Step 2 payments

(a) Introduction

10.223 The United States eliminated the Step 2 programme effective as of 1 August 2006. The Step 2 programme was a special marketing loan provision for upland cotton that had been authorized since 1990 under successive legislation, including the FAIR Act of 1996 and the FSRI Act of 2002. It provided for the issuance of marketing certificates or cash payments to eligible domestic users and

[520] Brazil's Rebuttal Submission, Annex I, para. 29.
[521] US Rebuttal Submission, Annex I, para. 7.

exporters of eligible upland cotton when certain market conditions existed such that US cotton pricing benchmarks were exceeded.[522] As such, the programme combined elements of export subsidization, when payments were made to US exporters of eligible cotton, and import substitution, when payments were made to eligible domestic users of US upland cotton.

10.224 The parties disagree on the effect of the elimination of the Step 2 programme on US production and exports of cotton.

(b) Main arguments of the parties

10.225 **Brazil** submits that the Step 2 programme caused price suppression independent from and in addition to the significant price suppression caused by the marketing loan and counter-cyclical payments programmes.[523] Although modest in comparison with the much larger effects of marketing loan and counter-cyclical payments, the world market price effects of Step 2 payments, in isolation, are clearly recognizable. Brazil submits, in this connection, that the removal of Step 2 payments will enhance the adverse effects of the counter-cyclical payments because it will result in lower US domestic prices and thereby lead to higher counter-cyclical payments.[524] Brazil refers to studies by the US Congressional Budget Office and by researchers of the University of Missouri that predict that the repeal of the Step 2 programme will only have a modest downward impact on the revenues of US upland cotton producers because of the increase in counter-cyclical payments caused by the decline in domestic prices.[525] Brazil also cites to studies that predict that repeal of the Step 2 programme will have no significant impact on US production and exports of upland cotton and on world market prices.[526] The relatively modest effects of the removal of Step 2 payments on US production and exports mean that marketing loan payments and counter-cyclical payments continue to be the main drivers of price suppression in the world market for upland cotton. That the Step 2 programme did not affect the causal link between the marketing loan and counter-cyclical payment programmes and significant price suppression is evidenced by the fact that the planted acreage for MY 2006 is

[522] Panel Report, *US – Upland Cotton*, para. 7.209.

[523] Brazil's First Written Submission, paras. 191-208.

[524] Brazil argues that the degree to which counter-cyclical payments will offset the loss of Step 2 payments depends on the level of the average farm price in a particular marketing year. Counter-cyclical payments are made if the average farm price is below a "trigger price" of 65.73 cents per pound. In the rare instances when the average farm price is above the counter-cyclical trigger price, the loss of Step 2 payments will negatively impact upland cotton producers' revenue. This is because any downward movement in the average farm price that is caused by the elimination of Step 2 payments, and yet does not lower prices below 65.73 cents per pound, will not be compensated by increased counter-cyclical payments. However, Brazil notes that in each of the last nine marketing years, the average US farm price has been below the counter-cyclical payment trigger price. It is therefore unlikely that domestic prices will rise to the level where counter-cyclical payments will not compensate US producers for a fall in domestic prices following the withdrawal of the Step 2 programme. Brazil notes that if the average farm price is below 52 cents per pound, a further decline in the price level will also *not* be compensated by counter-cyclical payments because the maximum counter-cyclical payment will have already been made. Thus, counter-cyclical payments will offset the loss of Step 2 payments where the average farm price is between the marketing loan rate of 52 cents per pound and the trigger price of 65.73 cents per pound for counter-cyclical payments. Brazil's First Written Submission, paras. 198-200.

[525] Brazil's First Written Submission, paras. 201-203.

[526] According to Brazil, the study conducted by the University of Missouri researchers found that the removal of the Step 2 payments would reduce US production by about 1 per cent, US exports by 2 per cent and increase world market prices by 0.39 cents per pound, or less than 1 per cent. Brazil also refers to an ICAC study that concluded that elimination of the Step 2 programme would have no significant effect on US exports of upland cotton. As support for its argument concerning the limited impact of the removal of Step 2 payments, Brazil also relies on the simulation model in Annex I to its First Written Submission and the expert testimony in Annex II to its First Written Submission. Brazil's First Written Submission, paras. 203-204.

estimated to be 7 per cent higher than in MY 2005, notwithstanding that US cotton producers knew that the Step 2 payments would be eliminated as of August 2006.[527]

10.226 Brazil asserts that, contrary to what the United States appears to argue, the Step 2 programme and the mandatory payments made thereunder were not the sole cause of the serious prejudice found by the original panel, and that the arguments of the United States in this regard are inconsistent with the findings of the original panel and the Appellate Body concerning the nature, magnitude and effects of the price contingent basket of measures found to cause serious prejudice.[528] Brazil emphasizes that its argument that the relative effects of the Step 2 subsidy are modest compared to the combined effects of the marketing loan and counter-cyclical payments is consistent with the reality of the operation of the three subsidies. The removal of the Step 2 programme will have a relatively insignificant impact on the amount of marketing loan payments. The increase in counter-cyclical payments following the repeal of the Step 2 programme far outweighs the decrease in marketing loan payments.[529] Brazil further submits that US upland cotton producers' revenue is critically dependent upon marketing loan and counter-cyclical payments but not on Step 2 payments. Thus, the repeal of the Step 2 programme has a very limited impact on US upland cotton producers' expected or actual revenues.[530] Finally, partial MY 2006 data regarding US exports does not support the argument of the United States that there are no significant production, export and world market price effects from the marketing loan and counter-cyclical subsidies. The primary cause of the decline in US exports is the world demand and supply situation. Moreover, the drop in exports in MY 2006 is not remarkable in light of the surge in exports that occurred immediately prior to the repeal of the Step 2 programme. USDA projections for MY 2006 indicate that the decline in exports will be temporary.

10.227 The **United States** submits that Brazil's arguments about the "relatively modest" impact of removal of the Step 2 programme are without merit. *First*, eliminating the Step 2 programme likely does not result in an increase in the counter-cyclical payment rate but does result in lower marketing loan payments. At the season average farm price that is projected for MY 2006, there cannot be any appreciable increase in the counter-cyclical payment rate in this current marketing year.[531] At the same time, the evidence suggests that elimination of the Step 2 programme will likely lead to lower marketing loan payments as a result of the increase in world market prices.[532] Rather than enhancing the adverse effects of counter-cyclical payments, as alleged by Brazil, the elimination of the Step 2 programme is likely to minimize the effect of marketing loan payments. *Second*, Brazil's efforts to

[527] In the section of Brazil's First Written Submission on the magnitude of the subsidies at issue, Brazil argues that elimination of the Step 2 subsidy from the analysis does not significantly reduce the overall magnitude of the price-contingent subsidies. According to Brazil, during MY 1999-2002 Step 2 payments represented only 13.7 per cent of the magnitude of the three price-contingent subsidies that the original panel found to stimulate production and exports and to result in lower world market prices than would prevail in their absence. Brazil's First Written Submission, para. 112.

[528] Brazil's Rebuttal Submission, para. 48.

[529] Brazil points out that a FAPRI study referred to by the United States estimates that without the Step 2 payments the AWP would increase by an average of 0.4 cents per pound in MY 2006-2012 and that a study by the US Congressional Budget Office (CBO) estimated the reduction in marketing loan payments as a result of the elimination of the Step 2 subsidy to be US$17 million over a period of ten years. According to the CBO, counter-cyclical payments will increase over the same period by US$484 million. Brazil's Rebuttal Submission, paras. 59-61.

[530] Brazil's Rebuttal Submission, paras. 66-75.

[531] US First Written Submission, paras. 159-170. The United States submits that the projected average farm price for MY 2006 is only a fraction of a cent higher than the marketing loan rate. When the farm price is at or below the marketing loan rate the counter-cyclical payment rate remains fixed at its maximum level. The United States notes that none of studies cited by Brazil as support for its argument that counter-cyclical payments are likely to increase predict such an increase for the current marketing year.

[532] US First Written Submission, paras. 171-178. The United States submits that the US Congressional Budget Office, FAPRI and ICAC have also found that elimination of the Step 2 programme will likely have the effect of reducing the amount of marketing loan payments.

demonstrate the "modest" effects on the market of eliminating the Step 2 programme are undermined by its own arguments in the original panel proceeding.[533] *Third*, data from August-October 2006 do not support Brazil's claim that elimination of the Step 2 programme has had "modest" effects. In this respect, the United States submits, in particular, that the current level of US exports of upland cotton is far below recent levels.[534]

(c) Evaluation by the Panel

(i) Assessing the effects on US cotton exports

10.228 Brazil argues that the elimination of Step 2 payments has not diminished the significant price-suppression from marketing loan and counter-cyclical payments. While Step 2 payments by themselves have an independent price suppression effect, Brazil believes that these effects are relatively "modest" and that other US subsidies, principally counter-cyclical and marketing loan payments, will be sufficient to ensure that US cotton producers continue to produce and export cotton. The United States disputes that the effect of eliminating Step 2 payments will be "modest".

10.229 In this connection, the United States refers to certain trends which it argues do not support Brazil's argument regarding the modest effects of the elimination of Step 2 payments, particularly the decline in US exports and the US share of world exports in MY 2006.[535] Brazil argues that the "temporal coincidence" between the removal of Step 2 payments and a decline in US exports is not remarkable.

10.230 The Panel concurs with the United States that the available evidence as of February 2007 suggests significant reductions in the volume of production and exports of US upland cotton in MY 2006. The absolute volumes of US cotton production and exports in MY 2006 are projected to fall by 9 per cent and 19.6 per cent, respectively, from MY 2005 levels. More importantly, the US share of world production is projected to fall to 18.6 per cent in MY 2006 from 20.9 per cent in MY 2005; the US share of world exports is projected to decline to 36.3 in MY 2006 per cent from 40.1 per cent in MY 2005. This means that decreases in the absolute levels of US production and exports are far sharper than for the rest of the world. The Panel also notes a document submitted by the United States that contains the results of the annual survey of planting intentions conducted by the National Cotton Council, which indicates that US upland cotton plantings are likely to be down an average of 14 per cent in MY 2007 from 2006 levels.[536]

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[533]The United States submits that Brazil's argument on the relative size of the Step 2 payments as compared to the size of marketing loan and counter-cyclical payments is inconsistent with the position taken by Brazil in the original proceeding that the focus of a serious prejudice analysis should be on the effects and not on the magnitude, value or amount of the subsidy. Similarly, Brazil's argument that Step 2 payments have no impact on the level of production and exports of US upland cotton cannot be reconciled with the argument of Brazil in the original proceeding that the Step 2 programme had a significant effect on the level of US exports of upland cotton. The statement by Brazil's expert that elimination of the Step 2 programme will have little impact on the world price for cotton in the long-term is inconsistent with the statement by the same expert in the original proceeding that Step 2 was one of three factors that enabled the United States to act as the driver of world prices. US First Written Submission, paras. 181-189.

[534] US First Written Submission, para. 193.

[535] According to the United States, among these trends for MY 2006 are: (i) US exports in MY 2006 are projected to be lower than in the previous marketing year; (ii) the US share of world exports is projected to fall to 36 per cent in MY 2006, (iii) world market prices are higher now (early in calendar year 2007) than year-ago levels, while US prices – as reflected by the New York futures market – are running well below those levels.

[536] Exhibit US-115.

10.231 The Panel considers that the data before it is certainly consistent with the argument that the elimination of Step 2 payments is having an effect on US export performance. The Panel believes that some part of the decline in the US share of the export market reflects the effect of the elimination of Step 2 payments. This is only consistent with the idea that the removal of payments which subsidize exports and which subsidize domestic users to substitute domestic production for imports will eliminate incentives to increase sales in the export market and to add to domestic production. Our view is also consistent with the results of the economic simulation model submitted by Brazil, which predicts a reduction in US production and exports. However, given that we are not yet one calendar year removed from the elimination of Step 2 payments, and that the amount of Step 2 payments was much smaller than the amounts of payments made under either the marketing loan or counter-cyclical programmes[537], it is not possible for the Panel to determine with any great deal of precision or confidence just how much of the projected decline in US exports of upland cotton is due to the elimination of the Step 2 payments.

(ii) Indirect effect on marketing loan and counter-cyclical payments

10.232 The parties have also advanced arguments to suggest that the elimination of Step 2 payments has indirect effects, through consequential changes in the amount of counter-cyclical or marketing loan payments, which either negate or accentuate the direct impact of the elimination of the Step 2 payments.

10.233 In the Panel's view, all things being equal, an export subsidy will increase the domestic price in the exporting country because a larger part of domestic production is diverted to the export market. Assuming that the exporting country is a large country, i.e. that it can affect world prices, the increased exports will also tend to depress the world price.[538] The export subsidy creates a wedge between the domestic price in the exporting country and the world price. A measure that subsidizes substitution of domestic production for imports will have a similar effect as export subsidies on domestic and world prices. The additional demand for domestic production puts upward pressure on the domestic price; if the country is a large country, the reduction in its imports puts downward pressure on the world price. Thus, eliminating a programme which has both elements of export subsidization and import substitution will reverse the process, lowering the domestic price even as the world price is increased.

10.234 Brazil argues that the decline in the domestic price of cotton in the United States, which comes about from the elimination of Step 2 payments, will trigger additional counter-cyclical payments.[539] The United States disagrees with Brazil that the elimination of Step 2 payments will

[537] In MY 2005, payments under the marketing loan and counter-cyclical programmes were about US$1.257 billion and US$838 million respectively. Table 8 below gives the amounts of payments under the Step 2 programme from MY 1999 until MY 2005. During its last marketing year, total payments under the programme amounted to US$350 million.

Table 8: Step 2 Payments, MY 1999-2005

(million US$)

ITEM	MY1999	MY2000	MY2001	MY2002	MY2003	MY2004	MY2005
Step 2 payments	$422	$236	$196	$429	$350	$544	$350

Source: Brazil's First Written Submission, Table 6.

[538] We find support for this view from the analysis of export subsidies in standard international economics textbooks such as that from Paul R. Krugman and Maurice Obstfeld (2003) *International Economics: Theory and Policy* (6th edition) Boston, San Francisco: Addison-Wesley, 2003.

[539] *Supra*, para. 10.225.

lead to a decline in domestic cotton prices that will result in compensating increases in counter-cyclical payments.[540]

10.235 Further, the United States argues that the elimination of the Step 2 programme is likely to result in lower marketing loan payments.[541] Thus, for the United States, the elimination of Step 2 payments will have spill-over effects on marketing loan payments, which accentuate rather than negate the direct impact of eliminating the export subsidy programme. Brazil does not seem to dispute this claim although it argues that the decrease in marketing loan payments is likely to be small.[542]

10.236 Brazil and the United States emphasize different aspects of the likely adjustment in domestic (US) and world prices resulting from the elimination of the Step 2 programme. Brazil emphasizes the reduction in the domestic price, which it argues, would tend to trigger additional counter-cyclical payments. The United States emphasizes the increase in the world price, which it argues, would tend to reduce marketing loan payments. Both parties are correct in their assessment of how domestic (US) and world cotton prices are likely to evolve, all things being the same, with the elimination of Step 2 payments. In our view the scenarios claimed by the parties – increases in counter-cyclical payments and decreases in marketing loan payments – will be played out simultaneously.

10.237 There are two questions remaining. First, what are the likely magnitudes of the changes in counter-cyclical payments and marketing loan payments that will be caused by the elimination of the Step 2 programme? The second and more important question is what are the likely impacts on US cotton production and exports?

10.238 On the first question, we find credible the US CBO projections, which both parties have referred to, of the likely changes in marketing loan and counter-cyclical payments that will result from the elimination of the Step 2 programme. Over the US fiscal year period 2006-2015, the CBO projects that the elimination of the Step 2 programme will reduce marketing loan payments by US$17 million and increase counter-cyclical payments by US$484 million. In this respect, one should take note of the clarification made by the United States that the projected reductions in marketing loan payments will apply only to MY 2006-2007, since no payments are expected beyond that.[543]

10.239 In answering the second question, the Panel observes that it will not suffice to just compare the magnitude of these payments. This is because a dollar of marketing loan payments provides a greater incentive to increase production than does a dollar of counter-cyclical payments. These projected changes are also rather modest, if one takes into account the scale of the annual payments made under the marketing loan and counter-cyclical programmes, and the ten-year horizon involved. The Panel is led to conclude that the indirect impacts on US production and exports are likely to be small, given the relatively modest changes projected in the amounts of marketing loan and counter-cyclical payments, and the fact that these changes run counter to one another.

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[540] *Supra*, para. 10.227.

[541] *Supra*, para. 10.227.

[542] Brazil refers to the CBO report which projects a reduction of US$17 million in marketing loan payments arising from the elimination of the Step 2 programme. Brazil's Rebuttal Submission, paras. 58-60.

[543] US Rebuttal Submission, para. 184.

12. Other factors impacting the world market price for upland cotton

(a) Main arguments of the parties

10.240 The **United States** submits that by failing to undertake any meaningful analysis of world market prices and the factors that influence them Brazil fails to ensure that the effects of other factors on prices are not improperly attributed to the marketing loan and counter-cyclical subsidies at issue in this proceeding. In this regard, the United States emphasizes that Brazil does not take into account the role of China's trade in cotton. Brazil ignores the fact that there exists a high correlation between China's net trade in cotton and the A-Index, that the A-Index itself has been changed to reflect the impact of China on the world cotton market, and that, as indicated by market reports submitted by Brazil, the uncertainty regarding China's trade in cotton results in downward pressures on prices.[544]

10.241 **Brazil** argues that any impact of China's purchases of upland cotton on the world market price does not diminish the significant price-suppressing effects of the US subsidies at issue. Brazil emphasizes that its claim is a claim of price suppression and not of price depression and that this claim does not depend upon the actual level of world prices for upland cotton, which is influenced by numerous factors, including the purchasing behaviour of China. While China's supply and demand may explain certain price movements in the world market for upland cotton, this does not alter the fact that removal of US subsidies would result in a significant increase in the US supply to the world market, which in turn would lead to significantly higher prices. In any case, while Brazil does not disagree that China exerts a strong influence on the world market price for upland cotton, China's role is not as dominant as argued by the United States. Thus, Brazil contests that there is a significant correlation between China's exports and the A-Index and asserts that the change in the A-Index is of little importance for the overall determination of world market prices. Finally, Brazil considers that uncertainty about China's demand and supply can lead to short-term price fluctuations, but that in the long-term prices are determined by market fundamentals of demand and supply.[545]

(b) Evaluation by the Panel

10.242 As observed by the Appellate Body and the panel in the original proceeding, in order to determine that the effect of a subsidy is significant price suppression within the meaning of Article 6.3(b) it is necessary "to ensure that the effects of other factors on prices are not improperly attributed to the challenged subsidies".[546] However, the *SCM Agreement* prescribes no precise methodology for such an analysis of the role of other factors in the context of Article 6.3.

10.243 As discussed above, the Panel has adopted a "but for" approach to the question of whether the effect of US marketing loan and counter-cyclical subsidies to upland cotton producers is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement.* The Panel considers that it is not necessary in this respect to undertake a comprehensive evaluation of factors affecting the world market price for upland cotton. Rather the question is whether the evidence before the Panel supports the conclusion that in the absence of the US marketing loan and counter-cyclical subsidies the world market price would increase significantly. The Panel considers, based on the evidence before it, that while China may play a significant role in the market for upland cotton, this does not diminish the significance of the impact of US subsidies on the world price for upland cotton as a result of their effect on US supply to the world market. Developments concerning the role of China's

[544] US First Written Submission, paras. 308-318; US Rebuttal Submission, paras. 387-396.
[545] Brazil's Rebuttal Submission, paras. 324-345.
[546] Appellate Body Report, *US – Upland Cotton*, para. 437; Panel Report, *US – Upland Cotton*, para. 7.1344.

demand and supply do not change the fact that, with a share of world exports of around 40 per cent, the United States is capable of exerting a substantial proportionate influence on the world market.[547]

13. Summary and conclusion of the Panel's analysis of Brazil's claim of serious prejudice within the meaning of Articles 5(c) and 6.3(c) of the *SCM Agreement*

10.244 The Panel recalls that the original panel found that the effect of certain price-contingent subsidies provided by the United States in respect of upland cotton – marketing loan programme payments, user marketing (Step 2) payments, market loss assistance payments and counter-cyclical payments – was significant price suppression in the same world market for upland cotton in the period MY 1999-2002 within the meaning of Article 6.3(c) of the *SCM Agreement* constituting serious prejudice within the meaning of Article 5(c) of the *SCM Agreement*.[548] In respect of this finding, the original panel recalled that under Article 7.8 of the *SCM Agreement* the adoption of a panel or Appellate Body Report in which it is determined that a Member has caused adverse effects within the meaning of Article 5 of the *SCM Agreement* requires the Member granting or maintaining the subsidy to take appropriate steps to remove the adverse effects or to withdraw the subsidy.[549] [550]

10.245 In this proceeding under Article 21.5 of the DSU, Brazil claims that the United States has failed to comply with its obligations under Article 7.8 of the *SCM Agreement* because two of the subsidies to US upland cotton producers that were the subject of the original panel's finding of "present" serious prejudice – marketing loan and counter-cyclical payments – cause "present" serious prejudice to the interests of Brazil within the meaning of Articles 5(c) and 6.3(c) of the *SCM Agreement.*

10.246 The Panel has considered the arguments and evidence presented by the parties in support of their positions on the issues raised by Brazil. The Panel's evaluation can be summarized as follows.

10.247 *First*, in view of the magnitude of the US shares of world production and exports, the Panel considers that the United States exerts a substantial proportionate influence on the world market for upland cotton, even if account is taken of the projected declines in these shares in MY 2006. This substantial proportionate influence of the United States, analyzed in light of the totality of the evidence before us, is an element that supports a finding that the marketing loan and counter-cyclical payments to US upland cotton producers cause significant price suppression in the world market for upland cotton.

10.248 *Second*, the Panel has found that marketing loan and counter-cyclical payments affect the level of US upland cotton acreage and production as a result of their mandatory and price-contingent nature and their revenue-stabilizing effect. In this respect, the Panel has concurred with the view of the original panel that these subsidies protect or "insulate" revenues of US upland cotton producers when prices are low. We have emphasized, however, that in determining whether the structure, design and operation of these subsidies support a finding of significant price suppression *under current factual conditions*, we need to consider this factor in conjunction with other factors.

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[547] The Panel notes that Brazil has not ignored the role of China in the world market for upland cotton. The analysis of the world cotton market prepared by Brazil's experts specifically refers to the fact that China is the largest producer and consumer of cotton and is now also the largest importer of cotton. Brazil's First Written Submission, Annex II (Declaration by Andrew Macdonald).

[548] Panel Report, *US – Upland Cotton*, paras. 7.1416 and 8.1(g)(i).

[549] Panel Report, *US – Upland Cotton*, para. 8.3(d).

[550] Brazil emphasizes that in explaining its decision not to address certain claims of Brazil, the original panel observed that as a result of the panel's finding of present serious prejudice "the United States is obliged to take action concerning its present statutory and regulatory framework." Panel Report, *US – Upland Cotton*, para. 7.1501. The United States argues that this statement is not a "recommendation" and that in any event the United States has amended its statutory and regulatory framework by repealing the Step 2 programme.

10.249 *Third*, the Panel considers that the order of magnitude of the marketing loan and counter-cyclical subsidies is such that in conjunction with other factors, this element supports a finding that significant price suppression is the effect of the subsidy, even when account is taken of the projected decline of marketing loan payments in MY 2006.

10.250 *Fourth*, the Panel has found that there exists a significant gap between the total costs of production of US upland cotton producers and their market revenue, suggesting that the subsidies at issue are a key factor affecting the economic viability of US cotton farming.

10.251 *Fifth*, the Panel considers that certain arguments of Brazil are less persuasive. Thus, in arguing that there exists a temporal coincidence of subsidies and suppressed prices, Brazil in our view fails to take sufficient account of the fact that the recent trends in world market prices and US world export shares differ considerably from the trends in world market prices and US world export share in the period considered by the original panel. The Panel is also not convinced that Brazil has been able to substantiate adequately its assertion that US upland cotton acreage, production and exports do not respond to market price signals. The Panel recalls, however, its conclusion that the fact that recent years have not witnessed the sharp decline in the world market price for upland cotton that occurred during the period considered by the original panel does not necessarily mean that there is currently no price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*. The Panel also recalls its observation that the stable US share of world production and exports does not mean that US producers are not insulated from market price signals, but that the degree of price insulation found by the original panel is now weaker, possibly because prices are not depressed as during the period examined by the original panel. Finally, the Panel recalls that all the simulations conducted by the parties support the view that US marketing loan and counter-cyclical payments have led to an increase in US production and exports of cotton that have then suppressed world prices.

10.252 *Sixth*, the Panel has examined the role of other factors that may have an effect on the world market price for upland cotton, notably the role of China's trade in cotton. The Panel concludes that this other factor does not attenuate the link between significant price suppression and the subsidies at issue in this proceeding.

10.253 Finally, with respect to the elimination by the United States of Step 2 subsidies – one of the subsidies that was the subject of the original panel's finding of "present" serious prejudice – the Panel considers that the evidence before it on the effect of the elimination of this subsidy on US exports and on the amounts of marketing loan payments and counter-cyclical payments suggests that the elimination of this subsidy does not affect the price suppressing effects of the marketing loan payments and counter-cyclical payments in the world market for upland cotton.

10.254 The Panel finds, on the basis of the above summarized evaluations, that without the marketing loan and counter-cyclical payments to US upland cotton producers the level of US upland cotton acreage and production would be significantly lower and that, as a consequence, the world market price for upland cotton would be higher. The Panel recalls that to determine whether there is significant price suppression within the meaning of Article 6.3(c) as the effect of the subsidies at issue, the Panel must ascertain whether, but for the subsidies at issue, the world market price for upland cotton would have increased significantly, or would have increased by significantly more than was in fact the case. The Panel concludes that the effect of the subsidies at issue is significant price suppression in this sense.[551]

10.255 Article 6.3(c) of the *SCM Agreement* provides that "serious prejudice in the sense of paragraph (c) of Article 5 *may arise* in any case where one or several of the following apply". (emphasis added). The Panel considers that this phrase must be interpreted to mean that "the

[551] See *supra*, paras. 10.50 for the Panel's view on the interpretation of the term "significant".

situations listed in Article 6.3(a)-(d) in themselves constitute serious prejudice".[552] As a consequence, a finding of significant price suppression under Article 6.3(c) of the *SCM Agreement* is a sufficient basis for a finding of serious prejudice within the meaning of Article 5(c) of the *SCM Agreement*.[553]

10.256 In light of the foregoing considerations, the Panel **finds** that the United States acts inconsistently with its obligations under Articles 5(c) and 6.3(c) of the *SCM Agreement* in that the effect of marketing loan payments and counter-cyclical payments provided to US upland cotton producers pursuant to the FSRI Act of 2002 is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement* in the world market for upland cotton constituting "present" serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*.

10.257 The Panel also **finds**, as a consequence, that by acting inconsistently with Articles 5(c) and 6.3(c) of the *SCM Agreement* the United States has failed to comply with the DSB recommendations and rulings. Specifically, the United States has failed to comply with its obligation under Article 7.8 of the *SCM Agreement* "to take appropriate steps to remove the adverse effects or ... withdraw the subsidy".

C. CLAIM OF BRAZIL OF "PRESENT" SERIOUS PREJUDICE WITHIN THE MEANING OF ARTICLES 5(C) AND 6.3(D) OF THE *SCM AGREEMENT*

1. Main arguments of the parties

10.258 **Brazil** submits that the effects of the marketing loan and counter-cyclical payment subsidies in MY 2005 cause the United States to hold an increased share of the world market for upland cotton. In this respect, Brazil argues that the US share of the world market for upland cotton in MY 2005 was greater than the average US world market share during MY 2002-2004, that this increase reflects a consistent trend over the period MY 1998-2005, which Brazil considers the most representative period for purposes of Article 6.3(d), and that the evidence presented by Brazil in the context of its price suppression argument regarding the effects of the nature and magnitude of the subsidies, coupled with the commanding US production and export market share, on production, export and world market price also supports a causal link between these subsidies and the increase in the world market share of the United States.

10.259 **The United States** argues that Brazil fails to make a *prima facie* case of WTO-inconsistency under Articles 5(c) and 6.3(d) of the *SCM Agreement*. Brazil fails to demonstrate that all of the elements of Articles 5(c) and 6.3(d) of the *SCM Agreement* are satisfied.[554] Brazil has not demonstrated that the slight increase in MY 2005 of the US share of world production (1.53 per cent) and of the US share of world production plus beginning stocks (0.46 per cent) was not caused by the Step 2 programme. Brazil has also failed to demonstrate that this increase "follows a consistent trend over a period when subsidies have been granted". In the later regard, the United States points out that US share of world production or production plus beginning stocks is stable if one looks back to MY 1980 and has actually declined significantly if one looks back to 1960.

[552] Panel Report, *Korea – Commercial Vessels*, para. 7.587.

[553] Panel Report, *US – Upland Cotton*, para. 7.1390.

[554] The United States also submits that not only are Brazil's claims against the marketing loan and counter-cyclical payment *programmes* not within the scope of this proceeding, but Brazil also fails to provide a legal basis for a finding against these programmes because it fails to demonstrate that these programmes mandate a breach of Articles 5(c) and 6.3(d). Since the legal provisions or "programmes" pursuant to which marketing loan and counter-cyclical payments are made by the US Government to US upland cotton farmers are not, as such, the subject of Brazil's claims of serious prejudice, we do not need to address these arguments of the United States.

2. Evaluation by the Panel

10.260 Articles 5(c) and 6.3(d) of the *SCM Agreement* provide:

> "Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply ...
>
> (d) the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity[17] as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted."
>
> ___________
>
> [17]Unless other multilaterally agreed specific rules apply to the trade in the product or commodity in question.

10.261 Thus, Article 6.3(d) requires, *first*, a showing that there has been an increase in the world market share of the subsidizing Member in a particular primary product or commodity as compared to the average market share of that Member in the previous period of three years. *Second*, it must be shown that this increase follows a consistent trend over a period when subsidies have been granted.

10.262 With respect to the first element that must be satisfied for a finding under Article 6.3(d), we note that the original panel interpreted the term "world market share" in Article 6.3(d) to mean the "share of the world market supplied by the subsidizing Member".[555] Brazil has used this definition and has noted that this definition suggests two potential measures of "supply". First, supply can be limited to the annual level of a Member's new production of a primary product or commodity. Alternatively, supply can additionally include residual produce from previous years, which, in the context of upland cotton, is known as "beginning stocks". In this present dispute, Brazil has presented data on the US world market share using both measures of supply.

10.263 Brazil argues that the world market share of the United States has increased in MY 2005, as compared to the average US share of world supply in MY 2002-2004. Brazil provides data showing that the US share of world production plus beginning stocks increased by 0.46 per cent over the average for MY 2002-2004 and the US share of world production increased by 1.53 per cent over the average for MY 2002-2004.[556] The Panel notes that while the United States does not dispute these figures, the United States considers these "slight" increases to be part of ordinary fluctuations in US market share, not the effect of the marketing loan and counter-cyclical payment programmes.[557]

10.264 The Panel agrees with the United States that Brazil has not been able to demonstrate that the small increase in the US world market share is the effect of marketing loan and counter-cyclical payments. It is not unreasonable to interpret such a small increase to be part of the ordinary fluctuations in the US market share. The sensitivity of the result, an increase in US market share compared to the average of the past three years, also becomes apparent if we change the terminal marketing year from MY 2005 to MY 2006. Brazil has been willing to admit the inclusion of MY 2006 projections provided that they are reliable. We have judged MY 2006 projections provided

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[555] Panel Report, *US – Upland Cotton*, para. 7.1454. While Brazil raised this issue in its appeal, the Appellate Body found that an interpretation of the phrase "world market share" in Article 6.3(d) was not necessary to resolve the dispute. Appellate Body Report, *US – Upland Cotton*, para. 511.

[556] Brazil's First Written Submission, paras. 222-226.

[557] US Rebuttal Submission, para. 402.

by the United States to this panel to be reliable. If one uses these projections for US and world cotton production in MY 2006, the US world market share will actually be lower in MY 2006 compared to the average of the three previous marketing years:

Table 9: US World Market Share, MY 2002-2006

Marketing Year	US Share of World Production	US Share of World Production plus Stocks
2002	19.5%	17.4%
2003	19.2%	17.0%
2004	19.3%	16.3%
2005	20.9%	17.5%
2006	18.6%	16.3%

Source: Exhibits US-27 and US-114.

10.265 We note in this connection that Brazil argues that the Panel should not take into account this data for MY 2006 because Brazil's claim is a claim of "present" serious prejudice, based upon data from MY 2005, the last year for which complete data is available.[558] The Panel disagrees with this argument of Brazil. The Panel must determine whether the effect of the subsidy "is" an increase in the world market share of the United States. As discussed above, the Panel considers that the use of the present tense in Article 6.3 suggests that the relevant period to consider is the present period and that where reliable data is available for MY 2006, that data must be taken into account. The Panel recalls that an important additional consideration for not limiting its analysis to MY 2005 is that the elimination of the Step 2 programme became effective on 1 August 2006.

10.266 The Panel therefore finds that the evidence does not support Brazil's argument that there is an increase in the world market share of the United States in upland cotton as compared to the average US world market share during the previous period of three years. Thus, the Panel cannot find that the effect of the subsidies at issue in this proceeding is an increase in the world market share of the United States within the meaning of Article 6.3(d).[559]

10.267 In light of this finding, the question of whether the second condition of Article 6.3(d) of the *SCM Agreement* has been met in this case, i.e. whether the increase in world market share follows a consistent trend over a period when subsidies have been granted, does not arise. The Panel notes that the parties disagree on how to interpret and apply the requirement of Article 6.3(d) that the increase in the subsidizing Member's world market share, as compared to the average share of the Member in the previous period of three years, be shown to follow a consistent trend over a period when subsidies have been granted.[560] The Panel does not consider it necessary to address the arguments made by the parties in this regard.

10.268 In light of the foregoing considerations, the Panel **finds** that Brazil has not made a *prima facie* case that the effect of marketing loan and counter-cyclical payments provided to US upland cotton producers pursuant to the FSRI Act of 2002 is an increase in the US world market share in upland cotton as compared to the average US world market share during the previous period of three years

[558] Brazil's Rebuttal Submission, para. 356.

[559] Brazil argues that, the model submitted by its economic consultant shows that, but for the marketing loan and counter-cyclical payments, the US world market share would have been significantly lower in MY 2005. The Panel considers that the terms of Article 6.3(d) require that it be demonstrated that there is an actual increase in market share of the subsidizing Member.

[560] Thus, for example, the United States argues that it must be shown under Article 6.3(d) that a Member's market share is consistently increasing over the previous three-year average. Brazil rejects this interpretation. US Rebuttal Submission, paras. 403-404; Brazil's Response to Panel Question 76.

and that this increase follows a consistent trend over a period when subsidies have been granted. Therefore, it has not been established that the United States acts inconsistently with Articles 5(c) and 6.3(d) of the *SCM Agreement*.

XI. BRAZIL'S CLAIM OF THREAT OF SERIOUS PREJUDICE UNDER ARTICLES 5(C) AND 6.3 OF THE *SCM AGREEMENT*

11.1 **Brazil** requests the Panel to find that the United States has failed to comply with the DSB recommendations and rulings in the original proceeding in that marketing loan and counter-cyclical payments to US upland cotton producers threaten to cause serious prejudice in the form of significant price suppression in the world market for upland cotton.

11.2 The **United States** submits that Brazil has failed to make a *prima facie* case of threat of serious prejudice caused by the marketing loan and counter-cyclical payments.

11.3 The Panel has found that marketing loan and counter-cyclical payments under the FSRI Act of 2002 to US upland cotton producers cause "present" serious prejudice to the interests of Brazil within the meaning of Articles 5(c) and 6.3(c) of the *SCM Agreement* and that in this regard the United States has failed to comply with the DSB recommendations and rulings in the original proceeding. In light of these findings of "present" serious prejudice and of non-compliance by the United States with the DSB recommendations and rulings, the Panel does not consider it necessary or appropriate to make an additional finding as to whether marketing loan and counter-cyclical payments to US upland cotton producers threaten to cause serious prejudice to the interests of Brazil in the form of significant price suppression in the world market for upland cotton.[561] The Panel also notes that Brazil has made clear that its claim of threat of serious prejudice is conditional. Specifically, Brazil has stated that the Panel "need only decide this claim if it is unable to find that there is present serious prejudice from marketing loan and counter-cyclical payments programmes of the FSRI Act of 2002".[562]

11.4 The Panel therefore decides not to make a finding on Brazil's claim of threat of serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*.

XII. BRAZIL'S CLAIM OF "PRESENT" SERIOUS PREJUDICE UNDER ARTICLES 5(C), 6.3(C) AND 6.3(D) OF THE *SCM AGREEMENT* AS A RESULT OF THE FAILURE OF THE UNITED STATES TO TAKE ANY ACTION BETWEEN 22 SEPTEMBER 2005 AND 31 JULY 2006

12.1 Brazil requests the Panel to find that the failure of the United States to take any measure to remove the adverse effects or to withdraw the three price-contingent upland cotton subsidy programmes between 22 September 2005 and 31 July 2006 cause present serious prejudice to the interests of Brazil in the form of significant price suppression in the world market for upland cotton and an increase in the US world market share, in violation of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*.

[561] The original panel also did not consider it necessary or appropriate to address Brazil's claims of threat of serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement* in light of its findings of present serious prejudice and of the existence of prohibited subsidies. Panel Report, *US – Upland Cotton*, para. 7.1503.

[562] Brazil's First Written Submission, para. 461; see also Brazil's Response to Panel Question 84. The Panel concurs with the argument in paragraph 240 of Brazil's First Written Submission that "a finding by the compliance Panel of either present serious prejudice or a threat thereof will suffice for the compliance Panel to find that the U.S. measures taken to comply are inconsistent with the covered agreements, within the meaning of Article 21.5 of the DSU".

12.2 In light of the Panel's ruling in paragraph 9.68 on the preliminary objection of the United States and in light of its findings above of "present" serious prejudice and of non-compliance by the United States with the DSB recommendations and rulings, the Panel does not consider it necessary or appropriate to make a finding on this claim of Brazil of "present" serious prejudice resulting from the failure of the United States to take certain action during the period 22 September 2005-31 July 2006. The Panel also notes that Brazil has presented this claim on a contingent basis.[563] The Panel therefore decides not to make a finding on this claim of Brazil of "present" serious prejudice under Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*.

XIII. ATTACHMENT 1: OVERVIEW OF NEW ECONOMIC LITERATURE ON COUNTER-CYCLICAL PAYMENTS

A. IMPACT OF COUNTER-CYCLICAL PAYMENTS

1. Studies cited by the United States

13.1 The United States submits a study "Risk Considerations in Supply Response: Implications for Counter-Cyclical Payments' Production Impact" by William Lin and Robert Dismukes.[564] This study attempts to simulate the acreage effects of counter-cyclical payments for three crops – corn, soybeans and wheat. The simulation is based on an acreage model, which was estimated using state-level data during 1991-2001, drawn from farms in the Northcentral region[565] of the United States. The study acknowledges the many ways in which programmes like the counter-cyclical payment programme can affect the acreage decision of farmers – through a reduction in risk, wealth effects, the increase in farm revenue, etc. Its primary focus, however, is how counter-cyclical payments reduce the price risk faced by farmers and how much this translates into increases in planting area. Essentially, counter-cyclical payments improve the probability distribution of prices faced by farmers by guaranteeing them the target price less the direct payment for that crop. The study finds that of the three crops examined (corn, soybeans and wheat), price risk reduction from counter-cyclical payments is likely to be important only in the case of soybeans. The simulation predicts that counter-cyclical payments will lead to a 3 per cent increase in soybean acreage.

13.2 A second study cited by the United States, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" by Paul Westcott[566], analyses the likely production effects of counter-cyclical payments. The author considers the case of a hypothetical corn farmer who plants all of his hundred acres of corn base with corn. He then examines how the farmer's revenues are affected by counter-cyclical payments (among other subsidies) depending on realizations of the market price. He comes to the conclusion that the impact of counter-cyclical payments differs depending upon the level of the market price. If farmers expect prices to be below loan rates, then counter-cyclical payments are at their maximum levels and become more like "fixed" payments. If farmers expect the market price to lie between the loan rate and the "effective target price", counter-cyclical payments will vary with market price and their effects may vary as well. It is in this price range that Westcott believes that, assuming the base acreage crop is planted, counter-cyclical payments have potential avenues to affect production. They do so by stabilizing farm revenues, offsetting changes in market prices with counter-cyclical payments. At the same time, Westcott points to several mitigating factors which may reduce these effects. Since commodity prices tend to move together, counter-cyclical payments on base acreage provide revenue stabilization for alternative crops. Thus this implies that the production effect need not be on cotton even though the

[563] Brazil's First Written Submission, para. 461.
[564] Exhibit US-34.
[565] The region includes the states of Ohio, Indiana, Illinois, Missouri, Iowa, Minnesota, Wisconsin, and Michigan.
[566] Exhibit US-35.

counter-cyclical payments are made on cotton base. Further, there are other farm programmes which mitigate the revenue risk faced by farmers so that counter-cyclical payments may not have much to contribute. Finally, a large portion of output in US agriculture is produced by large producers, and to the extent that risk aversion decreases as income rises, the revenue stabilization benefits of counter-cyclical payments may be lower. Taking these mitigating factors into account, Westcott concludes that the overall production effects of counter-cyclical payments through revenue risk reduction are likely to be limited, although the study is unable to provide an estimate of this magnitude.

13.3 The United States also submits a study "US Agricultural Policy: Overview and Recent Analyses" by Edwin Young, Anne Effland, Paul Westcott and Demcey Johnson.[567] This paper presents an overview of recent US agricultural policies as embodied in the 1996 and 2002 Farm Acts. It also provides a survey of recent analyses regarding the effects of those policies. With respect to counter-cyclical payments under the 2002 Farm Act, it suggests that recent studies have concluded that these payments "create small but positive production incentives".

13.4 Finally, the United States submits a paper entitled "Another Look at Decoupling: Additional Evidence on the Production Effects of Direct Payments" by B. Goodwin and A. Mishra in the American Journal of Agricultural Economics.[568] The Goodwin and Mishra study, published in 2005, examines the extent to which production flexibility contract or Agricultural Market Transition Act (AMTA) payments under the FAIR Act affected the acreage decisions of a set of farms in the US Corn Belt who grew corn, wheat, and soybeans. In particular, the authors use farm-level data for the years 2002 and 2003 to examine the acreage decisions of Corn Belt producers. They also examine responses to a number of survey questions regarding factors affecting acreage decisions and the disposition of funds received in the form of direct payments. Farmers' responses to the survey questions suggest that direct payments, counter-cyclical payments, and the potential for base acreage updates were all relatively minor factors. Finally, their empirical results find no statistically significant relationship between direct payments and acreage decisions for corn, wheat, and soybeans.

2. Studies cited by Brazil

13.5 Brazil submits a paper "Farm-Level Production Effect From Participation in Government Commodity Programs: Did the 1996 Federal Agricultural Improvement and Reform Act Make a Difference" by Nigel Key, Ruben Lubowski and Michael Roberts.[569] The paper, published in the American Journal of Agricultural Economics, looks at the production impact of participation in government commodity programmes. As such, it does not single out the influence of counter-cyclical payments from other elements of these commodity programmes. The results indicate that participants increased plantings of programme crops considerably (38-59 percentage points) more than non-participants. Estimated effects of participation on farm-size growth and total sales growth were also consistent across time, increasing 14-16 percentage points and 22-24 percentage points, respectively. Although the estimated effects do not isolate the impact of countercyclical payments, the study goes on to conjecture "that the results suggest decoupled payments affect production at the farm level".

13.6 Another study submitted by Brazil, "How distorting are direct payments?" by Erik J. O'Donoghue and James Whitaker[570], investigates the effects of direct payments on total harvested acres for farms growing programme crops (including upland cotton), non-programme crops and livestock. The study's main innovation is to control for the possible endogeneity of direct payments. Endogeneity can occur because, while direct payments could alter acreage changes (if the payments had wealth effects, caused expectations to change, etc.), acreage changes could also alter

[567] Exhibit US-40.
[568] Exhibit US-41.
[569] Exhibit BRA-566.
[570] Exhibit BRA-568.

the receipt of direct payments (if base was bought or sold). The authors use the updating of base acres allowed under the 2002 Farm Act to impute causation.

13.7 The authors divide farms into four categories by size of revenues. Their econometric estimates suggest that direct payments (which are "proxied" by average base acre changes for farms) affect farms differently. The smallest farms appear not to have changed their harvested acres. The next set of farms in terms of revenues increased their total cropland harvested by almost 25 per cent on average, while the third set of farms increased their total cropland harvested by nearly ten per cent. However, the largest farms decreased their total cropland harvested by approximately 20 per cent. The authors judge that altogether these magnitudes represent "substantial changes". They do not seem to have explicitly tested how direct payments affect harvested acreage for farms growing programme crops, non-programme crops or livestock. But in interpreting their econometric results, they offer the explanation that farms might be redistributing the acres from non-programme crop and livestock specialties to programme crop farms (which include upland cotton).

13.8 Another paper submitted by Brazil is entitled "Are decoupled payments really decoupled?" by B. K. Goodwin and A. Mishra[571]; published in the American Journal of Agricultural Economics in 2006.[572] This study examines the production effect of Agricultural Market Transition Act (AMTA) and market loss assistance payments. It finds modest evidence that AMTA payments may lead to increased production of corn, soybeans, and wheat. However, the acreage effects are very small. Acreage elasticities for the major crops, corn and soybeans, are about 0.025 to 0.035. These estimates suggest that even a very large increase in these decoupled payments would not be expected to significantly increase acreage. However, market loss assistance payments appeared to have a more significant effect on acreage. The estimated elasticity of corn acreage with respect to the payments was 0.10, suggesting that such payments may indeed lead to more corn production.

13.9 Brazil also submits a study, "Supply Response to Counter-Cyclical Payments and Base Acre Updating under Uncertainty: An Experimental Study" by Christopher R. McIntosh, Jason F. Shogren and Erik Dohlman.[573] The study, which is to be published in the American Journal of Agricultural Economics, reports on a laboratory experiment which attempts to mimic the price risks faced by farmers and the incentives provided by direct and counter-cyclical payments under the 2002 Farm Act. Four scenarios are considered. The baseline scenario is where only direct payments are provided. The second scenario includes both direct and counter-cyclical payments. The third scenario allows for some uncertainty about the policy regime. The fourth scenario requires mandatory updating of base acreage. Eighty-five students recruited from Economics and Finance undergraduate classes at the University of Wyoming were the subjects of the laboratory experiment. Based on the results of the experiments, the authors conclude that counter-cyclical payments influence crop allocation decisions in the laboratory — the average subject allocated more acres toward the base crop in the presence of counter-cyclical payments. They estimate that the presence of counter-cyclical payments will increase base crop acreage by 5.43 per cent. Larger estimates (7.92 per cent increase) are obtained if apart from price risk, the subjects face uncertainty about the policy regime.

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[571] Exhibit BRA-618.

[572] This article appears to be based on the same study cited by the United States in Exhibit US-41. Both studies cover the same crops (corn, soybeans, wheat) and the same geographical region (Corn Belt) of the United States. However, there appears to be some difference in the programmes covered. Exhibit US-41 includes AMTA payments only while BRA-618 covers both AMTA and MLA payments.

[573] Exhibit BRA-565.

B. ARE COUNTER-CYCLICAL PAYMENTS CAPITALIZED INTO HIGHER LAND VALUES?

1. Studies cited by the United States

13.10 The studies by Hoppe and Banker[574] and Young, Effland, Westcott and Johnson[575] examine the extent of land rental in US agriculture. The third study by Abler and Blandford[576] provides a survey of empirical studies on direct payments under the United States 1996 FAIR Act and subsequent Marketing Loss Assistance (MLA) payments.

13.11 The USDA study by Hoppe and Banker shows that an estimated 44 per cent of all farmland operated in 2003 was rented.[577] The study by Young, Effland, Westcott and Johnson gives even higher estimates for larger farms. They state that crop farms in which total sales exceeded US$250,000, also known as commercial crop farms, rented close to 60 per cent of their total acres operated.[578] Unfortunately, neither study refers specifically to upland cotton, so it is not possible to know to what extent upland cotton farmers conformed or differed with respect to these nationwide statistics.

13.12 The Abler and Blandford study was written for the OECD. The paper is a literature review of empirical studies on land allocation and production response to direct payments under the United States 1996 FAIR Act and subsequent MLA payments. Thus, it is again important to note that the study does not examine the experience with counter-cyclical payments. The main conclusion of this study on the link between such payments and land values is that PFC and MLA payments had a significant effect on land values and rental rates. Given the importance of the rental market for land in the United States, it appears that there was a relatively high "pass-through" of the additional income generated by the payments to landowners, many of whom are not the actual operators of the land. It appears that the payments primarily had the effect of increasing the value of the principal fixed asset in agriculture – land.[579]

13.13 However, the authors also point out that the empirical studies reviewed lend support to the view that PFC and MLA payments had some impact on production relative to the counterfactual case with no PFC or MLA payments. Empirical studies indicate that the payments may have influenced planted area and possibly the use of variable inputs, particularly farm household labour. In general, the estimated impacts are modest. In the econometric studies reviewed, PFC and MLA payment variables are sometimes statistically insignificant, and when they are statistically significant they imply in most cases that each type of payment increased planted area and on-farm work hours by less than 5 per cent. In no instance do the econometric results imply an increase in planted area or on-farm work hours due to PFC or MLA payments of more than 15 per cent. Some of the synthetic studies suggest larger impacts on production, but their results are sensitive to assumptions about the degree and nature of farmers' aversion to risk. The synthetic studies also do not consider the possibility that assets owned by farmers who would exit the industry in the absence of PFC or MLA payments, could be sold or rented to other farmers, which would diminish the impact of the payments on production.[580]

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[574] Exhibit US-67.
[575] Exhibit US-40.
[576] Exhibit US-32.
[577] US First Written Submission, para. 215.
[578] See Exhibit US-40, p. 7.
[579] Exibit US-32, para. 71.
[580] Exhibit US-32, para. 69.

XIV. FINDINGS ON BRAZIL'S CLAIMS UNDER ARTICLES 10.1 AND 8 OF THE *AGREEMENT ON AGRICULTURE* AND ARTICLES 3.1(A), 3.2 AND 4.7 OF THE *SCM AGREEMENT* WITH RESPECT TO EXPORT CREDIT GUARANTEES

A. INTRODUCTION

14.1 In this section of our Report, we address Brazil's claims concerning US export credit guarantees. Brazil requests the Panel to find that US measures "taken to comply" with the recommendations and rulings of the DSB with respect to export credit guarantees either do not exist, or to the extent they exist, are not consistent with Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*.

14.2 Specifically, Brazil makes the following claims:

(i) *First*, Brazil claims that the United States has taken no action to "withdraw the subsidy" with respect to GSM 102, GSM 103, and SCGP guarantees[581] outstanding on 1 July 2005.

(ii) *Second*, Brazil claims that the measures taken by the United States to comply with the DSB recommendations and rulings are inconsistent with Articles 10.1 and 8 of the *Agreement on Agriculture* and, to the extent of that inconsistency, with Articles 3.1(a) and 3.2 of the *SCM Agreement*. More specifically, Brazil claims that the United States continues to provide prohibited export subsidies in the form of GSM 102 export credit guarantees, and has applied those export subsidies subsequent to 1 July 2005 in a manner that results in circumvention of the US export subsidy commitments under the *Agreement on Agriculture*.[582] [583]

14.3 Brazil requests the Panel to find that the United States has failed to comply fully with its obligation, under Article 4.7 of the *SCM Agreement*, to "withdraw the subsidy" and that the original Article 4.7 recommendation adopted by the DSB therefore remains in effect. Brazil also requests that the Panel find that the United States has failed to bring itself into conformity with its obligations under the *Agreement on Agriculture*, and that the original recommendation adopted by the DSB in this respect therefore also remains in effect.

1. Description of the export credit guarantees at issue in this dispute

14.4 We recall the main characteristics of the three CCC export credit guarantee programmes at issue in this dispute.[584]

14.5 The GSM 102 programme guarantees credit extended by a US private bank (or, less commonly, a US exporter) to approved foreign banks using dollar-denominated, irrevocable letters of credit for purchases of US agricultural exports by foreign buyers. In practice, the foreign bank extends credit to the foreign importer and the US exporter – or more frequently, its bank (the US bank) – extends credit to the foreign bank. Of all the parties involved, only the foreign importer need

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[581] See above paras. 3.13 *ff*.

[582] The Panel notes that Brazil's claims are "as applied" claims. See *infra*. para. 14.41.

[583] The Panel also notes that Brazil claims that GSM 102 export credit guarantees provided to exports of three products not falling within the scope of the *Agreement on Agriculture*, lysine, lyocell and wood products, are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*.

[584] While Brazil's claim with respect to outstanding guarantees concerns guarantees issued under the three export credit guarantee programmes that were the subject of the original panel's findings (GSM 102, GSM 103 and SCGP), Brazil's claims with respect to guarantees issued after 1 July 2005 concern guarantees issued under the GSM 102 programme, as amended.

not be CCC-approved. The guarantee, which the US exporter obtains from the CCC, is triggered by a default on the part of the foreign bank. The US exporter then submits a notice of default to the CCC and the CCC pays the claim consistent with the terms of the guarantee. GSM 102 guarantees generally cover 98 per cent of the principal and a portion of the interest. The GSM 103 programme, which has now been discontinued, was similar to the GSM 102 programme. The main difference between guarantees issued under the two programmes relates to the terms of the underlying credit. GSM 102 guarantees cover credit terms between 90 days and three years, GSM 103 guarantees covered credit terms between 3 years and 10 years.

14.6 The SCGP programme guarantees the repayment of credit secured by promissory notes for periods not exceeding 180 days by a United States exporter to a foreign purchaser. SCGP guarantees typically cover a portion (65 per cent) of the value of principal only, the guarantee does not cover interest. The US exporter may negotiate an arrangement to be paid, in full or in part, by assigning the right to proceeds that may become payable under the CCC's guarantee to a US financial institution.[585]

2. Summary of the original panel and Appellate Body's findings concerning export credit guarantees

14.7 We first recall, as an introduction to this section of our Report, the main findings of the panel and Appellate Body concerning export credit guarantees in the original proceeding.

14.8 As in this compliance proceeding, Brazil had, before the original panel, made claims under both the *Agreement on Agriculture* and, to the extent of the inconsistency with the *Agreement on Agriculture*, the *SCM Agreement*. The original panel relied on item (j) of the Illustrative List of Export Subsidies in Annex I to the *SCM Agreement* (hereafter "Illustrative List") as "contextual guidance" in determining that the export credit programmes at issue (GSM 102, GSM 103, SCGP) constituted export subsidies under Articles 10.1 and 8 of the *Agreement on Agriculture*.[586] The panel declined to make additional factual findings on what it considered to be an alternative argument of Brazil that the same programmes constituted export subsidies under the general definition of "export subsidies" contained in Articles 1 and 3.1(a) of the *SCM Agreement* (also as context under Articles 10.1 and 8 of the *Agreement on Agriculture*). In the Interim Review section of its Report, the panel indicated that "Brazil's allegation invoking the elements of Articles 1 and 3.1(a) of the *SCM Agreement* [was] not a separate claim, but merely another argument, on a different factual basis, as to how the United States export credit guarantee programmes would meet the definition of an export subsidy in Article 3.1(a) of the *SCM Agreement*".[587]

14.9 Having determined that the export credit guarantees at issue constituted export subsidies within the meaning of Article 10.1 of the *Agreement on Agriculture*[588], the panel found that the United States had applied such subsidies in a manner which resulted in circumvention of its export subsidy reduction commitments in respect of cotton and other unscheduled products supported under the export credit guarantee programmes, as well as in respect of one scheduled product[589], rice.[590] To

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[585] See Panel Report, *US – Upland Cotton*, paras. 7.242-7.244 (quoted, *supra*, para. 3.14), Brazil's First Written Submission, paras. 351-355, Exhibit Bra-519.

[586] Panel Report, *US – Upland Cotton*, paras. 7.763, 7.804-7.869.

[587] Panel Report, *US – Upland Cotton*, para. 6.31.

[588] The panel rejected US arguments that Article 10.2 of the *Agreement on Agriculture* reflects the fact that export credit guarantee programmes are not subject to the export subsidy disciplines of the *SCM Agreement*. See Panel Report, *US – Upland Cotton*, paras. 7.897-7.944. The Appellate Body upheld the panel's findings in this respect, with one member of the Appellate Body Division hearing the dispute dissenting. See Appellate Body Report, *US – Upland Cotton*, paras. 585-627 and 631-641.

[589] *I.e.* a product for which the United States has undertaken export subsidy reduction commitments under the *Agreement on Agriculture*.

[590] Panel Report, *US – Upland Cotton*, paras. 7.875, 7.881 and 8.1(d)(i).

the extent that the programmes did not fully conform to the *Agreement on Agriculture*, the panel considered that they did not benefit from the exemption in Article 13 of the *Agreement on Agriculture* and found that they were prohibited export subsidies under Article 3.1(a) of the *SCM Agreement* and were also inconsistent with Article 3.2 of the same Agreement.[591] The panel considered that Brazil had failed to prove its claims with respect to exports of scheduled agricultural products other than rice, including pig meat and poultry meat, and with respect to exports of unscheduled agricultural products not supported under the programmes.[592]

14.10 The Appellate Body upheld the panel's findings with respect to unscheduled products and rice but reversed the original panel's finding that Brazil had failed to establish a violation of Article 10.1 of the *Agreement on Agriculture* with respect to exports of pig meat and poultry meat.[593] It did not, however, "complete the analysis" in this respect. Further, the Appellate Body rejected claims by Brazil that the panel had improperly exercised judicial economy with respect to Brazil's arguments under Articles 1.1 and 3.1(a) of the *SCM Agreement*.[594]

B. BRAZIL'S CLAIMS WITH RESPECT TO EXPORT CREDIT GUARANTEES OUTSTANDING ON 1 JULY 2005

1. Introduction

14.11 The original panel recommended that the United States bring its export credit guarantees under the GSM 102, GSM 103 and SCGP programmes in respect of upland cotton and other "supported" unscheduled agricultural products into conformity with the *Agreement on Agriculture*; it also recommended, pursuant to Article 4.7 of the *SCM Agreement*, that the United States "withdraw" the prohibited subsidies without delay, at the latest within six months of the date of adoption of the panel report by the DSB or 1 July 2005 (whichever was earlier).[595]

14.12 The panel's recommendations, which were upheld by the Appellate Body, were adopted by the DSB at its 21 March 2005 meeting.[596] As a consequence, the United States had until 1 July 2005 to "withdraw" the prohibited export subsidies identified by the original panel.

14.13 Brazil claims that the United States has taken no measures to comply with the DSB's recommendations to "withdraw the subsidy" under Article 4.7 of the *SCM Agreement* and otherwise bring itself into conformity with its obligations under Articles 10.1 and 8 of the *Agreement on Agriculture* with respect to "outstanding" guarantees, i.e. GSM 102, GSM 103 and SCGP export credit guarantees for unscheduled products and for rice issued prior to 1 July 2005 that were still outstanding on that date.[597]

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[591] Panel Report, *US – Upland Cotton*, paras. 7.946-7.948 and 8.1(d)(i).
[592] Panel Report, *US – Upland Cotton*, paras. 7.882-7.896 and 8.1(d)(ii).
[593] Appellate Body Report, *US – Upland Cotton*, paras. 763(e) and 763(f).
[594] Appellate Body Report, *US – Upland Cotton*, paras. 763(e)(v).
[595] Panel Report, *US – Upland Cotton*, para. 8(3)(b). Article 4.7 of the *SCM Agreement* provides that:
"If the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy without delay. In this regard, the panel shall specify in its recommendation the time-period within which the measure must be withdrawn." (underline added)
[596] WT/DSB/M/186.
[597] Brazil's First Written Submission, para. 341. Brazil's claims cover any guarantees that were outstanding on 1 July 2005, whether or not they subsequently expired. See paras. 390-393 of Brazil's Rebuttal Submission.

2. Main arguments of the parties

14.14 **Brazil** argues that the United States has done nothing to bring outstanding GSM 102, GSM 103 and SCGP export credit guarantees into conformity with Articles 10.1 and 8 of the *Agreement on Agriculture*, or to withdraw them under Article 4.7 of the *SCM Agreement*. Brazil considers that the obligation to "withdraw the subsidy" applies not only to the three programmes at issue in the original dispute, but also to outstanding guarantees.[598] Brazil relies on the panel and Appellate Body reports in *Brazil – Aircraft (Article 21.5 – Canada)*, in support of its argument that the United States may not, after the "implementation deadline" of 1 July 2005 (i.e. the date by which the United States had to comply with the recommendations and rulings of the DSB), continue to perform on guarantees issued before that date and still outstanding[599], either by making "payments" on claims following defaults or by rescheduling or restructuring debt covered by outstanding guarantees.

14.15 Brazil also argues that the obligation to abstain from performing on financial commitments outstanding under a programme as of the deadline for implementation follows from the text of the *SCM Agreement*: the obligation to withdraw the subsidy under Article 4.7 of the *SCM Agreement* applies to both the "granting" of new subsidies and the "maintenance" of existing subsidies under Article 3.2 of the *SCM Agreement*.[600] The United States has left the entirety of the outstanding prohibited export credit guarantees in place after the implementation date and, by continuing to perform on its commitments under the prohibited subsidies, "maintains" them unchanged. Further, continuing to perform on outstanding export credit guarantees does not satisfy the definition of "withdraw" offered by the Appellate Body in *Brazil – Aircraft (Article 21.5 – Canada)*, in which the Appellate Body defined the term "withdraw" as to "remove" or "take away" the subsidy".[601]

14.16 The **United States** considers that it has "withdrawn the subsidy" with respect to outstanding guarantees by lowering the long-term operating costs and losses of the programmes.[602] To comply, the United States was required to "withdraw" the prohibited subsidies identified in paragraph 8.1(d)(i) of the original panel report, which concerned the provision of guarantees at a net cost to the government; this is what the United States had to "withdraw".[603] The United States considers that the issue of rescheduling is irrelevant to Brazil's claims: any already rescheduled debt is a receivable, pursuant to which the CCC would receive money, not pay any. In response to Brazil's argument that rescheduling is a means for the United States to avoid default and the need to make a "payment" on the CCC obligation, the United States notes that the CCC does not reschedule debt prior to default, and that no obligation is owed to the CCC until it pays a claim and is subrogated to the original obligee.[604]

14.17 Moreover, nothing in the *SCM Agreement* provides that withdrawing a subsidy taking the form of a programme includes an obligation to abstain from performing on commitments outstanding

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[598] Brazil's Rebuttal Submission, paras. 394-395 and 399; Brazil's Closing Statement, para. 30.

[599] Brazil's Rebuttal Submission, paras. 396-398, citing Appellate Body Report, *Brazil – Aircraft (Article 21.5 – Canada)*, para. 45 and Panel Report, *Brazil – Aircraft (Article 21.5 – Canada)*, para. 6.17. See also Brazil's Response to Panel Question 37. Brazil also notes that the Appellate Body, in *US – FSC (Article 21.5 – EC)*, paras. 2 and 223-231, held that a recommendation to withdraw a subsidy in the form of an overarching measure, the FSC, included the obligation to stop making pre-committed payments to existing FSCs ("foreign sales corporations"). Brazil's Closing Statement, footnote 38.

[600] Brazil's Response to Panel Question 92.

[601] Brazil's Response to Panel Question 37, para. 46.

[602] US First Written Submission, paras. 143-145. In the case of GSM 103 and SCGP, the United States indicates that it has completely ceased providing guarantees. Further, the United States considers that there are no "outstanding" SCGP guarantees as it is exposed to no further liability under the programme. See US Rebuttal Submission, para. 129 and US Opening Statement, para. 48.

[603] US Opening Statement, para. 43.

[604] US Rebuttal Submission, paras. 131-133 and US Response to Panel Question 109.

under that programme as of the deadline for implementation.[605] That argument improperly equates "performing on commitments under the program" with the subsidy itself. Such an equation was appropriate in *Brazil – Aircraft (21.5)*, where Brazil continued to issue new WTO-inconsistent bonds even after the period of implementation on the basis that it had pre-existing contractual obligations to do so. However, it is not accurate here, where the guarantees are not themselves prohibited subsidies.

3. Main arguments of third parties

14.18 **Argentina** submits that the obligation of the United States to withdraw the subsidy implies the termination of the export credit guarantee programmes at issue in the first proceeding, and not merely the suspension of payments or the refusal of new applications for export credit guarantees.[606]

4. Evaluation by the Panel

(a) Introduction

14.19 Brazil's arguments in support of its claims that the United States has failed to "withdraw" outstanding export credit guarantees rely primarily on the reasoning of the panel and Appellate Body in the *Brazil – Aircraft (Article 21.5 – Canada)* dispute. According to Brazil, the panel and Appellate Body reports in that case stand for the proposition that a Member's obligation to "withdraw the subsidy" pursuant to recommendations from the DSB adopted in accordance with Article 4.7 of the *SCM Agreement* includes an obligation to abstain from performing on financial commitments outstanding under a programme as of the implementation deadline (i.e. the date by which the Member in question had to comply with the DSB's recommendations). Brazil draws an analogy between *Brazil – Aircraft (Article 21.5 – Canada)* and the present dispute: it considers that the panel and Appellate Body's findings in that dispute (according to which Brazil was precluded from issuing, after the implementation deadline, PROEX bonds pursuant to letters of commitments issued before the implementation deadline) can be transposed to the factual circumstances of this case, and that as a result, the Panel should find that the United States is precluded from making "payments" in the form of the payment of claims or of debt restructuring or rescheduling.[607]

14.20 Brazil also finds support for its position in the definition of "withdraw the subsidy" provided by the Appellate Body in *Brazil – Aircraft (Article 21.5 – Canada)*, in which the Appellate Body defined the term "withdraw" as to "remove" or "take away" the subsidy.

14.21 Given the emphasis that Brazil has put on the reasoning and the findings of the panel and Appellate Body in *Brazil – Aircraft (Article 21.5 – Canada)*, we first proceed to examine whether, as alleged by Brazil, the Appellate Body (and panel) held in that case that the obligation to "withdraw a subsidy" under Article 4.7 of the *SCM Agreement* means that a Member is in all cases precluded from performing on commitments outstanding under a programme as of the deadline for implementation. In doing so, we also examine whether the analogy that Brazil seeks to draw between the two disputes is justified. We then proceed to examine whether, as Brazil argues, the Appellate Body's statement as to the meaning of "withdraw the subsidy" in that case should lead us to a finding that the United States has failed to implement the recommendation of the DSB.

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[605] US Opening Statement, para. 46.

[606] Argentina's Third Party Submission, paras. 9-19.

[607] In other words, from "perform[ing] on ECG's issued before adoption of the DSB's recommendation". Brazil's Response to Panel Question 37, para. 45.

(b) Panel and Appellate Body reports in *Brazil – Aircraft (Article 21.5 – Canada)*

14.22 The *Brazil – Aircraft (Article 21.5 – Canada)* dispute concerned the PROEX programme, under which the Brazilian Government granted interest rate equalization payments, notably on the export of regional aircraft. The original panel had concluded that the PROEX payments constituted prohibited export subsidies under the *SCM Agreement*.

14.23 One of the issues before the compliance panel was whether Brazil had failed to "withdraw the subsidy" because it continued to issue bonds under the PROEX programme ("NTN-I" bonds) after the implementation deadline, pursuant to letters of commitment issued before that date.[608] The *Brazil – Aircraft (Article 21.5 – Canada)* panel considered that it was sufficient, in order to resolve that issue, to conclude that "a Member cannot be deemed to have withdrawn prohibited subsidies if it has not ceased to act in a manner inconsistent with the *WTO Agreement* in respect of those subsidies".[609] The panel noted that Article 3.2 of the *SCM Agreement* provides that a Member shall "neither grant nor maintain" export subsidies and therefore concluded that to continue to grant or to maintain prohibited export subsidies after the implementation date would be inconsistent with Brazil's obligation to withdraw these subsidies.[610] The panel therefore considered that it had to determine whether the continued issuance of bonds by Brazil pursuant to letters of commitments issued under the PROEX programme before it was amended constituted the "grant" of export subsidies under Article 3.2 of the *SCM Agreement*. Before the panel, Brazil argued that PROEX subsidies existed under Article 1 of the *SCM Agreement*, (and therefore, were "granted") at the time the Brazilian Government issued a letter of commitment, not at the time the bonds were issued.[611] The panel rejected Brazil's argument, recalling that in the original dispute it had found, and the Appellate Body had agreed, that for the purposes of Article 27.4 of the *SCM Agreement*, the export subsidies at issue were "granted" at the time of the issuance of the bonds[612], and considered that a similar reasoning was appropriate under Article 3.2. The panel therefore concluded that by continuing to issue NTN-I bonds pursuant to commitments made prior to 18 November 1999, Brazil had failed to withdraw the export subsidies for regional aircraft under the PROEX programme.[613]

[608] Commitments under the programme at issue, PROEX, were made in the form of letters of commitment issued to Brazilian manufacturers, by which the Brazilian Government undertook to provide support as specified for the transaction provided that the contract was entered into in accordance with the terms and conditions specified in the request for approval within a specified period of time (usually 90 days), and provided the aircraft was exported. Panel Report, *Brazil – Aircraft (Article 21.5 – Canada)*, para. 2.5.

[609] Panel Report, *Brazil – Aircraft (Article 21.5 – Canada)*, para. 6.8.

[610] Panel Report, *Brazil – Aircraft (Article 21.5 – Canada)*, para. 6.9.

[611] See Panel Report, *Brazil – Aircraft (Article 21.5 – Canada)*, para. 6.12.

[612] Panel Report, *Brazil – Aircraft (Article 21.5 – Canada)*, paras. 6.10-6.11. In the original dispute, the Appellate Body had affirmed the panel's finding on this issue, though on a different reasoning. The panel and Appellate Body both found that the export subsidies at issue were not yet "granted" when the letter of commitment was issued, because at that point, the export sales contract had not yet been concluded and the export shipments had not yet occurred: "For the purposes of Article 27.4, we conclude that export subsidies ...are 'granted' when all the legal conditions have been fulfilled to entitle the beneficiary to receive the subsidies." Appellate Body Report, *Brazil – Aircraft*, para. 158, quoted by the 21.5 panel at para. 6.10. The Appellate Body however rejected the original panel's approach of focusing on the language of Article 1 of the *SCM Agreement* in order to determine when payments should be considered to have been granted for the purposes of Article 27.4 of the *SCM Agreement*. The panel had, notably, sought to determine whether PROEX payments constituted "direct transfers of funds" or "potential direct transfer of funds" under Article 1. The Appellate Body noted that the issue was not when or whether subsidies "existed" (Brazil had already conceded that subsidies did exist) but when the subsidies should be considered to have been "granted" for the purposes of Article 27.4. Appellate Body Report, *Brazil – Aircraft*, paras. 156 *ff.*, cited in Panel Report, *Brazil – Aircraft (Article 21.5 – Canada)*, para. 6.13.

[613] Panel Report, *Brazil – Aircraft (Article 21.5 – Canada)*, para. 6.17. Brazil had also argued that it had a contractual obligation to issue PROEX bonds pursuant to commitments already entered into and would be

14.24 The Appellate Body affirmed the panel's findings, but considered that Brazil's arguments about when a subsidy is deemed to "exist" under Article 1.1 of the *SCM Agreement*, and when it is "granted" under Article 3.2 of that Agreement were not relevant to the analysis of Canada's allegation that Brazil has failed to "withdraw the subsidy".[614]

14.25 The Appellate Body noted that Brazil did not contest that the measures in question conferred a prohibited export subsidy.[615] It considered that in its ordinary meaning, the "withdrawal" of a subsidy under Article 4.7 of the *SCM Agreement* refers to the "removal" or "taking away" of that subsidy:

> Turning to the ordinary meaning of "withdraw", we observe first that this word has been defined as "remove" or "take away", and as "to take away what has been enjoyed; to take from." This definition suggests that "withdrawal" of a subsidy, under Article 4.7 of the *SCM Agreement*, refers to the "removal" or "taking away" of that subsidy.[616] (footnotes omitted)

14.26 The Appellate Body then observed that Brazil conceded that it continued to issue bonds pursuant to letters of commitments issued prior to the implementation deadline, meaning that such bonds continued to be issued on "precisely the same terms and conditions as they were before".[617] The Appellate Body considered that the issuance of the bonds essentially represented "disbursements" made under PROEX, given that the financing institution could choose to either sell the bonds in the market or receive payments when they became due and that Brazil was thus continuing, after the implementation deadline, to make payments under a subsidy programme found to involve prohibited export subsidies. It concluded that:

> … to continue to make payments under an export subsidy measure found to be prohibited is not consistent with the obligation to "withdraw" prohibited export subsidies, in the sense of "removing" or "taking away".[618]

(c) Whether the obligation to "withdraw the subsidy" includes an obligation to abstain from performing on outstanding financial commitments

14.27 As is clear from the brief summary above, the issue of "prior commitments" arose, in *Brazil – Aircraft (Article 21.5 – Canada)*, because of Brazil's arguments regarding the timing of the granting of the subsidy. The fact that the bonds were issued "pursuant to" letters of commitments that pre-dated the implementation deadline was not, in our view, an important consideration in this respect and there is no indication that either the panel or the Appellate Body would have reached a different conclusion had the bonds been issued independently of any prior commitment. In fact, it seems safe to assume that the issue of prior or outstanding "commitments" would not have been discussed at all had it not been for Brazil's arguments regarding the timing of the granting of the subsidy.

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liable for breach of damages if it failed to do so. The panel rejected Brazil's arguments that such considerations should affect its conclusion: "[a]ssuming that Brazil is correct in this regard, the implication of this view would be that Members could contract to grant prohibited subsidies for years into the future and be insulated from any meaningful remedy under the WTO dispute settlement system." The panel also noted that under Article 21 of the *Vienna Convention*, a party to a treaty may not invoke the provisions of its internal law as justification for its failure to perform a treaty. Panel Report, *Brazil – Aircraft (Article 21.5 – Canada)*, para. 6.16 and note 23. The Appellate Body endorsed the latter part of the panel's reasoning. Appellate Body Report, *Brazil – Aircraft (Article 21.5 – Canada)*, para. 46.

[614] Appellate Body Report, *Brazil – Aircraft (Article 21.5 – Canada)*, para. 44.
[615] Appellate Body Report, *Brazil – Aircraft (Article 21.5 – Canada)*, para. 44.
[616] Appellate Body Report, *Brazil – Aircraft (Article 21.5 – Canada)*, para. 45.
[617] Appellate Body Report, *Brazil – Aircraft (Article 21.5 – Canada)*, para. 45.
[618] Appellate Body Report, *Brazil – Aircraft (Article 21.5 – Canada)*, para. 45.

14.28 This reading of the reports of the panel and the Appellate Body is confirmed by the absence of any reference to prior "commitments" in the Appellate Body statement quoted above, and on which Brazil puts so much emphasis.[619] The Appellate Body, unsurprisingly, found that by continuing to issue PROEX bonds as it had before – and which had been found, in the original dispute, to amount to the granting of an export subsidy – Brazil was continuing to grant the subsidies in question and had therefore not "withdrawn" them.

14.29 Further, in our view, Brazil ascribes a broader meaning to the Appellate Body's use of the term "payment" than is warranted: Brazil reads that term as encompassing any disbursements made under a measure found to be a prohibited subsidy. In our view, the Appellate Body's reference to "mak[ing] payments" was clearly meant as a reference to the granting of a PROEX *subsidy* as the Appellate Body was not discussing the issue of "payments" in an abstract or general sense, but rather was referring to PROEX "payments" (in the form of NTN-I bonds) made on the export of regional aircraft.[620] In any case, the term "payment" appears in neither of Article 4.7 or Article 3.2 of the *SCM Agreement*. Both provisions concern *subsidies*.

14.30 We thus find no support, in either of the panel or the Appellate Body report in that dispute, for Brazil's contention that a Member is necessarily precluded, under Article 4.7 of the *SCM Agreement*, from making "payments" or otherwise performing on "commitments" pursuant to measures pre-dating the implementation deadline. Rather, as can be deducted from our analysis above, the panel and the Appellate Body's findings in that case rest on the simpler proposition that a Member has not "withdraw[n] the subsidy" where it continues to provide prohibited export subsidies after the deadline set by the DSB for implementing its recommendation. Making "payments" is inconsistent with the Member's obligation to "withdraw a subsidy" when the "payments" themselves amount to the granting of a subsidy. The fact that a subsidy is granted pursuant to a prior or outstanding commitment is, in our view, simply of no relevance.[621]

14.31 Brazil also relies on the Appellate Body Report in *US – FSC (Article 21.5 – EC)*. Brazil submits that the Appellate Body held in that case that a recommendation to withdraw a subsidy in the form of an overarching measure, the FSC, included the obligation to stop making "pre-committed" payments to existing FSCs (Foreign Sales Corporations).[622] Again, Brazil ascribes a broader meaning to certain statements or findings of the Appellate Body than is warranted. The *US – FSC (Article 21.5 – EC)* dispute concerned transitional provisions which allowed legislative measures that had been found, in the original dispute, to confer prohibited export subsidies, to continue to apply with respect to certain transactions. The "payments" in question were therefore not "pre-committed", as Brazil alleges. Rather, the legislative measure that allowed for subsidies to be provided simply continued to apply, albeit to a limited number of transactions.[623] Again, we read the Appellate Body's findings in

[619] That "… to continue to make payments under an export subsidy measure found to be prohibited is not consistent with the obligation to 'withdraw' prohibited export subsidies, in the sense of 'removing' or 'taking away'", Appellate Body Report, *Brazil – Aircraft (Article 21.5 – Canada)*, para. 45.

[620] See Appellate Body Report, *Brazil – Aircraft (Article 21.5 – Canada)*, paras. 42 and 45.

[621] We also note that the panel and Appellate Body did not have to address, *in Brazil – Aircraft (Article 21.5 – Canada)*, the question of whether Brazil had failed to "withdraw the subsidy" because Brazil was continuing to honour its obligations under bonds issued prior to the implementation deadline. That aspect of the dispute only concerned the issuance, by Brazil, of new bonds pursuant to letters of commitment entered into before the date of implementation. The United States notes that, in that case, Brazil presumably continued to make payments under outstanding bonds for more than a decade after the implementation date. See US Opening Statement, para. 47.

[622] Brazil refers to the Appellate Body Report, *US – FSC (Article 21.5 – EC)*, paras. 223-231. See Brazil's Response to Panel Question 37, footnote 28 to para. 46, and Brazil's Closing Statement, footnote 38.

[623] Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 224. For the sake of completeness, we note that in the *Brazil – Aircraft (Article 21.5 – Canada)* case, the panel and the Appellate Body rejected arguments by Brazil that it should be allowed to continue to grant prohibited export subsidies after the end of the

that dispute as a reaffirmation of the principle that a Member has not "withdraw[n] the subsidy" where it continues to grant it after the end of the implementation period or where it "maintains" in place the legislative measure under which the subsidies are granted.

14.32 Thus in our view, the relevant question is not whether the United States, after the end of the implementation period, makes *any* "payment" in a general sense under programmes that were found, in the original proceeding, to constitute prohibited export subsidies, pursuant to prior commitments. The relevant question is whether the United States continues or continued, after the end of the implementation period, to provide export subsidies.[624]

14.33 The equivalent, in the present dispute, of the issuance of bonds in *Brazil – Aircraft (Article 21.5 – Canada)* is, we believe, the issuance of CCC export credit guarantees, not the payment, by the US Government, of claims under such guarantees, or the rescheduling or restructuring of debt following the payment of claims. We recall that the subsidies at issue in this dispute are not the payment of claims by the US Government (or rescheduling or restructuring of debt) but the issuance of export credit guarantees through the CCC. Brazil did not claim in the original proceeding that the United States provided export subsidies in the form of payments pursuant to existing export credit guarantees. On the contrary, Brazil challenged the very issuance of guarantees as part of programmes meeting the conditions of item (j) of the Illustrative List. The panel's recommendation to "withdraw the subsidy" concerned subsidies in the form of guarantees, not in the form of payments (of claims) under guarantees. Even before this Panel, in seeking to demonstrate that the United States circumvented its export subsidy commitments, Brazil does not refer the Panel to the volume of US agricultural exports for which claims were paid, but rather to the volume of US agricultural products covered by guarantees, whether or not claims were ultimately paid under such guarantees. Further, Brazil has not, in our view, sought to establish that the payment of a claim under a guarantee or the rescheduling/restructuring of debt are, in themselves, prohibited export subsidies, independently of the subsidy that is conferred in the form of an export credit guarantee.

14.34 In sum, Brazil has not convinced us that the obligation to "withdraw the subsidy" pursuant to a recommendation adopted in accordance Article 4.7 of the *SCM Agreement* includes a general obligation to cease making payments or otherwise performing under outstanding or prior

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implementation period because it had assumed contractual obligations to do so under municipal law (see *supra*, note 613) and that the Appellate Body rejected similar arguments made by the United States in *US – FSC (Article 21.5 – EC)*. In the latter case, the United States had argued that it should be allowed to continue granting prohibited export subsidies to protect the contractual interests of private parties and to ensure an orderly transition to the new legislative regime. Appellate Body Report, *US – FSC (Article 21.5 – EC)*, paras. 223-239. The rejection of the arguments made, respectively, by Brazil and the United States in these two disputes does not assist Brazil's argument in the present dispute. The panel and Appellate Body, in these disputes, rejected arguments by a responding Member that it should be allowed to continue granting prohibited export subsidies because it had committed to do so or because of other municipal law considerations (e.g. because of private parties' expectations). The rejection of these arguments is not equivalent to a finding that a Member is, in all cases, precluded from granting subsidies because they were pre-committed.

[624] While the Appellate Body indicated in *Brazil – Aircraft (Article 21.5 – Canada)* that Brazil's arguments regarding the timing of the existence of the granting of subsidies was not relevant to its analysis, we recall that in the original *Brazil – Aircraft* proceeding, both the panel and the Appellate Body reached the conclusion that PROEX subsidies were "granted" at the time of the issuance of the bonds. Were we, like the *Brazil – Aircraft (Article 21.5 – Canada)* panel, to consider that the "timing" of the granting of the subsidy is of relevance, we would conclude that export subsidies in the form of export credit guarantees are not "granted" at the time when the issuing agency makes a payment pursuant to a claim of default or when it reschedules or restructures debt covered by a guarantee. In our view, the recipient's "unconditional legal right" to receive the subsidy in question (i.e. export credit guarantee) arises at an earlier point in time, at the time of the issuance of the guarantee. A conclusion that the subsidies in question are granted at the time the United States makes a payment (on default) or upon the rescheduling or restructuring of debt would lead to the logically flawed result that many, if not most, of export subsidies in the form of export credit guarantees would never be granted.

commitments under a measure found to constitute a prohibited export subsidy. As a consequence, Brazil has not established, on that basis, that the United States has failed to "withdraw the subsidy" because it continues to pay claims pursuant to outstanding guarantees or because it reschedules or restructures debt covered by such guarantees.

(d) Meaning of the term "withdraw"

14.35 Brazil also relies on the definition of the term "withdraw" provided by the Appellate Body in *Brazil – Aircraft (Article 21.5 – Canada)*. As mentioned above, in that case, the Appellate Body interpreted that term in Article 4.7 of the *SCM Agreement* as requiring that a Member "remove" or "take away" the subsidy. For Brazil, "[p]aying a claim on default of a GSM 102 credit subject to the DSB's recommendation to 'withdraw the subsidy' does not 'remove' or 'take away' that subsidy".[625]

14.36 Further, Brazil argues that the obligation to "withdraw" the subsidy in Article 4.7 of the *Agreement*, interpreted in the sense of "removing" or "taking away", extends to both elements of Article 3.2, the "granting" and the "maintenance" of a subsidy.[626] Brazil argues that the Appellate Body, in *US – FSC (Article 21.5 – EC II)* held that "the obligation to 'fully' withdraw a prohibited subsidy is not achieved if the Member '*leaves* the entirety or part of the original prohibited subsidy *in place*'".[627] Thus, Brazil submits that "[b]y continuing to perform on its commitments under the prohibited subsidies, the United States 'maintains' them unchanged".[628]

14.37 Neither of the two Appellate Body Reports cited by Brazil support its argument that the obligation to "withdraw the subsidy" includes an obligation to remove or take away individual subsidies *that were granted in the past*. Again, the *Brazil – Aircraft (Article 21.5 – Canada)* dispute concerned a situation where a Member continued to grant, *after* the end of the implementation period, *new* (individual) subsidies. The second Appellate Body Report cited by Brazil, *US – FSC (Article 21.5 – EC II)*, addressed a situation where a Member maintained the *legislative provisions* that allowed the (future) granting of subsidies. In neither case did the Appellate Body indicate that the Member concerned was required to "withdraw" (in the sense of "removing" or "taking away") *individual* subsidies that had already been granted. Thus, Brazil has pointed to no precedent for the proposition that the obligation to "withdraw" in the sense of "removing" or "taking away", whether viewed in terms of the granting of a subsidy or in terms of its maintenance, extends to individual subsidies that were granted under a programme found to confer prohibited export subsidies, prior to the end of the implementation period.

14.38 We need not, in this dispute, develop a comprehensive analysis of the extent of a Member's obligation to "withdraw the subsidy" pursuant to a recommendation adopted under Article 4.7 of the *SCM Agreement*. In particular, we need not decide whether the obligation to "withdraw the subsidy" pursuant to a panel recommendation adopted under Article 4.7 of the *SCM Agreement* imposes an obligation on a Member to "remove" or "take away", *retrospectively,* individual subsidies that were provided in the past. Brazil has emphasized that the remedy it is seeking is not a retroactive remedy and that its claims are entirely prospective in nature.[629] It is therefore the Panel's understanding that Brazil considers that the WTO Agreements (in particular, the *SCM Agreement*) do not provide for retroactive remedies. Brazil has not explained how its interpretation of the obligation set out under Article 4.7 would not amount to a retroactive remedy, even though it would require the United States

[625] Brazil's Response to Panel Question 37, para. 46.
[626] Article 3.2 of the *SCM Agreement* provides that "A Member shall neither grant nor maintain" prohibited subsidies.
[627] Brazil's Response to Panel Question 92, para. 199, referring to Appellate Body Report, *US – FSC (Article 21.5* – EC *II)*, para. 84 (emphasis added by Brazil).
[628] Brazil's Response to Panel Question 92, para. 200.
[629] Brazil's Response to Panel Question 92, para. 201.

to, in effect, eliminate subsidies previously granted and therefore take action with respect to acts which took place before the end of the time-period within which the United States had to "withdraw the subsidy". A finding on our part that the United States is precluded from making payments (or rescheduling or restructuring debt) pursuant to guarantees issued before 1 July 2005 would, in our view, amount to a retroactive remedy, similar to a finding that a Member must demand repayment, from the recipient, of a subsidy in the form of a direct transfer of funds.

14.39 In light of the foregoing considerations, the Panel **finds** that Brazil has not established that the United States has failed to comply with the panel recommendations, adopted by the DSB, to "withdraw the subsidy" with respect to export credit guarantees issued prior to the end of the implementation period on 1 July 2005[630], and to bring its measures into conformity with the *Agreement on Agriculture*.

C. BRAZIL'S CLAIMS CONCERNING GSM 102 EXPORT CREDIT GUARANTEES ISSUED AFTER 1 JULY 2005

1. Introduction

14.40 Brazil claims that the US measures taken to comply with the DSB recommendations and rulings are inconsistent with Articles 10.1 and 8 of the *Agreement on Agriculture* and, to the extent of that inconsistency, with Articles 3.1(a) and 3.2 of the *SCM Agreement*. This claim concerns GSM 102 export credit guarantees provided to exports of unscheduled products and exports of three scheduled products – rice, pig meat and poultry meat[631] – since the end of the implementation period, i.e. 1 July 2005. In addition, Brazil claims that GSM 102 export credit guarantees provided to exports of three products not falling within the scope of the *Agreement on Agriculture*, lysine, lyocell and wood products, are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*.

14.41 Brazil indicates that its claims of inconsistency under the *Agreement on Agriculture* and the *SCM Agreement* are "product-specific": Brazil claims that the United States has applied the GSM 102 programme in a manner that circumvents its export subsidy commitments with respect to unscheduled products and three scheduled products. Thus, we understand Brazil to be challenging GSM 102 export credit guarantees "as applied".

14.42 We examine each of these claims in turn, starting with Brazil's claims under Articles 10.1 and 8 of the *Agreement on Agriculture*.

2. Brazil's claims under Articles 8 and 10.1 of the *Agreement on Agriculture*

14.43 Article 8 and 10.1 of the *Agreement on Agriculture* read as follows:

> Article 8: *Export Competition Commitments*
>
> Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule.
>
> [...]

[630] Given this conclusion, we need not determine whether the fact that the original panel's findings were reached on the basis of item (j) means, as the United States submits, that only the export credit programmes, and not individual export credit guarantees, needed to be withdrawn.

[631] The Panel has rejected the US request for a preliminary ruling concerning Brazil's claims relating to exports of pig meat and poultry meat. See *supra*, para. 9.27.

> Article 10: *Prevention of Circumvention of Export Subsidy Commitments*
>
> 1. Export subsidies not listed in paragraph 1 of Article 9 shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments; nor shall noncommercial transactions be used to circumvent such commitments.

14.44 A violation of Article 10.1 requires a demonstration of two elements: first, that "export subsidies not listed" in Article 9.1 are "applied", and second, "in a manner which results in ... circumvention of export subsidy commitments." Brazil argues that GSM 102 are export subsidies under the terms of Article 10.1. It was not in dispute before the original panel that export credit guarantees are not included in the list of export subsidies contained in Article 9.1 of the *Agreement on Agriculture*, and that Article 10.1 was therefore the applicable provision.[632] Neither of the parties in this compliance proceeding suggests otherwise.

14.45 The *Agreement on Agriculture* does not generally define the meaning of the term "export subsidies". Article 1(e) of the Agreement provides that export subsidies are "subsidies contingent upon export performance, including the export subsidies listed in Article 9 of this Agreement". Panels and the Appellate Body have, in interpreting the meaning of "export subsidies" in Article 10.1, relied, *inter alia*, on the relevant provisions of the *SCM Agreement* (including Articles 1 and 3 and items of the Illustrative List) as "context".[633] These provisions define what measures constitute, respectively, "subsidies", and "export subsidies", for the purposes of the *SCM Agreement*.

14.46 Regarding the "circumvention of export subsidy commitments" in Article 10.1 of the *Agreement on Agriculture*, the disciplines to which Members are subject differ as between products for which a Member has entered "export subsidy reduction commitments" in its Schedule of commitments (so called "scheduled" products) and those for which it has made no such commitments ("unscheduled" products). For the latter, Members are subject to a general prohibition on the provision of export subsidies. This results from the language of the ending clause of Article 3.3 of the *Agreement on Agriculture* ("... shall not provide such subsidies [i.e. export subsidies under Article 9.1] in respect of any agricultural product not specified in [Section II of Part IV] of its Schedule") and Article 10.1, which precludes a Member from "applying" subsidies not listed in Article 9.1 in a manner that results (or threatens to result) in circumvention of its export subsidy commitments.[634] With respect to scheduled products, a Member is allowed to grant export subsidies up to the level of its reduction commitments in its Schedule. Reduction commitments are expressed on a budgetary outlay (total amount of subsidy provided) basis as well as on a quantity (volume) basis for each agricultural product concerned. Any export subsidy provided beyond the specific reduction commitments applicable to the agricultural product in question is prohibited.

14.47 Given that only some of Brazil's claims of circumvention under Article 10.1 of the *Agreement on Agriculture* are subject to the special burden of proof rules of Article 10.3 of the *Agreement* [635] –

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[632] Panel Report, *US – Upland Cotton*, para. 7.788.

[633] See Appellate Body Report, *US – FSC*, paras. 136-141; Panel Report, *US – FSC (Article 21.5 - EC)*, para. 8.116; Appellate Body Report, *US – FSC (Article 21.5 – EC)*, paras. 187-196; Panel Report, *US – Upland Cotton*, paras. 7.797-7.803; Panel Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 5.152-5.162, Panel Report, *Canada – Dairy*, paras. 7.125 *ff*. This last panel considered that Article 9.1 of the *Agreement on Agriculture* can also serve as "context" to interpret the meaning of "export subsidy" under Article 10.1 of the *Agreement*.

[634] The term "export subsidy commitments" includes both reduction commitments undertaken with respect to scheduled products, and the commitment not to provide any subsidy on exports of unscheduled products. See Appellate Body Report, *US – FSC*, paras. 145-147.

[635] Under the usual rules on the burden of proof, the complaining Member would bear the burden of proving both aspects of its claim: that (1) export subsidies are provided; (2) the total amount of subsidies

the partial reversal of the burden of proof operated by Article 10.3 applies only to claims under the *Agreement on Agriculture*, and only with respect to scheduled products[636] – we first conduct our analysis as if Brazil bore the burden of proof with respect to both the quantitative and the subsidization elements of its claims, *i.e*. as if Article 10.3 did not apply. Thus, we first proceed to determine whether GSM 102 export credit guarantees are "export subsidies" for the purpose of Article 10.1 of the *Agreement on Agriculture*. We conduct that analysis by relying on the provisions of the *SCM Agreement* as contextual guidance. Only if Brazil fails to demonstrate that GSM 102 export credit guarantees are export subsidies will we proceed – for those claims of Brazil that are subject to Article 10.3 of the *Agreement on Agriculture* (scheduled products) – with the analysis mandated under Article 10.3, first determining whether Brazil establishes that the United States exported the products concerned in quantities exceeding its commitments and then shifting the burden on the United States to prove that no subsidies were provided with respect to the quantities exported in excess of its commitments.

3. Are GSM 102 export credit guarantees "export subsidies" – legal bases for Brazil's arguments

14.48 We proceed to the first step of our analysis, whether GSM 102 export credit guarantees constitute "export subsidies" under Article 10.1 of the *Agreement on Agriculture*. As suggested above, given that the *Agreement on Agriculture* does not contain a comprehensive definition of the term and that the *Agreement* does not provide other guidance as to whether and under what conditions export credit guarantees may constitute export subsidies, we consider that it is appropriate to refer to the *SCM Agreement* as contextual guidance to determine whether GSM 102 guarantees are "export subsidies" under Article 10.1 of the *Agreement on Agriculture*. The parties have not suggested that we proceed otherwise.

14.49 Brazil relies on two legal bases to demonstrate that GSM 102 export credit guarantees are "export subsidies" in the sense of Article 3.1(a) of the *SCM Agreement*. First, Brazil asks the Panel to find that GSM 102 export credit guarantees meet the definition of an export subsidy under the terms of Articles 1.1 and 3.1(a) of the *SCM Agreement*, i.e. that they are "financial contributions", that confer a "benefit" and that are contingent upon export performance. Alternatively, Brazil asks the Panel to conclude that GSM 102 export credit guarantees fall within the scope of item (j) of the

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provided exceeds the Member's commitments (expressed in terms of budgetary outlays) for the product in question or the total quantity of exports supported by the subsidy(ies) in question exceeds the Member's commitments (expressed in volume of exports) for the product in question. Article 10.3 of the *Agreement on Agriculture* operates a partial reversal of the burden of proof in certain disputes under Articles 3, 8, 9 and 10 of the *Agreement on Agriculture* where the complaining Member alleges that volume commitments were exceeded. See, for a discussion of the effects of Article 10.3, Appellate Body Report, *US – Upland Cotton*, paras. 642 *ff.*, Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, paras. 67 *ff.* Article 10.3 "'cleaves the complaining Member's claim' into two parts: a quantitative aspect, and an export subsididization aspect, 'allocating to different parties the burden of proof with respect to the two parts." Appellate Body Report, *US – Upland Cotton*, para. 644, quoting from Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, para. 69. For those claims subject to Article 10.3, consistent with the usual rules of burden of proof, it is for the complaining Member (in this dispute, Brazil) to prove that the responding Member (here the United States) has exported an agricultural product in quantities exceeding its commitment level. If the complaining Member succeeds in establishing this quantitative part of the claim, then under Article 10.3, the burden of proof shifts to the responding Member to prove that the quantities exported in excess of its commitments are not subsidized. Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, para. 74, quoted in part in Appellate Body Report, *US – Upland Cotton*, para. 645. The reversal of the burden of proof is total and complete – the complaining Member does not have to make a *prima facie* case that subsidisation exists. See Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, para. 75.

[636] Appellate Body Report, *US – Upland Cotton*, paras. 649, 652.

Illustrative List of Export Subsidies. Item (j) (in conjunction with Article 3.1(a)) indicates that the following are prohibited export subsidies:[637]

> (j) The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.

14.50 Brazil regards these two alternative "bases" as separate *claims*, rather than arguments in support of a single claim.[638] As we have already mentioned, Brazil first asks the Panel to consider its "claim" that GSM 102 guarantees meet the definitional elements of an "export subsidy" under Articles 1 and 3 of the *SCM Agreement*. Only if the Panel rejects Brazil's "claim" in this respect does Brazil ask the Panel to also consider its "claim" under item (j) of the Illustrative List of Export Subsidies.[639]

14.51 In our view, the two legal bases on which Brazil relies in support of its argument that GSM 102 export credit guarantees are export subsidies under the terms of the *SCM Agreement* and the *Agreement on Agriculture* are not separate claims, but are rather alternative arguments as to why these guarantees are export subsidies under Articles 3.1(a) and 3.2 of the *SCM Agreement*.[640] A Panel finding under either of the legal bases relied upon by Brazil would, in both cases, be that the United States is providing export subsidies under the terms of Article 3.1(a) of the *SCM Agreement* and under Article 10.1 of the *Agreement on Agriculture*. Item (j) of the Illustrative List does not, in itself, provide that certain measures are prohibited, it merely indicates that certain measures are export subsidies under Article 3.1(a). In any case, we recall that we are, at this point, only relying on Article 3.1(a) of the *SCM Agreement* as contextual guidance to determine whether GSM 102 export credit guarantees are export subsidies under Article 10.1 of the *Agreement on Agriculture*. There can be no doubt that, in this context, the two legal bases relied upon by Brazil are indeed mere alternative arguments, and not separate claims.

14.52 We first proceed to examine Brazil's arguments that GSM 102 export credit guarantees are export subsidies because they fall under the scope of item (j) of the Illustrative List.[641] Our decision first to proceed with Brazil's arguments under item (j) is motivated by the fact that there is no dispute between the parties that measures that fall within the scope of item (j) are, under Article 3.1(a) of the *SCM Agreement*, *per se* export subsidies.[642]

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[637] This is by virtue of Article 3.1(a) of the *SCM Agreement*, which provides that:

> "Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:
>
> (a) subsidies contingent, in law or in fact , whether solely or as one of several other conditions, upon export performance, *including* those illustrated in Annex I;" (footnotes omitted, emphasis added).

[638] Brazil's Comments on US Response to Panel Question 38, para. 112.

[639] Brazil indicates that its request for review of its item (j) claim solely in the alternative stands even if the Panel considers item (j) to be the source of an alternative argument, rather than an alternative claim. See Brazil's First Written Submission, footnote 593.

[640] The original panel reached the same conclusion. See Panel Report, *US – Upland Cotton*, para. 6.31.

[641] This is similar to the approach followed by the original panel. See Panel Report, *US – Cotton*, para. 7.803.

[642] The United States considers that item (j) of the Illustrative List provides the only test to determine whether export credit guarantees are export subsidies. See, *inter alia*, US First Written Submission, paras. 62-70. Brazil considers that export credit guarantees may be found to constitute export subsidies within the meaning of Article 3.1(a) of the *SCM Agreement* either because they meet the terms of item (j) or because they

14.53 As a result of our conclusion that the two legal bases invoked by Brazil are alternative "arguments", not "claims", were we to conclude that GSM 102 export credit guarantees are export subsidies by virtue of the fact that they fall within the scope of item (j), we do not consider that we would necessarily need to determine whether they also, independently, meet the definitional elements of an export subsidy under Articles 1 and 3 of the *SCM Agreement*.

4. Brazil's arguments under item (j) of the Illustrative List of Export Subsidies

(a) Original panel's analysis under item (j) of the Illustrative List of Export Subsidies

14.54 Before proceeding with our analysis, we recall the main findings of the original panel in its analysis under item (j) of the Illustrative List, as context to determine whether the programmes at issue conferred export subsidies under Article 10.1 of the *Agreement on Agriculture*.

14.55 The original panel considered that item (j) does not require the use of any particular methodological approach or accounting philosophy to determine whether a programme is run at a net cost to the government.[643] The panel considered that it was reasonable, on the basis of the evidence and arguments submitted to it, to take into account the period since 1992.[644] But it also considered that the analysis under item (j) needed not be purely retrospective and could take into account elements of the structure, design and operation of the measure which may affect the long-term operating costs and losses of the GSM 102, GSM 103 and SCGP programmes.[645]

(i) Past performance of the programmes

14.56 The panel reviewed data submitted by the parties concerning the profitability of the programmes. Data under different methodologies was presented by the parties and relied upon by the panel. The first approach concerned the "net present value" approach to budget accounting used by the US Government with respect to export credit guarantees. The US Government projects, in each year's budget, the "net present value" of the costs associated with its export credit guarantees issued in that year.[646] The United States budget data for 1992 to 2002 (and estimates for 2003 and 2004) showed a positive "guaranteed loan subsidy" (i.e. a loss). Although the panel recognized that these amounts were only initial estimates of the long-term costs of the programme, representing neither "random guesses nor historically verifiable real amounts", it considered that the consistently positive subsidy numbers indicated that the US Government "believes, based upon its own assessment, that it may not, even over the long term, be able to operate the export credit guarantee programmes without

meet the definitional elements of an export subsidy under Article 3.1(a) of the *SCM Agreement* (and, by reference, Article 1 of the *SCM Agreement*), i.e. that they are "financial contributions", that confer a "benefit" (thereby constituting a "subsidy" under Article 1), which is contingent upon export contingency under Article 3.1(a). See Brazil's Rebuttal, paras. 454-481. A number of third parties (Australia, Canada, Chad, and China) consider, like Brazil, that export credit guarantees can be prohibited export subsidies under either Articles 1.1 and 3.1(a) of the *SCM Agreement* or item (j) of the Illustrative List. The Panel understands the European Communities to agree with the United States' position. See Australia's Third Party Submission, para. 24, Canada's Oral Statement Submission, paras. 8-13, Chad's Third Party Submission, paras. 50-56, China's Third Party Submission, paras. 4-8 and China's Oral Statement, EC Oral Statement, para. 33.

[643] Panel Report, *US – Upland Cotton*, para. 7.804.

[644] Panel Report, *US – Upland Cotton*, para. 7.831.

[645] Panel Report, *US – Upland Cotton*, para. 7.835.

[646] A positive net present value means the US Government is granting a "subsidy" to borrowers and therefore expecting a loss, a negative present value means that the programme is generating a "profit." This value does not include administrative costs. See Panel Report, *US – Upland Cotton*, para. 7.842. Administrative costs are usually relatively modest in comparison to the value itself (US$5 million in the most recent years).

some net cost to government".[647] The panel also took into account the fact that "actual historical experience was a primary factor" on which the estimates are based.[648]

14.57 These initial estimates are subject to annual re-estimations over the lifetime of the guarantees involved. The United States argued in this respect that the re-estimates, over time, erased the initial positive "estimate" figure, in other words, that taking the re-estimates into account, the programmes would not give rise to a net cost to the US Government. The United States provided the panel with cumulative re-estimates on a cohort-specific basis (a cohort is comprised of all guarantees issued in a given year). These figures showed a positive subsidy of US$230 million. The United States noted an overall downward re-estimate of US$1.9 billion (i.e. overall, re-estimates brought the subsidy down), that, with the exception of 2002 (for which only very recent data was available), the trend for all cohorts was favourable as compared to the original subsidy amount, and that the data for the 1992-1996 and 1999 cohorts indicated profitability. According to the United States, when data for the – as yet uncompleted – 2001 and 2002 cohorts were removed, the US$230 million was almost entirely eliminated. While the panel took into account the fact that the process of estimates and re-estimates by cohort is necessarily a fluid one that cannot be definitively analyzed until a cohort is "closed", it disagreed with the United States that data for certain of the more recent cohorts should be disregarded; the panel was also not persuaded that cohort re-estimates over time, would necessarily not give rise to a net cost to the US Government. It therefore rejected the arguments of the United States in this respect.[649]

14.58 The second "methodology" under which the original panel examined the US programmes was a <u>constructed cost formula</u> submitted by Brazil, based on data from the US budget.[650] Brazil submitted a table which showed a net cost to government of US$1.08 billion from FY 1993 to FY 2002 (using data taken in the "prior year" column in the US budget).[651] The panel considered it an "an additional informed appraisal, based on information generated by the US Government itself, of the performance of export credit guarantee programmes" which, the panel noted, takes into account the actual level of guarantees issued by the CCC in a given year, as opposed to an estimate of this level.[652] The panel compared the result of this formula with evidence submitted by the United States, which it asserted, reflected a profit of US$630 million to the US Government. The difference between the results of Brazil's and the United States' calculations corresponded to the amount of rescheduled claims (US$1.6 billion), which the United States did not treat as "outstanding claims": rather, the standard accounting treatment of reschedulings by the CCC was to treat them as new direct loans; this, in the panel's view, represented an instant reduction of the amount in outstanding claims in the year in which the rescheduling was finalized. The panel thus shared Brazil's concerns that the United States' treatment of rescheduled debt understated the net cost to the US Government.[653]

14.59 The panel also took into account the fact that <u>the CCC financial statements</u> for the years 2002 and 2003 indicated a "credit guarantee liability" of US$411 million and US$22 million, respectively. The panel observed that these "credit guarantee liability" amounts "are not actual losses. They are but another indicator, used and relied upon by the US government, to assess the estimated long-term cost

[647] Panel Report, *US – Upland Cotton*, para. 7.843.
[648] Panel Report, *US – Upland Cotton*, para. 7.843.
[649] Panel Report, *US – Upland Cotton*, paras. 7.852-7.854.
[650] The formula calculated the following: (Premiums collected + Recovered principal and interest (line 88.40 of the US budget) + Interest revenue (line 88.25)) – (Administrative expenses (line 00.09) + Default claims (line 00.01) + Interest expense (line 00.02)). See Panel Report, *US – Upland Cotton*, para. 7.844.
[651] See the table at para. 7.845 of the Panel Report, *US – Upland Cotton*.
[652] Panel Report, *US – Upland Cotton*, para. 7.846.
[653] Panel Report, *US – Upland Cotton*, para. 7.851.

to the United States government of export credit guarantees", and that these amounts were consistently positive.[654]

14.60 Overall, the panel found that these considerations relating to the past performance of the programmes supported a view that the programmes were run at a net cost to the government.[655]

(ii) Structure, design and operation of the programme

14.61 The panel also took into consideration the structure, design and operation of the export credit guarantee programmes. Several elements in this respect led the panel to believe that the programmes were "not designed to avoid a net cost to government".[656] The panel took into consideration the fact that the CCC borrows from the US Treasury and that access to Treasury borrowings facilitates the functioning of the programmes and that, for a creditor, the guarantees provide the backing of the full faith and credit of the US Government. Further, the panel was of the view that the premiums were not geared toward ensuring adequacy to cover long-term operating costs and losses for the purposes of item (j) of the Illustrative List. *First*, it noted in this respect the 1 per cent fee cap imposed by US legislation on the fees.[657] *Second*, it considered that the premiums were not risk-based, either with respect to country risk or the creditworthiness of the borrower in an individual transaction. Country risk and foreign obligor risk only impacted the US Government subsidy estimates and re-estimates, and not the fees charged.[658] Moreover, the statute imposed no limitation on the amount of guarantees that could be provided annually to a high-risk country or to high risks transactions. The CCC was, therefore, able to provide large amounts of guarantees to high-risk countries with a resulting high rate of default. The panel also noted the lack of substantial or regular review of the premiums by the US Government to ensure that they were adequate to cover long-term operating costs and losses. Finally, the panel noted evidence (an annual review of fees by the USDA) that indicated that the US Government did not consider that the fees were risk-based and that they did not cover the "subsidy cost of the programme"; the document also stated that the 1 per cent fee cap likely prevented the adoption of risk-based fees.[659] Thus, for the panel, the evidence indicated that the premiums were not proportionate to, reflective of, nor geared towards, *covering* long-term operating costs and losses.[660]

(iii) Overall conclusion by the original panel

14.62 Thus, on the basis of the totality of the evidence, the panel found that Brazil had established that the three export credit guarantee programmes were provided "at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes" within the meaning of item (j) of the Illustrative List. This view was "based on a careful consideration of the evidence, taken as a whole, and no one element, in isolation, is determinative".[661] The panel therefore found that the GSM 102, GSM 103 and SCGP export credit guarantee programmes constituted a *per se* export subsidy within the meaning of item (j) of the Illustrative List and were therefore export subsidies under Article 10.1 of the *Agreement on Agriculture*.

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[654] Panel Report, *US – Upland Cotton*, para. 7.855.
[655] Panel Report, *US – Upland Cotton*, para. 7.856.
[656] Panel Report, *US – Upland Cotton*, para. 7.857.
[657] Panel Report, *US – Upland Cotton*, para. 7.860.
[658] Country risk is the risk – represented by a credit rating – associated with a given country, and usually relates to the risk of political or economic crises, etc; foreign obligor risk is the risk specific to an individual foreign obligor.
[659] Panel Report, *US – Upland Cotton*, para. 7.865.
[660] Panel Report, *US – Upland Cotton*, para. 7.867.
[661] Panel Report, *US – Upland Cotton*, para. 7.867.

(iv) Appellate Body

14.63 The Appellate Body agreed with the panel's approach to assessing whether the programmes at issue met the conditions set forth in item (j) of the Illustrative List[662] and that "[t]he text of item (j) does not suggest that this provision requires a Panel to choose one particular basis for the calculation and then to make a precise quantification of the difference between premiums and long-term operating costs and losses on that basis".[663]

14.64 Like the original panel, we conduct a two-step analysis. *First*, we review the evidence of a quantitative nature submitted by the parties to determine whether the GSM 102 programme is provided at premium rates that are inadequate to cover its long term operating costs and losses; *second*, we examine the evidence pertaining to elements of the "structure, design and operation" of the GSM 102 programme submitted by Brazil.

(b) "Quantitative" analysis under item (j)

(i) Main arguments of the parties

14.65 **Brazil** submits that the US Government continues to predict that GSM 102 export credit guarantees will be provided at a loss, even under the new fee schedule. Brazil relies on the "subsidy" estimates for FY 2006, 2007 and 2008, which continue to be positive. Brazil refers to the findings of the original panel, which took similar projections as an indication that the US Government considers that the programmes would be provided at a net cost.[664]

14.66 The **United States** submits that current budget financial data shows that the fee structure in place during the original panel proceeding provided premia more than adequate to cover the long term costs and losses of the programmes at issue in that proceeding. The data – which concerns subsequent reestimates of initial subsidy estimates – became available as more cohorts of export credit guarantees closed. The data demonstrates that the programmes were profitable even before the suspension of the GSM 103 and SCGP programmes and the significant modifications of the fee structure and eligibility under the programmes. Further, the United States argues that the initial subsidy estimates in the US budget are not derived from the actual experience of the CCC. The original estimates are calculated before any use is made of the export credit guarantee programme in the year for which the estimate is made and are based on an historically overly-optimistic projection of the actual use of the programme. In addition, the CCC is, in establishing these estimates, required to use government-wide estimation rules, without regard to the actual experience specific to the CCC export credit guarantee programmes.[665]

14.67 **Brazil** counters that the result of the US Government "re-estimates" is elsewhere tracked in the CCC's Financial Statements. The Financial Statements report a positive "credit guarantee liability" of US$220 million for guarantees outstanding as of 30 September 2006. Brazil also submits "cash basis" calculations which, in its view, confirm that the programmes have not been profitable since 1992.[666]

14.68 The **United States** rejects Brazil's reading of the "credit guarantee liability" figure in the CCC's Financial Statements. In addition, the United States questions the significance of Brazil's cash

[662] Appellate Body Report, *US – Upland Cotton*, paras. 665 *ff*.
[663] Appellate Body Report, *US – Upland Cotton*, para. 665.
[664] Brazil's First Written Submission, paras. 433-437; Brazil's Opening Statement, paras. 252-253.
[665] US First Written Submission, paras. 100-104; US Rebuttal Submission, paras. 108-126
[666] Brazil's Rebuttal Submission, paras. 482 *ff*.

basis accounting methodology and submits that Brazil omits to include recoveries in respect of guarantees issued before 1992 in its calculation.[667]

(ii) Evaluation by the Panel

14.69 Before this Panel, Brazil again relies on the initial or original "subsidy estimates" reported in the US Budget. The 2007 US budget projected a "positive subsidy" (or loss) of US$125 million for the 2006 cohort and US$114 million for the 2007 cohort.[668] The 2008 budget revised these numbers to, respectively, US$71 and US$60 million, and in addition, projected a US$53 million subsidy estimate for the guarantees issued in the 2008 year.[669] None of these figures include administrative costs (which amount to US$5 million a year).[670]

14.70 We recall that the original panel found that the initial estimates were one of the "considerations relating to the past performance of the programmes" that supported its conclusion that the programmes were provided "at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes" within the meaning of item (j) of the Illustrative List.[671] The original panel found as follows with respect to these initial estimates:

> "We realize that these amounts are *initial estimates* of the long-term costs to the United States government. They are not, however, mere random guesses as to the amount of possible, but highly unlikely, costs to the government. Nor, at the other extreme, are they historically verifiable real amounts that have been, or actually will be, disbursed by the United States government. Rather, this is a methodology used and relied upon by the United States government to assess the estimated long-term net cost to the United States government of export credit guarantees. Actual historical experience is a "primary factor" on which estimates are based.[672] The consistently positive numbers in the United States budget guaranteed loan subsidy line indicate to us that the United States government believes, based upon its own assessment, that it may not, even over the long term, be able to operate the export credit guarantee programmes without some net cost to government." [673] (emphasis original)

14.71 We agree with the original panel that consistently positive initial subsidy estimates provide an indication by the US Government that it expects the export credit guarantee programmes in question to be run at a net cost. It is in our view highly significant that the US Government continues to

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[667] US Rebuttal Submission, paras. 84 *ff*.

[668] The CCC is required to make annual subsidy estimates as a result of the Federal Credit Reform Act of 1990 (the "FCRA"). The purpose of the reform implemented by the FCRA is to "measure more accurately the costs of Federal credit programs". See 2 U.S.C. § 661(a), Exhibit Bra-545. The net present value analysis attempts to calculate the value today of a future stream of income or cost; under its budget accounting, the US Government identifies an annual "cost" in terms of the "net present value" associated with its export credit guarantee programmes. See Panel Report, *US – Upland Cotton*, para. 7.842.

[669] See line 233001 of the 2007 (for years 2006 and 2007) and 2008 budgets (respectively, Exhibits Bra-544 and US-71). The revision occurs because the subsidy estimate that first appears is based on an estimate of the use of the programme. Budgets for the two subsequent years following that budget progressively take into account the actual use of the programme. See discussion, *infra*, para. 14.76.

[670] See line 00.09 for each of the 2006, 2007, and 2008 budgets (respectively, Exhibits Bra-544 and US-71).

[671] Panel Report, *US – Upland Cotton*, paras. 7.856, 7.867.

[672][original footnote] Federal Accounting Standards Advisory Board, 'Statement of Federal Financial Accounting Standards, No. 19, Technical Amendments to accounting Standards for Direct Loans and Loan Guarantees' in Statement of Federal Financial Accounting Standards No. 2" (March 2001), p. 16, para. 36, reproduced in Exhibit BRA-118 states: "Actual historical experience of the performance of a risk category is a primary factor upon which an estimation of default cost is based".

[673] Panel Report, *US – Upland Cotton*, para. 7.843.

project, at the time of their issuance, that new GSM 102 guarantees issued under the revised programme will be provided at a net cost.

14.72 We now address the arguments the United States makes against the use of the initial estimates to assess the long term net cost of the GSM 102 programme to the US Government. The United States raises two arguments in this respect.[674] *First*, the United States argues that the initial subsidy estimates are inflated because they are issued before any use is made of the programme and therefore do not reflect the actual use of the programme. *Second*, the United States argues that the initial subsidy estimate is unreliable because the CCC is required, in preparing the estimates, to use government-wide estimation rules, including mandated risk assessment country grades, without regard to CCC's actual default experience. The United States submits in support of this second argument a Report from the General Accounting Office which explains that the principal factors used in the calculation of the original subsidy rate are provided by the Office of Management and Budget (OMB).[675] For the United States, this "one-size-fits-all approach ... largely explains the continuing presence of an original subsidy estimate for CCC export credit guarantee programmes in fiscal years 2006 and 2007".[676]

14.73 In both cases, however, the United States is reasserting arguments that it made in the original proceeding and that were, at least implicitly, rejected by the original panel.[677]

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[674] We address below, in paras. 14.78 *ff.* the evidence submitted by the United States with respect to subsequent reestimates of the initial subsidy estimates.

[675] US Rebuttal, paras. 108 *ff.* and Exhibit US-73. The document indicates that the OMB provides such agencies with "expected loss rates", a key component of their subsidy costs. OMB also provides the discount rates that are used to calculate subsidy estimates. The United States also explains that, starting with fiscal year 2003, OMB changed its method for determining expected loss rates because emerging finance literature indicated its former approach might overstate losses to the Government. OMB's methodology, however, continues to make certain assumptions that are not consistent with CCC's experience nor with its programme. More specifically, the United States indicates that the OMB uses "the market price of credits with the lowest ICRAS rating (category 11) [as] the predominant basis for recovery rates." OMB's use of the market price of the "lowest-rated credits is based on the assumption that this value represents the most the US government would recover in the event of default." Each sovereign borrower or guarantor is rated on an 11-category scale, ranging from A through F– (or their numerical counterparts, categories 1-11). For CCC, however, no country below a certain ICRAS rating is eligible for the programme at all. Consequently, OMB's imposed assumption about recovery rates as part of the calculation of expected loss rates is much more conservative than would be warranted with respect to the CCC". The United States also argues that, to date, the OMB has not incorporated any data specific to CCC experience in its calculations of expected loss rates that it requires CCC to employ in the preparation of its budget at the beginning of each fiscal year.

[676] US Rebuttal, para 116.

[677] For instance, the United States made the following statements in the original proceeding:

> "The original subsidy estimate, in contrast [to the "actual" estimate figure two years thereafter] begins with what is an historically overly optimistic projection of actual use of the program and then is required to use the government-wide estimation rules, including mandated risk-assessment country grades without regard to the actual experience specific to the CCC export credit guarantee programs. These two factors are the answer to Brazil's question, 'why does [CCC] continue to offer original estimates that are so high?' (footnotes omitted).
> (US Further Submission, 30 September 2003, para. 147.)
> ...
> "The United States has previously noted that the original subsidy estimate in the US budget begins with an historically overly optimistic projection of the actual use of the programme and then the use of government-wide estimation rules is required, including mandated risk assessment country grades without regard to the actual experience specific to the CCC export credit guarantee programmes. The original subsidy estimate for these cohorts, like the

14.74 Notwithstanding these arguments of the United States, the original panel concluded that the original subsidy estimate could be relied upon as an indicator of the long term net cost of the programmes to the US Government – or at least of an indicator of the US Government's assessment of such costs.[678]

14.75 As Brazil points out "[t]he process by which the CCC arrives at initial estimates of long-term programme performance has not changed since the original proceedings; nor have the criteria used by the CCC to make this assessment".[679] There are, in sum, no changes in the underlying circumstances that would justify us revisiting the original panel's reasoning in this respect.[680]

14.76 In any case, we would note that while the United States is factually correct that the *initial* estimates are established before any use is made of the programme and that the initial estimates are based on the *projected use* of the programme, these initial estimates are subsequently re-adjusted in the US Budget two years after the budget year in which the initial estimate appears.[681] In no case has

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original subsidy estimate for all cohorts, necessarily reflects no actual operating experience with respect to that cohort." (footnotes omitted).

(US Response to original panel's Question 221(g), Panel Report, *US – Upland Cotton*, Annex I, page I-371)

...

"The United States has noted that such [original] estimates are compelled by government-wide accounting rules for credit programs..." (US Further Rebuttal Submission, 18 November 2003, para. 196)

...

"Brazil also mysteriously alleges that 'according to CCC's 2002 financial statements, CCC has been relieved of what the United States argues are onerous government-wide accounting rules that 'compel' projection of enormous losses.' CCC, however, has never been so 'relieved.' It remains compelled to adhere to the requirements of the federal Credit Reform Act of 1990, and relevant provisions of the Office of Management and Budget Circular A-11, implementing that legislation. CCC remains subject to government-wide requirements for subsidy estimates and the risk categories mandated by OMB with respect to exposure to debt from different countries. The government-wide rules continue to dictate the methodology for calculation of estimates, and reestimates..." (US Closing Statement at the Second Panel Meeting, 3 December 2003, para. 10).

[678] Panel Report, *US – Upland Cotton*, para. 7.843 (cited above, para. 14.70):

"We realize that these amounts are *initial estimates* of the long-term costs to the United States government. *They are not, however, mere random guesses as to the amount of possible, but highly unlikely, costs to the government. Nor, at the other extreme, are they historically verifiable real amounts that have been, or actually will be, disbursed by the United States government. Rather, this is a methodology used and relied upon by the United States government to assess the estimated long-term net cost to the United States government of export credit guarantees. Actual historical experience is a 'primary factor' on which estimates are based.* The consistently positive numbers in the United States budget guaranteed loan subsidy line indicate to us that the United States government believes, based upon its own assessment, that it may not, even over the long term, be able to operate the export credit guarantee programmes without some net cost to government." (footnotes omitted, emphasis added).

[679] Brazil's Response to Panel Question 105, para. 300.

[680] See Appellate Body Report, *US – Softwood Lumber VI (Article 21.5 – Canada)*, para. 103, citing Appellate Body Report, *Mexico – Corn Syrup (Article 21.5 – US)*, para. 121.

[681] Each annual budget provides long-term subsidy estimates for three cohorts of export credit guarantees: the cohort of guarantees to be issued in the fiscal year that has not yet begun (for instance, in the 2008 budget, the 2008 cohort), the cohort of guarantees issued in the fiscal year that has partly elapsed at the time the budget is released (in the 2008 budget, the 2007 cohort), and the cohort of guarantees issued in the fiscal year that has most recently ended (in the 2008 budget, the 2006 cohort). In subsequent years, re-estimates

such an adjustment turned a positive subsidy estimate into a negative one.[682] We recall that, in this case, we are only interested in the presence of a net cost to the US Government resulting from the provision of GSM 102 export credit guarantees. We need not quantify such a cost. Therefore, the fact that the initial subsidy estimate may be overstated does not, in our view, mean that it is not a reliable predictor of a net cost to the US Government.

14.77 Nor do we see a reason to depart from the original panel's conclusion that the subsidy estimates are, at least in part, based on historical experience and can be read as the US Government's own assessment of the long term costs of the programme(s). Brazil also directs us to the USDA's "Agriculture Financial Standards Manual", which states that "[i]n estimating default costs, the following risk factors are considered: (1) loan performance experience...".[683] and to a "self-assessment" of the programmes by the USDA Foreign Agricultural Service (FAS) in 2004.[684] The self-assessment states that the credit models used to calculate the subsidy estimate were revised in FY2001 and 2003 and "currently provide reliable estimates".[685] While we take note of the United States' arguments that the OMB continues to impose expected loss rates or estimated default costs, in our view, this does not bring into question the fact that this is the method which is relied upon by the US Government itself to assess the long-term net cost of its export credit guarantee programmes at the time of issuance of the guarantees.

14.78 The United States also submits that new US budget data that became available after the original panel conducted its analysis demonstrates that the programmes were in fact not provided at a net cost to the US Government even before it took measures to comply with the DSB recommendations. The data submitted by the United States concerns cumulative subsequent "re-estimates" of the initial subsidy estimates on a cohort-specific basis: initial "subsidy" estimates in the US budget are subject to re-estimates over the lifetime of the guarantees involved.[686] As mentioned above, the United States had made similar arguments before the original panel, but the panel was not convinced that the evidence presented by the United States showed that the cohort estimates (which showed an overall positive subsidy estimate, i.e. a "loss") would eventually turn into a negative figure. We understand the United States to argue that the Panel should take into consideration the reestimates data in addition to the initial subsidy estimates. The United States is therefore also challenging the fact that initial estimates may (by themselves, without taking the re-estimates into account) be relied

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are tracked in Table 8 of the Federal Credit Supplement accompanying the budget. Thus, for each cohort, subsequent budgets will provide three estimates: the estimate reported in the budget for the first fiscal year takes no account of the actual use of the programme, the estimate reported in the budget for the second fiscal year partly takes into account the actual use of the programme, and the estimate reported in the budget for the third fiscal year (and which is released after the cohort has closed) is based on the actual use of the programme. The amounts reflecting the actual use of the programme usually decline in absolute amounts. See Brazil's Rebuttal Submission, para. 508 and accompanying footnote. We do not believe there was any misunderstanding between the parties and the Panel on this issue in the original dispute. See for instance, US Further Submission (30 September 2003), para. 149:

> "Actual guarantee issuance can first be reflected only in the budget two fiscal years after the original subsidy estimate. Once the actual use of the program is determined all subsequent reestimates are based on that figure, not on the original subsidy estimate. Other than with respect to interest (because of independent market forces), a downward reestimate never occurs based on the original subsidy estimate."

[682] See Exhibits Bra-617 and US-8.

[683] Exhibit Bra-616, US Department of Agriculture, Office of the Chief Financial Officer, Credit, Travel, and Accounting Division, *Agriculture Financial Standards Manual* (May 2004), pages 120-121.

[684] See Brazil's Opening Statement, para. 253.

[685] Exhibit Bra-588 (Agricultural Export Credit Guarantee Programs Assessment, ExpectMore.gov, Section 3.CR2).

[686] US First Written Submission, para. 83, also referring to the original panel report, para. 7.843.

upon as a reliable indicator of the long-term net cost of the programmes or, at least, as representing the US Government's assessment of the projected long-term net cost of the programme.

14.79 We note that the new data submitted by the United States concerns the three programmes examined by the original panel (GSM 102, GSM 103 and SCGP). The issue before us is whether the GSM 102 programme, as revised, is provided at premium rates inadequate to cover its long term operating costs and losses. The original panel found that the United States provided the three programmes at a net cost to its government. That issue has been definitively disposed of in the original proceeding and is not before us. However, we must consider the arguments and evidence submitted by the United States to the extent that they are relevant to determine whether the revised GSM 102 programme is run at a net cost to the US Government or, as we understand the United States' argument, that we should rely on the reestimates rather than the initial subsidy estimates as an indicator of the long-term cost of the programme. The United States submits to the Panel a table[687] that includes reestimates for the 1992 to 2006 cohorts. The table shows, for all three programmes, an aggregate overall negative "subsidy estimate net of reestimates" (i.e. anticipated "profit") of US$926 million for the 1992-2002 cohorts (i.e. the cohorts examined by the original panel) and of US$403 million for the 1992-2006 cohorts.

14.80 The original panel was not persuaded that cohort reestimates, over time, would necessarily not give rise to a net cost to the United States Government.[688] Similarly, we are not convinced that the re-estimates data submitted by the United States establishes that all positive subsidy estimates – and in particular, those for cohorts 2006-2008 – will eventually turn into negative ones. We note in this respect that the US Government continues to project, for the new cohorts of GSM 102 guarantees issued after 1 July 2005 (i.e. after the CCC revised the programme's fee structure and discontinued its use of the GSM 103 and SCGP programmes), that the guarantees will be provided at a long-term net cost.

14.81 Nor are we convinced that the subsidy reestimates data demonstrates that the GSM 102, GSM 103 and SCGP programmes were provided at no net cost to the US Government in the concerned periods. The reestimates data provided by the United States (except those related to the 1994 and 1995 cohorts, which have closed) are revised estimates. They indicate that the US Government now projects the cohorts of guarantees at issue to be profitable. But, because they are revised *estimates*, they do not establish that the programmes were provided at no net cost to the US Government.[689] We further recall that the original panel's conclusion that the three programmes at issue fell within the scope of item (j) was based on a number of indicators of the past performance of the programmes, in addition to the subsidy estimates.[690] The original panel took into consideration "cash accounting" evidence submitted by Brazil and the "credit guarantee liability" figure reported in the CCC's Financial Statements.[691] The evidence considered by the Panel under both of these methodologies pointed to the programmes being provided at a net cost to the US Government. The CCC continues to report, in its Financial statements, a "credit guarantee liability": the CCC's 2005-2006's Financial

[687] The table was submitted by the United States as part of its Response to Panel Question 111. It includes data contained in the 2008 budget. The United States had initially submitted a table containing re-estimates data contained in up to the 2007 budget. See paras. 87-89 of the US First Written Submission.

[688] Panel Report, *US – Upland Cotton*, para. 7.853.

[689] The Panel notes that, according to the re-estimates data submitted by the United States, certain cohorts (the 1997, 1998 and 2002-2006 cohorts) continue to present a positive "subsidy estimate net of re-estimates".

[690] The United States recognizes this. See US Response to Panel Question 105: "... in the original panel's conclusions, the original subsidy estimates were not dispositive on the question of whether the three export credit guarantee programs met the test of item (j). It was but one factor in the original panel's analysis."

[691] The panel's conclusion also rested on its findings that a number of elements of the structure, design and operation of the programme indicated that the programme was not designed to cover its long term operating costs and losses. See *supra*, para. 14.61.

Statement[692] report a "credit guarantee liability" of US$220 million.[693] The original Panel noted the following with respect to the "credit guarantee liability" figure reported in the CCC's Financial Statements:

> "The CCC defines the term "credit guarantee liability" as the estimated cash outflows of the guarantees on a net present value basis. "Liability" is defined as "...a probable future outflow or other sacrifice of resources as a result of past transactions or events." We observe that these amounts are not actual losses. They are but another indicator, used and relied upon by the United States government, to assess the estimated long-term cost to the United States government of export credit guarantees. They are consistently positive, indicating to us that the CCC believes, based upon its own assessment, that it may not, even over the long term, be able to operate the export credit guarantee programmes without some net cost to government." [694] (footnotes omitted)

14.82 Notwithstanding that the original panel relied in part on the "credit guarantee liability" figure reported in the CCC's Financial Statements, the parties disagree as to the meaning of this figure.[695] The United States argues that the credit guarantee liability is merely a balance sheet entry (corresponding to a future disbursement under the programme) of a liability for which an offsetting entry of an asset exists and that the CCC has an expectation of a recovery associated with the payment for default on the guaranteed loan, such that such receivables may not properly be considered "losses".[696] Brazil rejects the United States' reading as being inconsistent with the definition of the term "credit guarantee liability" provided in the Financial Statements themselves. Brazil draws attention to the use of the word "net": this, in Brazil's view, belies the US assertion that the credit guarantee liability figure in the CCC financial statements includes only a liability for which an offsetting entry of an asset exists:[697]

> "Credit guarantee liabilities represent the estimated **net** cash outflows (loss) of the guarantees on a net present value basis. To this effect, CCC records a liability and an expense to the extent, in management's estimate, CCC will be unable to recover claim payments under the Credit Reform Export Credit Guarantee programs." (emphasis by Brazil). [698]

14.83 We see no reason to depart from the line of reasoning adopted by the original panel. It is clear, in our view, that the "estimated net cash outflow" of outstanding guarantees means that with respect to guarantees that were outstanding as of 30 September 2006, the US Government estimates

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[692] Brazil's Rebuttal Submission, paras. 484-486.

[693] See Exhibit Bra-585 (Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2006 and 2005, November 2006, p. 11 of Notes to the Financial Statements). The financial statements define the term "credit guarantee liability" in the following terms:

> "Credit guarantee liabilities represent the estimated net cash outflows (loss) of the guarantees on a net present value basis. To this effect, CCC records a liability and an expense to the extent, in management's estimate, CCC will be unable to recover claim payments under the Credit Reform Export Credit Guarantee programs."

[694] Panel Report, *US – Upland Cotton*, para. 7.855.

[695] The parties have, in their Responses to Panel Questions 107-108 and Comments thereon, provided an extensive discussion of their arguments on this point.

[696] US Responses to Panel Questions 107 and 108. See also the US Rebuttal Submission, paras. 87-88.

[697] Brazil's Comments on US Response to Panel Questions 107 and 108, para. 298.

[698] See Brazil's Comments on US Response to Panel Questions 107 and 108, paras. 297-298 and Exhibit Bra-585, p. 11.

future disbursements of US$220 million.[699] Thus, in our view, the "credit guarantee liability" reported in the CCC's financial statements provides another indication of the US Government's view that further costs will be incurred with respect to guarantees outstanding as of 30 September 2006.

14.84 As mentioned above, Brazil also submits evidence concerning the cumulative receipts and disbursements for the three programmes pursuant to a "cash basis accounting" methodology. The chart submitted by Brazil in this respect is similar to the results of the constructed "cost" formula it submitted to the original panel[700], but covers the period from FY1993 to FY2005 (the table submitted to the original panel covered the period up to 2002). The table (Exhibit Bra-613) is as follows:

	US$							
FY	**Premiums collected (88.40)**	**Recovered principle and interest (88.40)**	**Interest revenue (88.25)**	**Sub Total**	**Administrative expenses (00.09)**	**Default claims (Line 00.01)**	**Interest expense (Line 00.02)**	**Sub-Total**
1993	27,608,000	12,793,000	15,672,000	*56,073,000*	3,320,000	570,000,000	0	*573,320,000*
1994	20,893,000	458,954,000	0	*479,847,000*	3,381,000	422,363,000	0	*425,744,000*
1995	18,000,000	62,000,000	0	*80,000,000*	3,000,000	551,000,000	10,000,000	*564,000,000*
1996	20,000,000	68,000,000	26,000,000	*114,000,000*	3,000,000	202,000,000	61,000,000	*266,000,000*
1997	14,000,000	104,000,000	26,000,000	*144,000,000*	4,000,000	11,000,000	62,000,000	*77,000,000*
1998	17,000,000	81,000,000	54,000,000	*152,000,000*	4,000,000	72,000,000	62,000,000	*138,000,000*
1999	14,000,000	58,000,000	0	*72,000,000*	4,000,000	244,000,000	62,000,000	*310,000,000*
2000	16,000,000	100,000,000	99,000,000	*215,000,000*	4,000,000	208,000,000	62,000,000	*274,000,000*
2001	18,000,000	149,000,000	125,000,000	*292,000,000*	4,000,000	52,000,000	104,000,000	*160,000,000*
2002	21,000,000	155,000,000	61,000,000	*237,000,000*	4,000,000	40,000,000	93,000,000	*137,000,000*
2003	20,000,000	187,000,000	56,000,000	*263,000,000*	4,000,000	102,000,000	84,000,000	*190,000,000*
2004	22,000,000	219,000,000	61,000,000	*302,000,000*	4,000,000	130,000,000	81,000,000	*215,000,000*
2005	508,000,000	0	0	*508,000,000*	4,000,000	190,000,000	80,000,000	*274,000,000*
				2,914,920,000				**3,604,064,000**

14.85 Over the period FY 1993-2005, the table shows programme receipts of US$2.9 billion, against programme disbursements of US$3.6 billion, for a net loss of over US$689 million.[701]

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[699] We do not understand the United States to fundamentally disagree with the original panel's interpretation of the meaning of the "credit guarantee liability" reported in the CCC's Financial Statements. See US Response to Panel Questions 107 and 108, para. 271:

> "Turning to the Panel's question as to whether the liability figure may be considered a loss, the United States notes the original panel's explanation that a 'liability' is defined as "... a probable future outflow or other sacrifice of resources as a result of past transactions or events." The United States considers that this is an accurate and proper definition of liability. The original panel specifically noted that such a 'probable future outflow' does not equate with 'loss.' Citing the Federal Accounting Standards Advisory Board Statements of Federal Financial Accounting Concepts and Standards, the panel noted that the definition of 'loss,' in contrast, is 'any expense or irrecoverable cost, often referred to as a nonrecurring charge, an expenditure from which no present or future benefit may be expected.' CCC clearly has an expectation of recovery on the receivable it has obtained in exchange for its payment for a default on a guaranteed loan. Therefore, the receivables are not properly considered to be 'losses.'" (footnotes omitted)

[700] Exhibit Bra-613. See Panel Report, *US – Upland Cotton*, paras. 7.844-7.845 for a discussion of the data presented to the original panel.

[701] Exhibit Bra-613 (CCC Cost Formula). See also Exhibit Bra-614 (Budgets of the United States Government, Fiscal Year 1993-2006). The United States notes two minor omissions with respect to the 2005

14.86 The United States considers that Brazil's table is deficient because it does not include amounts recovered under guarantees issued prior to 1992 (the United States indicates that such recoveries, in 1993-2005, total over US$5.6 billion).[702] We disagree. The Panel does not believe that it would be appropriate to include recoveries for pre-1992 guarantees unless all costs and all other revenues associated with the same guarantees are also included. In addition, the Panel considers that including these amounts would not allow a comparison with the re-estimates data submitted by the United States, which only covers guarantees issued after 1992.

14.87 This "cash basis accounting" data leads to results which stand in sharp contrast to the "reestimates" data submitted by the United States. This is not surprising. The difference between the two methods primarily has to do with the fact that the data submitted by the United States includes not only amounts for a past period, but also *projected* disbursements and receipts. Brazil's cash basis formula however only captures receipts and disbursements to date. It does not, therefore, record *projected* receipts and disbursements, including (as the United States indicates) projected recoveries under rescheduled amounts.[703]

14.88 The "credit guarantee liability" figure reported in the CCC's Financial Statements and the cash accounting basis data submitted by Brazil at the very least raise questions as to whether subsequent subsidy reestimates indeed establish that the programmes at issue in the original proceeding were not provided at a net cost to the US Government.

14.89 In conclusion, notwithstanding the reestimates data submitted by the United States, we find it highly significant that the US Government continues, at the time of their issuance, to project that new GSM 102 export credit guarantees will, in the long-term, be provided at a net cost to the Government. In light of this, we consider that the initial subsidy estimates provide a strong indication that GSM 102 export credit guarantees are provided against premia which are inadequate to cover the long-term operating costs and losses of the GSM 102 programme.

14.90 Brazil also adduces other evidence which further convinces us that the GSM 102 programmes fall within the scope of item (j) of the Illustrative List. We analyze this evidence below.

(c) Comparison with MPRs under the OECD Arrangement

(i) Main arguments of the parties

14.91 **Brazil** asks us to take into consideration the minimum premium rates ("MPRs") provided in the OECD Arrangement on Officially Supported Export Credits (hereafter "the Arrangement").[704]

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fiscal year: First, Brazil overlooked US$60 million in additional revenue in line 88.25 ("interest on univested funds"), second, Brazil (understandably) reproduced a printing error in the US budget: premiums collected in that year amounted to just above US$21 million; the balance of US$487 million for FY 2005 should have been printed in the recovery line 88.40 for the financing account. This does not affect the sub-total of revenues for the 2005 year. US Rebuttal Submission, footnote. 145.

[702] The United States refers to Exhibit US-68, budget line 88.40 of the "liquidating account" (relative to pre-1992 guarantees); Brazil only uses line 88.40, which pertains to the "financing account" (relative to post-1991 guarantees). See US Rebuttal Submission, para. 95: the US otherwise agrees, that with the two small exceptions noted in the preceding footnote, Brazil reports the correct figures.

[703] US Response to Panel Question 102.

[704] See Brazil's First Written Submission, paras. 438-443, Exhibits Bra-546 (OECD Arrangement – 2005 revision) and Bra-547 OECD document TD/PG(2004)10/FINAL, 6 July 2004, Premium and Related Conditions: Explanation of the Premium Rules of the Arrangement on Officially Supported Export Credits (the Knaepen Package). The Panel notes that Brazil, in its Rebuttal Submission, includes its arguments with respect to the OECD MPRs in its discussion of the design, structure and operation of the GSM 102 programme. See Brazil's Rebuttal Submission, paras. 499-500.

Brazil argues that the MPRs represent the assessment by the Participants in the OECD Arrangement – including the United States – of the fees that prudently should be charged in order to meet long-term costs and losses. Brazil recognizes that the Arrangement – and therefore, the MPRs – does not apply to export credits in the agricultural field. Yet, Brazil asks us to take into consideration its comparison of GSM 102 fees with the MPRs as a "qualitative" demonstration that GSM 102 fees are well below the level at which they should be to be consistent with item (j) of the Illustrative List.[705]

14.92 The **United States** rejects the relevance of Brazil's arguments based on the OECD MPRs.[706] The United States submits that item (j) of the Illustrative List provides that the proper comparison is between the premium rates charged under the programme at issue and the long-term operating costs and losses of that programme. Item (j) of the Illustrative List does not refer to the Arrangement as the standard under which to assess whether a programme covers its long term operating costs and losses under item (j) of the Illustrative List.

(ii) Main arguments of third parties

14.93 **Japan**[707] argues that Brazil's reliance on the OECD Arrangement in this proceeding is inappropriate. Japan notes that the Arrangement does not cover agricultural products and that the risks of financing arrangements for bulk agricultural commodity products, such as cotton, are not only substantial, but also unique. Moreover, the scope of the Arrangement is limited to export credits with terms of two years or more.

(iii) Evaluation by the Panel

14.94 It is clear to the Panel that the MPRs do not directly apply in determining whether an export credit guarantee programme falls within the scope of item (j) of the Illustrative List. While the MPRs were developed at least in part to ensure that Participants would comply with item (j), item (j) itself does not refer to the OECD Arrangement or to any other international agreement or benchmark in determining whether the premia are inadequate to cover the long term operating costs and losses of export credit guarantee programmes and other programmes covered by item (j) of the Illustrative List. As the United States points out, this contrasts with the second paragraph of item (k) of the Illustrative List, where such a reference is made. In consequence, there is in our view no basis to treat the OECD MPRs as providing a legally binding benchmark to determine whether an export credit guarantee programme falls within the scope of item (j) of the Illustrative List. In any event, GSM 102 fees are not subject to the Arrangement – and therefore to the MPRs – because the Arrangement does not apply to exports of agricultural commodities. Moreover, the Arrangement only applies to official support for terms of two years or more, while GSM 102 guarantees, which are provided for tenors up to three years, are also provided for tenors of less than two years.[708]

14.95 That being said, in our view, while the MPRs have no legal status in the context of an analysis under item (j) of the Illustrative List, they may, from an evidentiary point of view, provide an indication as to whether GSM 102 fees are sufficient to cover the long-term operating costs and losses of the programme. Indeed, recognizing that the MPRs do not directly apply to the GSM 102 programme, Brazil asks us to take into consideration its comparison of GSM 102 fees with the MPRs as a "qualitative" demonstration that GSM 102 fees are well below the level at which they should be to be consistent with item (j) of the Illustrative List.[709] We note that the OECD explains that the Arrangement's benchmark rates, including MPRs, are set "to ensure that Participants to the

[705] Brazil's Response to Panel Question 43, para. 69.
[706] US Response to Panel Question 42.
[707] Japan's Third Party Submission, paras. 24-26.
[708] Arrangement, para. 5(c).
[709] Brazil's Response to Panel Question 43, para. 69.

Arrangement charge premium rates in addition to interest charges that ... are not inadequate to cover long-term operating costs and losses associated with the provision of export credits". Thus, the MPRs were developed, within the context of the OECD, with a view to ensure that Participants would respect the disciplines of item (j):

> "The objectives of the Knaepen Package, as reflected in Article 22 of the Arrangement on Officially Supported Export Credits (the "Arrangement"), are to ensure that Participants to the Arrangement charge premium rates in addition to interest charges that:
> i. cover the risk of non-repayment of export credits (i.e. credit risk); and
> ii. are not inadequate to cover long-term operating costs and losses[2] associated with the provision of export credits."
>
> [2] This obligation is in relation to the list of prohibited subsidies, *i.e.* Item (j) of Annex I of the WTO Agreement on Subsidies and Countervailing Measures (ASCM), which prohibits the provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.[710]

14.96 The MPRs may thus be regarded as representing an assessment, developed by and agreed upon by the export credit experts of the Participants to the Arrangement, of the premia levels that are necessary to ensure that export credit guarantee programmes cover their long-term operating costs and losses. We note, in this respect, that the United States itself, as a Member of the OECD and a Participant to the Arrangement, participated in the elaboration of the MPRs.

14.97 We consider that, in this particular case, because of the magnitude of the difference between the MPRs and GSM 102 fees, the MPRs may provide an indication, on an informed basis, of the fact that GSM 102 fees are set at a level which is insufficient to cover the long term operating costs and losses of the programme. We emphasise that we take into account Brazil's comparison of GSM 102 fees with the MPRs because of the importance of the difference between them; we do not suggest that *any* difference in this respect could be relied upon as an indication that an export credit guarantee programme meets the criteria of item (j) of the Illustrative List.

14.98 Using the formula for the calculation of MPRs contained in Annex VI to the Arrangement, Brazil finds that, for 1063 of 1064 comparison points, GSM 102 fees fall below the Arrangement's MPRs.[711] On average, the MPRs are 106 per cent above GSM 102 fees.[712]

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[710] Exhibit Bra-547, Introduction, para. 1.

[711] Exhibit Bra-548 compares GSM 102 fees for transactions involving annual repayment of principal to MPRs, Exhibit Bra-549 performs the same comparison for GSM 102 fees involving semi-annual repayment of principal. The charts submitted by Brazil include both country and tenor-specific comparisons for any country (i) for which GSM 102 provides a risk rating of 1-6; and, (ii) for which any GSM 102 allocation has been made available in any year during the period FY 2001 through FY 2006 (even if those allocations were not used). Brazil uses the list of countries assigned a GSM 102 risk rating published on 28 July 2006. Confirmation of GSM 102 allocations is drawn from the fiscal year-end editions of "Monthly Summaries of Export Credit Guarantee Program Activity" See Brazil's First Written Submission, paras. 439-440. The sole "comparison point" for which GSM 102 fees are below the MPRs relates to China. Brazil notes that the CCC ranks China in category 6, while the OECD ranks China in category 2. Brazil also notes that Standard & Poor's ranks China as A/Stable/A1, making China's sovereign risk comparable to that of Botswana, Chile, Estonia, Lithuania and South Korea, all countries that are ranked by both the OECD and the CCC in risk category 2. See Brazil's First Written Submission, para. 441, footnote 615.

[712] Brazil's First Written Submission, para. 440 and Exhibits Bra-548 and Bra-549.

14.99 In addition, Brazil highlights the fact that, for longer tenors and higher country risk, GSM 102 fees are well below the OECD MPRs and that the difference between the two increases significantly as country risk increases and tenors lengthen.[713]

14.100 The fact that GSM 102 fees are not subject to the Arrangement does not, in our view, fundamentally undermine the value of Brazil's comparison of GSM 102 fees with the MPRs as a qualitative indication that the fees are inadequate to cover the long term operating costs and losses of the programme.

14.101 With respect to product coverage, Brazil submits that, if anything, the MPRs would increase if agricultural products were made subject to it. That is because, in Brazil's view, in an agricultural transaction, the value of the product sold holds little value to the guarantor (agricultural products are normally consumed shortly after sale or may not preserve). In contrast, industrial products are more durable and offer a better security to the guarantor, should he wish to obtain one.[714] We agree. The fact that agricultural products are perishable in our view suggests that agricultural transactions, if anything, contain an added element of risk to the guarantor, as the products sold would hold little value on which security may be taken. As a consequence, there is in our view no reason why the MPRs should be lowered were agricultural products to fall under its product coverage.

14.102 With respect to the fact that the Arrangement only applies to transactions of two years or more, we note Brazil's indication that the MPR formula allows the determination of fees for a shorter period of time, which has allowed Brazil to calculate the MPRs for tenors of less than two years. But in any case, we note that Brazil has included in its comparison the fees for tenors that would be covered by the Arrangement (tenors of 24, 30 and 36 months). Our conclusion above that GSM 102 fees are well below the MPRs holds true even with respect to only these three tenors, as does our conclusion that the difference between the two increases significantly as risk in the form of higher country risk and longer tenors increases.

14.103 Thus, in our view, the factual differences between the product coverage and the coverage in term of tenors of GSM 102 guarantees and the OECD MPRs do not fundamentally undermine the value of the comparison performed by Brazil. We recall that we consider that the MPRs provide an indication – on an informed basis – that GSM 102 fees are insufficient to cover the long term costs and losses of the programme because of the significant difference between the GSM 102 fees and the MPRs. Any adjustment to take into consideration the differences pointed out by the United States would not, in our view, lead to a markedly different result.

[713] See the following table submitted by Brazil in Exhibit Bra-547, p. 15 (the table concerns guarantees with annual repayment of principal, Brazil submits a similar table with respect to guarantees with semi-annual repayment of principal in Exhibit Bra-548):

Average Percentage by which MPR Fees Exceed GSM-102 Rates (Annual Repayment of Principal)								
USDA Risk Level	**9 Months**	**12 Months**	**15 Months**	**18 Months**	**24 Months**	**30 Months**	**36 Months**	**All Tenors**
0	19%	23%	22%	23%	27%	27%	30%	24%
1	20%	26%	25%	27%	33%	35%	40%	29%
2	24%	32%	31%	34%	43%	46%	54%	38%
3	65%	68%	69%	76%	99%	110%	130%	88%
4	79%	93%	95%	104%	135%	150%	177%	119%
5	101%	122%	124%	136%	173%	192%	225%	153%
6	138%	175%	179%	194%	240%	264%	306%	216%
All risk levels	81%	98%	100%	109%	138%	152%	178%	122%

[714] Brazil's First Written Submission, paras. 442-443.

(d) Structure, design and operation of the GSM 102 programme

(i) Main arguments of the parties

14.104 **Brazil** recalls that the original panel took into consideration elements of the structure, design and operation of the three programmes at issue in the original proceeding to conclude that they fell within the scope of item (j) of the Illustrative List. For Brazil, a programme that breaks even by chance would still not be structured or designed to do so in the long-term. Brazil considers that the GSM 102 programme is not designed to cover its long-term operating costs and losses. Brazil identifies five elements in this respect. *First*, the original panel found it relevant that the CCC borrows from the US Treasury and that access to US Treasury borrowings facilitate the functioning of the CCC programmes. This still holds true. *Second*, Brazil considers that the United States has not adopted a truly risk-based fee schedule. It recalls that the original panel relied on a USDA statement acknowledging that moving to a truly risk-based system would require raising fees to a level that "would most likely exceed" the one per cent fee cap imposed by US law on GSM 102 fees. The United States has not removed the cap. *Third*, although the CCC establishes individual risk ratings for each approved foreign obligor, those risk ratings do not affect the GSM 102 fee that is charged. Brazil considers that prudent fiscal management compels commercial banks to take varying borrower risk into account not only via exposure limits, but also through fees. *Fourth*, Brazil recalls that GSM 102 fees are well below the OECD MPRs. *Fifth*, the US Government continues to predict, year after year, that the programmes will be loss making – that, on one view of the data, the programmes have beaten the odds and met their costs and losses does not mean that they are structured and designed to do so.[715]

14.105 The **United States** submits that the GSM 102 programme is structured and designed to cover its long term operating costs and losses.[716] The United States notes that higher premia are now assessed in respect of obligors in higher-risk countries. Fees increase with each of the 6 eligible country risk categories, and all countries outside those 6 categories are wholly ineligible. The United States reclassified into an ineligible risk category a number of countries previously eligible under the programmes. Fees also increase with tenor. Also, the United States increased fees, on average, by 46 per cent across all programmes and 23 per cent, on a trade-weighted basis, for the GSM 102 programme alone over fiscal year 2004, the last year in which the prior fee schedule exclusively applied. In addition, the CCC ceased issuing guarantees under the GSM 103 and SCGP programmes.[717] Of the three programmes originally examined, the GSM 102 programme exhibited the lowest risk profile. These changes made to implement the DSB recommendations and ruling bolster other disciplines already in place. The United States notes among those the need for foreign banks to be approved before a guarantee can be issued in respect of a transaction (this means in effect, that some countries that are listed as potentially eligible for GSM 102 export credit guarantees are *de facto* ineligible because no banking institution in the country is CCC-approved). Also, the CCC establishes internal bank limits to govern exposure to potential defaults by obligor banks in individual transactions.[718] In any case, the budget data reflects the profitability of the programme over the last 14 years, even before the adoption of the recent changes in 2005. The profitability of the programmes is neither "against the odds", nor "avoiding losses by good fortune", as Brazil argues.[719]

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[715] For Brazil's arguments, see Brazil's First Written Submission, paras. 444-446; Brazil's Rebuttal Submission, paras. 487-512; Brazil's Opening Statement, paras. 240-255.

[716] See US First Written Submission, paras. 73-80; US Rebuttal Submission, paras 101-107, US Opening Statement, paras. 9.

[717] US First Written Submission, paras. 73-80.

[718] US First Written Submission, paras. 77-78.

[719] US Rebuttal Submission, paras. 101 *ff*.

14.106 The United States considers that Brazil's argument that the CCC is part of the US Government and can borrow from the US Treasury would lead to the result that a government agency could never satisfy the item (j) test.[720] With respect to the one per cent statutory fee cap, the United States submits that the operating assumption of the USDA statement on which Brazil relies was that all of the then-eligible countries would remain eligible. Instead, in light of the fact that the fee cap has not been repealed, the CCC eliminated from eligibility 22 countries with respect to which participation in the programme might require fees in excess of the statutory maximum.[721] As to foreign obligor risk, the United States submits that no WTO rule governs how a government programme shall ensure that its premia are adequate to cover its long-term operating costs and losses.

(ii) Evaluation by the Panel

14.107 This dispute concerns a new fee structure for which, by definition, no past performance data exists and therefore for which only projections of the long term net cost of the programme to the US Government are available. Given this, evidence concerning the "structure, operation and design" of the programme would seem to be particularly relevant. This is consistent with the approach of the original panel, which also took into consideration such prospective elements to determine that the programmes at issue in the original dispute were not designed to meet their long term costs and losses.[722]

14.108 The original panel considered that:

> "In this dispute, in order objectively to assess premiums in relation to long-term operating costs and losses, we believe it is also appropriate for us to take into account aspects of the structure, design and operation of the measure before us. We are entitled to inquire whether the programme, including in terms of the premiums charged, was set up in such a way that the total of all premiums would be likely to cover the total of all operating costs and losses under the programme. For example, where a programme does not provide for premium rates that are fully reflective of the risks of a particular transaction, this might be one indicator that the programme was set up in such a way that its long-term operating costs and losses have to be borne, in total or in part, by the government."[723] (footnote omitted)

14.109 We therefore proceed to examine whether, as Brazil argues, there are elements of the structure, design and operation of the GSM 102 programme that indicate that it is not designed to cover its long term costs and losses.

14.110 *First*, we recall that the original panel noted that the CCC has access to funds from the US Treasury and benefits from the full faith and credit of the US Government.[724] This is still the case, and were the GSM 102 programme to incur massive losses, it would have access to additional funds from the US Treasury.

14.111 *Second*, the original panel found that the fees charged by the CCC were not "risk based". This was one of the elements that led to the panel's conclusion that the programmes were not designed

[720] US Rebuttal Submission, para. 104.
[721] US Rebuttal Submission, para. 106.
[722] The panel considered that "[i]n terms of the structure, design and operation of the export credit guarantee programmes before us, there are several elements which lead us to believe that the programmes are not designed to avoid a net cost to government." Panel Report, *US – Upland Cotton*, para. 7.857.
[723] Panel Report, *US – Upland Cotton*, para. 7.805.
[724] Panel Report, *US – Upland Cotton*, para. 7.858.

to cover their long term costs and losses.[725] The original panel noted the following with respect to the fees not being affected by either country risk or foreign obligor risk:

> "... the premiums are not risk-based[726], either with respect to country risk or the creditworthiness of the borrower in an individual transaction.[727] All countries eligible for any of the CCC export credit guarantee programmes are categorized according to risk. CCC categorization of countries is based on a United States government internal risk classification system, which, according to the United States, 'is administratively controlled and may not be released outside of the US Government'.[728] However, the United States has confirmed that "a country's risk classification has no impact on the premiums payable under the United States export credit guarantee programmes".[729] Rather than the premiums, it is the United States government subsidy estimates and re-estimates for the export credit guarantee programmes that are determined in large part by the obligor's sovereign or non-sovereign country risk grade."[730] [731]

14.112 The panel also took into consideration the fact that the statute governing the CCC export credit guarantee programmes did not impose any limitation on the amount of guarantees that could be provided annually to any high risk country (in the aggregate or individually) or to high risks transactions. It concluded that the "CCC is, therefore, able to provide large amounts of guarantees to high-risk countries with a resulting high rate of default".[732]

14.113 Brazil notes that GSM 102 fees still do not take into consideration foreign obligor risk at all.[733] Although the CCC establishes individual risk ratings for each foreign obligor approved for participation in the GSM 102 programme, those risk ratings do not affect the GSM 102 fees. Brazil notes that none of the CCC-approved foreign obligors banks enjoy a credit rating superior to that of its sovereign.[734] In addition, Brazil argues that prudent fiscal management compels commercial banks to take varying borrower risk into account not only via exposure limits, but also through fees, and that

[725] See Panel Report, *US – Upland Cotton*, paras 7.861-7.866.

[726] [Original footnote:] The US Government acknowledges this. See Exhibit US-150 and United States' Response to Panel Question No. 86.

[727] [Original footnote:] e.g. United States' response to Panel Question No. 85. The United States has confirmed to us that under the SCGP "CCC does not determine the creditworthiness of participating importers[...]". Rather, according to the United States, the risk sharing between the CCC and the exporter is intended to ensure that due diligence is performed.

[728] [Original footnote:] United States' response to Panel Question No. 86. According to 7 USC 5622, the CCC shall not make credit guarantees available in connection with sales of agricultural commodities to any country that the Secretary determines cannot adequately service the debt associated with such sale.

[729] [Original footnote:] See e.g. Exhibit US-150 and United States' response to Panel Question No. 86. See also, "US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition and Forestry, US Senate, *Former Soviet Union, Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60", February 1995, pp. 135-136, reproduced in Exhibit BRA-181: "Although GSM 102 recipient countries vary significantly from one another in terms of their risk of defaulting on GSM 102 loans, CCC does not adjust the fee that it charges for credit guarantees to take account of country risk. [...] CCC fees that included a risk-based component might not cover all of the country risk, but they could help to offset the cost of loan defaults." In Exhibit BRA-153**,** *Audit Report of CCC for FY 2000*, June 2001, USDA's Office of the Inspector General stated that fees for the GSM 102 and GSM 103 programmes had not been changed in 7 years, and as a result "may not be reflecting current costs." Without accounting for country risk in the fees charged, the CCC foregoes an opportunity to cover the cost of loan defaults.

[730] [Original footnote:] e.g. Exhibit US-150.

[731] Panel Report, *US – Upland Cotton*, para. 7.861.

[732] Panel Report, *US – Upland Cotton*, paras. 7.862-7.863.

[733] Brazil's Rebuttal Submission, paras. 496-498.

[734] Brazil's First Written Submission, para. 416.

the GSM 102 programme's failure to adjust its guarantee fees to take account of material risks is not cured by diversifying its portfolio of inaccurately-priced guarantees.[735]

14.114 The United States argues that the new fee structure is risk-based. With respect to foreign obligor risk, the United States considers that the changes made to the GSM 102 programme bolster other disciplines already in place. The CCC conducts an independent analysis of each foreign bank in order to establish the risk rating of each foreign bank obligor. The United States argues that Brazil's assertion that because GSM 102 fees do not vary according to the particular foreign bank obligor, the CCC "ignores" foreign obligor risk is inaccurate and that it is similarly inaccurate to assert that the CCC assumes that foreign banks have a credit rating that is identical to that of the sovereign: to the contrary, the CCC establishes an exposure limit with respect to each bank. Once such limit is attained, no further guarantees of obligations of that bank are issued.[736] The United States submits that a Member may choose to control exposure to defaults by foreign banks (and therefore, costs) by either establishing fees that vary with foreign obligor risk or, as the CCC does, by establishing internal bank limits.

14.115 We see no reason to depart from the reasoning adopted by the original panel, and find that GSM 102 fees are not risk-based insofar as they do not take into account one of the main elements of risk associated with the guarantees, the risk of default that is specific to an individual foreign obligor. The impact of this is not insignificant – Brazil points out that over 90 per cent of GSM 102 guarantees are issued with respect to non-sovereign foreign obligors.[737] The fact that the United States sets bank limits with respect to each foreign bank obligor does not, in our view, alter the fact that foreign obligor risk is not reflected in GSM 102 fees.

14.116 *Third*, Brazil notes that the one per cent fee cap has not been repealed. Brazil refers the Panel to a statement of the USDA, in which the latter acknowledged that moving to a risk-based system would raise fees to a level that "would most likely exceed 1 per cent...".[738] The statement was taken into consideration by the original panel. The one per cent fee cap applied to GSM 102 and SCGP fees.

14.117 The United States refutes Brazil's argument by noting that the USDA statement in question was made before measures were taken to implement the DSB recommendations and rulings. Under the new fee structure, fees increase with country risk and with tenor (length of the loan), and all countries outside the eligible risk categories are wholly ineligible under the programme, a step aimed at reducing the risk exposure of the programmes.[739] [740] The United States also brings to our attention

[735] Brazil's Rebuttal Submission, para. 498.
[736] US First Written Submission, para. 79.
[737] Brazil's First Written Submission, para. 416, Exhibits Bra-541 and Bra-542.
[738] Brazil's First Written Submission, para. 418, quoting Panel Report, *US – Upland Cotton*, para. 7.865 and Exhibit Bra-543 (Annual Review of Fees for USDA Credit Programs, 25 March 2003, p. 4 (Exhibit US-150 in the original proceeding)).
[739] Fees continue to vary according to the duration of the underlying loan (30 days to 3 years) and the frequency of the repayment of principal (annual or semi-annual) as they did under the previous fee structure.
[740] The Panel notes that, in their comments on the interim report of the panel, both parties indicated that there are 6, rather than 7 eligible country risk categories under the GSM 102 programme. The parties have, in their submissions, been inconsistent in their designation of the number of eligible country risk categories. Compare, for instance, US First Written Submission, para. 74 to US Response to Panel Question 113; see also Brazil's First Written Submission, para. 334. The Panel conducts its analysis of GSM 102 fees on the basis of its understanding, supported by the evidence submitted by the parties, that countries in categories 0-6 are eligible under the GSM 102 programme.

the fact that a number of high-risk countries have been reclassified into an ineligible category (in addition, some countries are *de facto* ineligible as no bank in the country is approved).[741]

14.118 Brazil argues in response that the changes the United States made had no significant impact on the profitability of the programme. *First*, Brazil argues that discontinuing applications for GSM 103 and SCGP could not have had a significant impact on the riskiness of the CCC's guarantees portfolio as GSM 102 export credit guarantees made up 93 per cent of the CCC guarantees portfolio;[742] *second*, the fact that 19 countries are now ineligible does not significantly impact the riskiness of the portfolio. Brazil points out that, as of the implementation deadline, no GSM 102 guarantees were outstanding for 14 of those 19 countries,[743] and that, for 4 of the 5 remaining countries, GSM 102 guarantees outstanding on the same date amounted to less than one half of one per cent of total outstanding GSM 102 guarantees. Of the countries that had GSM 102 guarantees outstanding, only Algeria accounted for outstanding guarantees of any significance.[744] [745]

14.119 We note that, of relevance to this issue, the United States has indicated that the fees were increased, on average, by 46 per cent for all export guarantee programmes, and by 23 per cent for GSM 102 export credit guarantees (on a weighted-average basis) compared to the last year under the prior fee schedule. Further, the United States explains that the GSM 102 programme was the most profitable of the three programmes examined by the original panel.

14.120 The original panel did not quantify the margin by which the fees for the programmes at issue fell below the level that would have been sufficient to cover the long term operating costs and losses of the programmes. We are therefore unable to assess whether a 46 per cent average fee increase (23 per cent trade-weighted increase) is sufficient to ensure that the GSM 102 programme is not provided at a net cost to the US Government.[746] We cannot rule out that changes made by the US Government to the programmes may affect the USDA's evaluation of whether the one per cent fee cap still remains a constraint on the adoption of risk-based fees. Yet, we consider that the evidence submitted by Brazil concerning outstanding guarantees with respect to countries that have now been made ineligible suggests that the factual context in which the USDA's statement was made has not been altered fundamentally. In this context, we regard the non-repeal of the one per cent fee cap as an indication that the fees charged for GSM 102 export credit guarantees are still not "risk-based".

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[741] US First Written Submission, paras. 75, 77.

[742] Brazil's Rebuttal Submission, para. 15, Exhibit Bra-586 (Commodity Credit Corporation, Guarantee Loan Program Summary for FAS as of 30 June 2005).

[743] See Brazil's Opening Statement, para. 171 and Exhibit Bra-586 (Commodity Credit Corporation, Guarantee Loan Program Summary for FAS as of 30 June 2005). See also Brazil's Rebuttal Submission, para 17.

[744] See Brazil's Opening Statement, para. 17. Exhibit Bra-586 indicates outstanding guarantees for Algeria totalling US$584 million over a total of US$7.9 billion in outstanding guarantees (7.38 per cent of that amount).

[745] The Panel notes that, of the countries that were ineligible on 1 July 2005, only Algeria (7.4 per cent) and Pakistan (3.9 per cent) had significant shares of GSM 102 guarantees outstanding on 1 July 2005; all others had less than 0.3 per cent of the total outstanding GSM 102 guarantees and together amounted to just over 0.8 per cent of total outstanding guarantees. Exhibit Bra-586. Pakistan was later returned to eligibility. See US First Written Submission, footnote 15. The divergence in the number of countries referred to by the parties is explained by the fact that some countries became ineligible after 1 July 2005 and others were returned to eligibility after that date.

[746] We note however that Brazil submits that multiplying the figures in the "premiums collected" column in Exhibit Bra-613 by 1.46 per cent to reflect the average fee increase for all programmes would still result in a net loss of US$574 million (US$632 million if multiplied by 1.23 per cent to reflect the 23 per cent trade-weighted increase in GSM 102 fees calculated by the United States). Brazil's exercise of course assumes that the Panel would consider that the cash-basis accounting provides the relevant assessment of the long-term cost of the programme to the US Government in the 1992-2005 period. In any case our analysis only concerns GSM 102 fees, and not the fees applicable under the three programmes at issue in the original proceeding.

14.121 Our assessment of the effects of the remaining presence of the one per cent fee cap is confirmed by the evidence presented by Brazil with respect to the insufficient "scaling" of GSM 102 fees with the risks that it does take into consideration – country risk and tenor.

14.122 Brazil argues that the one per cent fee cap has prevented the United States from implementing a fee structure that is truly risk-based: for Brazil, "where no fee cap stands in the way of taking relevant risks more fully into account, the upward slope of the fee curve varies dramatically from the insignificant scaling that can be observed with respect to GSM 102 fees".[747] Brazil refers the Panel to the rate of increase, with risk, of fees charged by the ExIm Bank (the US export credit agency) for two of its products, the Letter of Credit Insurance (LCI) and the Medium-Term Export Credit Insurance (MTI).[748]

14.123 The United States rejects Brazil's arguments in this respect.[749] It considers that the fees are sufficiently scaled to take account of country risk, that the *SCM Agreement* imposes no standards in this respect, and that, in any case, the only issue under item (j) of the Illustrative List is whether the programme's "structure, design and operation" – including any scaling – when taken as a whole indicate that the premia are inadequate to cover the long-term costs and losses of the program".[750]

14.124 In addition, the United States objects to Brazil's comparison of GSM 102 fees with those charged by the ExIm Bank. The United States notes that the MTI is not available for agricultural

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[747] Brazil's First Written Submission, paras. 419 and 446 and Brazil's Rebuttal Submission, para. 495:

> "...despite all the pomp attached by the United States to the adoption of 'a risk-based fee schedule,' calling something 'risk-based' does not make it truly reflective of the risks involved. Brazil recalls that the statutorily-imposed one-per cent fee cap imposed on GSM 102 does not permit the program to set fees that take account of all the risks faced by the CCC in issuing GSM 102 ECGs. USDA has acknowledged that moving to a truly risk-based system would require raising fees to a level that 'would most likely exceed 1 per cent ….' Despite the original panel's conclusion that the fee cap was significant in preventing the United States from respecting its WTO obligations, the United States has not removed the cap..."

In the footnotes of this paragraph of its Rebuttal Submission, Brazil refers to its argument that the scaling of GSM 102 fees in terms of country risk and tenor is insufficient when compared to the rate of increase of ExIm Bank fees under the LCI and MTI. See also Brazil's Response to Panel Question 43, para. 73, where Brazil makes a similar argument in the context of its discussion of the OECD MPRs. We therefore examine the parties' arguments concerning Brazil's comparison of GSM 102 and ExIm Bank LCI and MTI fees in this section of our findings, but note that they were made primarily in the context of addressing Brazil's arguments that GSM 102 fees confer a benefit because they are provided for a below-market fee.

[748] Brazil compares GSM 102 fees to those of the LCI for tenors of up to 360 days and to those of the MTI for tenors exceeding 360 days. Unlike GSM 102, ExIm Bank has no single product with tenors from 30 days to three years. See Brazil's First Written Submission, para. 384 and Exhibits Bra-530, pp. 54 and 59. The LCI provides protection against default on irrevocable letters of credit issued by foreign financial institutions. For agricultural commodities, cover is normally limited to 180 days but may be extended to 360 days on a case-by-case basis. 98 per cent of the principal and a portion of the interest are covered by the insurance for exports of agricultural commodities. The MTI covers transactions involving obligations from a foreign bank, and protects the insured against nonpayment due to the foreign bank’s failure to pay because of unforeseen commercial or political reasons. The MTI does not cover transactions for exports of agricultural products. It provides cover for 100 per cent of the transaction amount. Brazil indicates that MTI cover is available for repayment terms between 1 and 5 years, exceptionally 7 years. See Brazil's Comments on US Reponses to Panel Question 98 and Exhibit Bra-534.

[749] Again, the United States makes these specific arguments in the context of answering Brazil's arguments that GSM 102 export credit guarantees confer a benefit because they are provided for a below-market fee; but it is clear from the US Response to Panel Question 99 that the United States considers these arguments to be relevant to Brazil's item (j) arguments.

[750] US Response to Panel Question 99, para. 234.

products and that MTI fees are subject to the OECD Arrangement's MPRs, which cover transactions of two years or more, whereas hundreds of GSM 102 transactions totalling hundreds of millions of dollars are for terms of less than 2 years.[751] The United States also identifies a number of other differences between GSM 102 guarantees and the ExIm Bank products, notably in terms of interest cover[752] and principal coverage. Principal coverage is 100 per cent under the MTI, compared to 98 per cent for a GSM 102 guarantee. Further, the ExIm Bank allows, under the LCI product, the insured to arrange recourse or "pass back" to a third party of all or any part of any uninsured amount. The United States submits that this is not permitted under the GSM 102 programme:

> "Upon default the claimant must subrogate to CCC the claim to the entire amount in default, not just the guaranteed portion. CCC then has the right to recover from the obligor all moneys in default. Unlike the LCI product, the holder of the GSM-102 guarantee is therefore unable to sell the unguaranteed portion of the obligation to another party to insulate himself from any exposure to principal default. Under the MTI product, the holder is similarly insulated from any risk because of the full 100 percent coverage. Inferior coverage of principal relative to the Ex-Im products renders the GSM-102 guarantee less desirable, which is reflected in the price parties are willing to pay. Brazil has also not accounted for the difference in 'pass back' policies of the programs in its comparisons."[753]

14.125 We agree with Brazil that a significant difference in the rate of increase of fees between ExIm Bank's products and the CCC's GSM 102 may indicate that the latter do not sufficiently increase with risk and, as a consequence, are not truly "risk-based". The fact that ExIm Bank's MTI is not available for agricultural products does not, in our view, fundamentally undermine the value of the comparison, nor does the fact that the financial products are not identical, provided that adjustments are made to render them comparable. Taking into account the concerns of the United States that the interest coverage of the products differs, Brazil estimates that GSM 102 fees should be adjusted by approximately 5 per cent to take this difference into account.[754] We consider that Brazil's adjustment is appropriate.[755] With respect to principal coverage, we note that Brazil was able to use a variable on

[751] US Response to Panel Question 98, para. 223.

[752] Under ExIm Bank's MTI product, the obligor is required to use a form of promissory note promulgated by the Bank. The MTI covers "100 per cent of the rate provided in the note". See Exhibit Bra-535. Under the LCI product, "the insured interest rate is generally prime rate minus 0.5 per cent or the rate stated in the credit agreement, whichever is less". The "prime rate" refers to the prime rate published in the Wall Street Journal, under the table "Money Rates". See Exhibit Bra-531. In contrast, GSM 102 guarantees cover "eligible interest", which is the lesser of the interest rate specified between the US bank (or exporter) and the foreign bank or 55 per cent of the average investment rate of the most recent Treasury 26-week bill auction. Exhibit US-153. According to the United States, the interest cover of both LCI and MTI greatly exceeds that of the GSM 102 guarantee. The United States provides a comparison of the GSM 102 interest cover (55 per cent of the applicable 26-week T-bill rate with the LCI interest cover (Wall Street prime rate minus 0.5 per cent), and concludes that LCI interest cover was, on 1 March 2007, 491 basis points higher than CCC interest coverage (7.75 per cent vs. 2.839 per cent) (the difference varied between 374 and 499 basis points since 1 July 2005). The United States also notes that interest cover for the LCI is less than under the MTI). US Response to Panel Question 98, paras. 226-231 and Exhibit US-155.

[753] US Response to Panel Question 98, para. 232.

[754] See Brazil's Comments on the US Response to Panel Question 98, paras. 243-267.

[755] Brazil relies on the maximum possible difference in interest coverage between GSM 102 and ExIm Bank guarantees – i.e. as alleged by the United States, a difference of 5 per cent (7.8 per cent minus 2.8 per cent). Brazil however submits evidence which satisfies us that proceeding on this basis is conservative and favourable to the United States as the 7.8 per cent – which represents the LCI interest coverage cap, and which Brazil applies for both LCI and MTI fees – in fact overestimates the actual interest coverage in recent years. Brazil assumes that in case of default, the CCC would pay 100.8 per cent of the remaining principal (98 per cent towards principal and 2.8 per cent towards interest) and that the ExIm Bank would, in case of default, pay 105.8 per cent of the remaining principal (98 per cent towards principal, and 7.8 per cent towards interest).

the ExIm Bank's website fee calculator to calculate MTI fees on the basis of a principal coverage of 98 per cent. With respect to the possibility to arrange recourse, or "pass-back" under the ExIm Bank LCI product, Brazil submits that the United States' contention that the holder of a GSM 102 export credit guarantee is not "permitted" to insure the remaining 2 per cent of principal not covered by the guarantee is misleading and incorrect insofar as "the United States implies that although a GSM 102 ECG only covers 98% of principal, in the event of default and payment by CCC to the holder of the ECG of 98% of principal, the CCC enjoys a claim on 100 per cent of any monies recovered from the foreign obligor".[756] Brazil submits that, under section 1493.130(c) of the GSM 102 Regulations, the guarantee holder's claim to the 2 per cent of debt not covered by the guarantee ranks *pari passu* with the CCC's own claim to recover the 98 per cent when the CCC pursues recovery. In light of this fact, the Panel does not consider that the difference in principal coverage between GSM 102 export credit guarantees and the LCI would materially affect the fee comparison performed by Brazil.

14.126 In any case, the Panel recalls that it is not comparing the fees charged, on the one hand, by the CCC for the issuance of GSM 102 guarantees and, on the other hand, by the ExIm Bank for the issuance of LCIs and MTIs. Rather, the Panel is considering the rate of increase (or scaling) of fees with increased risk, as an element to assess whether the one per cent fee cap constrains the adoption of a risk-based fee schedule. The fact that the financial products being compared are not identical (for instance, in terms of product coverage) does not fundamentally undermine the comparison of the "scaling" of their fees.[757]

14.127 Brazil has in our view convincingly demonstrated that GSM 102 fees only minimally respond to increased country risk and increased risk in the form of longer tenors, as compared to the fees charged by the ExIm Bank for its LCI and MTI products.[758] The Panel notes, in particular, that while the fees for the lowest country risk categories are relatively similar between GSM 102 and the LCI

Brazil notes that this assumes that interest payments by the borrower on the loan are due annually – an assumption that is favourable to the United States, since if interest is due on a shorter interval, the dollar magnitude of the difference in interest coverage will decrease (less interest will be due at the time of default). See Brazil's Comments on the US Response to Panel Question 98, in particular footnote 409 thereof. The amended results of Brazil's fee comparison are reported in Exhibits Bra-693 and Bra-694.

[756] Brazil's Comments on US Response to Panel Question 98, para. 272.

[757] Further, we recall our finding above (see the Panel's discussion of Brazil's arguments concerning the OECD MPRs, *supra*, para. 14.101) that, if anything, fees should increase where risk in respect of agricultural products is covered. Likewise, the Panel does not regard differences in terms of the tenors of the financial products compared as material. Brazil has established that the "scaling" of GSM 102 fees is greatly inferior to that under either LCI or MTI fees.

[758] Tables in Figure 32, para. 400 of Brazil's First Written Submission. With respect to the rate of increase with country risk, see also the following table submitted by Brazil and which reports the average percentage by which ExIm Bank fees exceed GSM 102 fees:

	GSM 102 annual repayment of the principal	GSM 102 semi-annual repayment of the principal
Risk Level 6	206%	175%
Risk Level 5	145%	125%
Risk Level 4	109%	94%
Risk Level 3	76%	67%
Risk Level 2	30%	29%
Risk Level 1	28%	27%
Risk Level 0	19%	20%

Table 31 of Brazil's First Written Submission, para. 396. The table does not adjust GSM 102 fees for the difference in interest coverage but, as indicated above, we do not consider that an adjustment of approximately 5 per cent would materially affect the comparison of the rates of increase of the fees.

and MTI, there is a sharp difference between the fees charged by the ExIm Bank and the CCC for the highest risk categories.[759]

14.128 The significant difference between the rates of increase for, on the one hand, GSM 102 fees and, on the other hand, the ExIm Bank's LCI and MTI products suggests that the 1 per cent fee cap imposed by US law on GSM 102 fees does indeed prevent the adoption of a truly risk-based fee structure by the CCC.[760]

14.129 Further, we note that, in all cases, GSM 102 fees vary by, at most, 100 per cent between the lowest and highest country risk category, for identical tenors and repayment frequencies.[761] In our view, an increase in fees of, at most, 100 per cent suggests that fees insufficiently take account of this factor. We recall that the countries placed in risk category 0 will by definition present a very low (even virtually inexistent) risk of default and that countries in the highest risk categories present a high risk of default. Finally, we recall our finding above concerning the increasing difference between GSM 102 fees and the OECD MPRs as risk increases.[762] These additional elements lend further support to our conclusion that the rate of increase of GSM 102 fees is insufficient to meaningfully account for increased risks in the form of higher country risk and longer tenors and that the one per cent fee cap prevents the adoption, by the CCC, of risk-based fees for the GSM 102 programme.

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[759] For instance, according to Exhibit Bra-548, the respective fees for GSM 102 and for ExIm Bank's LCI (with annual repayment of principal) for a country falling within each agency's risk category 6 are, for a tenor of 12 months: respectively, 0.612 per cent (GSM 102) and 2.410 per cent (ExIm Bank LCI); for a tenor of 36 months: 1.0 per cent (GSM 102), 4.325 per cent (ExIm Bank MTI). In contrast, the fees for a country falling under each agency's risk category 2 are: 12 months tenor: 0.373 per cent (GSM 102), 0.570 per cent (ExIm Bank LCI); for 36 months: 0.637 per cent (GSM 102), 1.060 per cent (ExIm Bank MTI). The Panel notes that the ExIm Bank and the CCC's risk categories do not perfectly correspond. See Brazil's First Written Submission, footnote 508:

> "GSM 102 risk categories correspond with ExIm Bank risk categories as follows:
> - Countries rated by CCC in GSM 102 risk category 6 have an average ExIm Bank risk category of 5.64;
> - Countries rated by CCC in GSM 102 risk category 5 have an average ExIm Bank risk category of 4.78;
> - Countries rated by CCC in GSM 102 risk category 4 have an average ExIm Bank risk category of 4.13;
> - Countries rated by CCC in GSM 102 risk category 3 have an average ExIm Bank risk category of 3.33;
> - Countries rated by CCC in GSM 102 risk category 2 have an average ExIm Bank risk category of 2.00;
> - Countries rated by CCC in GSM 102 risk category 1 have an average ExIm Bank risk category of 1.83;
> - Countries rated by CCC in GSM 102 risk category 0 have an average ExIm Bank risk category of 1.33.
>
> Thus, GSM 102 fees for GSM 102 risk categories 2, 3, 4, 5 and 6 are compared, respectively, to ExIm Bank fees for ExIm Bank risk categories 2, 3, 4, 5 and 6. GSM 102 fees for GSM 102 risk categories 0 and 1 are compared, respectively, to ExIm Bank fees for ExIm Bank risk categories 1 and 2."

[760] Again, applying an adjustment of approximately 5 per cent to account for the differences between the two products would not, in our view, affect meaningfully the overwhelming difference in the manner in which the increased riskiness of guarantees associated with higher country risk and longer tenors is taken into consideration by LCI/MTI and GSM 102 fees.

[761] US Response to Panel Question 99, para. 235: "under the current fee schedule, the difference in premia for the same tenor between the least risky countries and the most risky countries is in all cases between 81.5 per cent and 100.6 per cent"; see also the GSM 102 Fee Rate Schedule, Exhibit Bra-505.

[762] See *supra*, para. 14.99.

14.130 Brazil also relies, in support of its arguments that the GSM 102 programme is not designed to cover its long term operating costs and losses, on the fact that the CCC continues to project that the programme will be run at a net cost to the US Government in the long term and on the fact that GSM 102 fees are well below the OECD MPRs. The Panel notes that it has already found these elements to provide an indication that GSM 102 export credit guarantees are provided at premium rates which are inadequate to cover the long-term operating costs and losses of the GSM 102 programme.

14.131 In light of these considerations – the CCC's access to funds from the US Treasury, which facilitates the functioning of the programme, the fact that GSM 102 fees do not vary with foreign obligor risk, the fact that the one per cent fee cap has not been repealed and in our view prevents the adoption of risk-based fees (notably due to the insufficient "scaling" of GSM 102 fees) – we conclude that the GSM 102 programme is not designed to cover its long term operating costs and losses.

(e) Overall conclusion of the Panel's analysis under item (j) of the Illustrative List

14.132 We recall that we have conducted our analysis under the general rules of the burden of proof, i.e. we have assumed that it was for Brazil to establish that GSM 102 export credit guarantees constitute export subsidies because they fall within the terms of item (j) of the Illustrative List.[763]

14.133 We find that Brazil has met its burden of proof in this respect and that it has established that the GSM 102 export credit guarantee programme constitutes an "export subsidy" because it is provided against premiums which are inadequate to cover its long term operating costs and losses under the terms of item (j) of the Illustrative List. We reach this conclusion on the basis of the totality of the evidence submitted by Brazil in this respect. We recall that we have taken into consideration the following elements:

(a) The US Government continues to project that new GSM 102 export credit guarantees issued under the new fee schedule will be provided at a net cost to the Government;

(b) GSM 102 fees are well below the OECD MPRs, which we consider to provide an informed appraisal of the level of fees necessary to cover the long-term operating costs and losses of an export credit guarantee programme;

(c) Elements of the structure, design and operation of the GSM 102 programme indicate that the programme is not designed to cover the long term operating costs and losses of that programme.

14.134 On the basis of this evidence, taken as a whole, we find that Brazil has established that GSM 102 export credit guarantees constitute *per se* export subsidies within the meaning of Article 3.1(a) of the *SCM Agreement* because they are provided as part of a programme that falls within the scope of item (j) of the Illustrative List. Relying on the definition of "export subsidy" in Article 3.1(a) of the *SCM Agreement* as context, we conclude that GSM 102 export credit guarantees are "export subsidies" within the meaning of Article 10.1 of the *Agreement on Agriculture*.

14.135 We recall that we consider that the two legal bases relied upon by Brazil in support of its argument that GSM 102 export credit guarantees are "export subsidies" under the terms of Article 3.1(a) of the *SCM Agreement* are not separate claims, but mere separate arguments in support of that contention. We do not consider it necessary to examine whether, in addition to constituting export subsidies because they fall within the scope of item (j) of the Illustrative List, these guarantees

[763] See *supra*, para. 14.47.

also meet the definitional elements of an export subsidy under Articles 1.1 and 3.1(a) of the *SCM Agreement*. In any case, we consider that our findings with respect to item (j) of the Illustrative List suffice to resolve the matter between the parties.[764]

5. Whether the United States has applied GSM 102 guarantees in a manner that results in circumvention of its export subsidy commitments under the *Agreement on Agriculture*

(a) Introduction

14.136 Having concluded that GSM 102 export credit guarantees provide export subsidies under the terms of Article 10.1 of the *Agreement on Agriculture*, we must now determine whether the United States has, subsequent to 1 July 2005, applied such export subsidies in a manner which has resulted in circumvention of its export subsidy commitments.[765]

14.137 The elements necessary to establish that the export subsidies resulted in the circumvention of the United States' export subsidy commitments vary depending on whether scheduled or unscheduled products are at issue. For unscheduled products, "circumvention" of the United States' export subsidy commitments will occur if *any* export subsidies (in the form of GSM 102 export credit guarantees) are provided in respect of *any* quantity of exports of the product in question.[766] For scheduled products, "circumvention" will occur if the United States provides export subsidies to volumes of exports of the product at issue *in excess* of its "quantity" reduction commitments or of its "budgetary outlay" reduction commitments.[767]

14.138 Brazil submits evidence concerning the quantity of exports of certain products that benefited from export subsidies in the form of GSM 102 export credit guarantees since 1 July 2005. We examine whether this evidence suffices to establish Brazil's claims of circumvention below, first with respect to unscheduled products, and in a second time, with respect to scheduled products.

(b) Unscheduled products

14.139 Brazil submits evidence to the effect that the CCC has, subsequent to 1 July 2005, provided GSM 102 guarantees to support the export of the following unscheduled products:[768]

(i) between 1 July and 30 September 2005:[769] cotton, oilseeds (including soybeans/soybean meal), protein meals, fresh vegetables, hides/skins and tallow.[770]

[764] We note that in the original proceeding the Appellate Body rejected a claim by Brazil that the original panel had improperly exercised judicial economy in refusing to make additional factual findings under Articles 1 and 3 of the *SCM Agreement*. See Appellate Body Report, *US – Upland Cotton*, paras. 726-733.

[765] Given our finding that Brazil has established that GSM 102 export credit guarantees constitute export subsidies under Article 10.1 of the *Agreement on Agriculture*, we need not conduct the analysis that would normally follow from the partial reversal of the burden of proof under Article 10.3 of the *Agreement on Agriculture*. See *supra*, para. 14.47.

[766] See Appellate Body Report, *US – FSC*, para. 150. See also the ending clause of Article 3.3 of the *Agreement on Agriculture*: "... a Member shall not provide export subsidies ... in respect of any agricultural product not specified in [Section II of Part IV] of its Schedule."

[767] This follows from the fact that a Member's export subsidy reduction commitments include both a volume ("quantity") and a financial ("budgetary outlay") component. See Appellate Body Report, *EC – Export Subsidies on Sugar*, para. 200 and the text of Article 3.3, which provides that "... a Member shall not provide export subsidies ... in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein."

[768] See Brazil's First Written Submission, paras. 450 *ff*.

(ii) in FY 2006 (1 October 2005-30 September 2006): cotton, oilseeds, soybeans/soybean meal, protein meals, hides/skins, tallow and corn products.[771]

14.140 Given that the United has made no specific export subsidy *reduction* commitments for these products, the United States has committed itself to providing no export subsidies on the export of these products (Article 3.3. of the *Agreement on Agriculture*). Thus, we find, on the basis of the evidence submitted by Brazil, that the United States has after 1 July 2005, applied export subsidies in the form of GSM 102 export credit guarantees in a manner which resulted in circumvention of its export subsidy commitments under the *Agreement on Agricultur*e.

(c) Scheduled products

14.141 With respect to scheduled products, Brazil's claims under Article 10.1 of the *Agreement on Agriculture* concern exports of three products – rice, pig meat and poultry meat. The subsidy reduction commitments of the United States for these products are as follows:

Agricultural product	**Final Commitments**	
	Outlays (US$)	**Quantity (MT)**
Rice	2,368,925	38,544
Pig meat	497,055	395
Poultry meat	14,554,827	27,994

(Source: United States Schedule XX, Part IV, Section II)

14.142 We recall that we have rejected the US arguments that Brazil's claims in respect of pig meat and poultry meat are not properly before us.[772]

14.143 Brazil determines the quantity of export of each of these three products as follows: it takes the value of GSM 102 exporter applications received for each product in the period concerned (July-September 2005 and FY 2006). It then divides that amount by the average US export price for the commodity in question for FY 2006 (US$/metric ton)[773] and thereby obtains the volume, in metric tons, of exports of the product in question in the period concerned.

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[769] *I.e.* the portion of FY 2005 running from 1 July 2005 – GSM 102 export credit guarantee activity is tracked on the basis of a fiscal year running from 1 October to 30 September (FY 2005 ran from 1 October 2004 to 30 September 2005; FY 2006 ran from 1 October 2005 to 30 September 2006).

[770] Compare the summaries of export credit activity as of July 2005 (Exhibit Bra-551) and for the whole of FY 2005 (Exhibit Bra-511). We note that Brazil also submitted evidence to the effect that the United States also provided GSM 102 export credit guarantees to exports of lysine and wood products in the same period. We address Brazil's claim under the *SCM Agreement* in respect of these products below in Section XIV.D.

[771] Exhibit Bra-513. Exports of lyocell and wood products (wood pulp) also benefited from GSM 102 export credit guarantees in the same period. We address Brazil's claims under the *SCM Agreement* in respect of these products below in Section XIV.D.

[772] See *supra*, section IX.B.2.

[773] Brazil obtains the US export price from the following sources: FY 2006, rice: October to September average of monthly prices of US long grain rough rice, bulk, FOB, New Orleans from the 13 October 2006 ERS/USDA "Rice Outlook." See Exhibit Bra-552. July-September 2005, rice: average of July to September 2005 monthly prices of US long grain rough rice, bulk, FOB, New Orleans from the

Agricultural product	Quantity commitment	Exports under GSM 102 (July-September 2005) (MT)	Exports under GSM 102 (FY 2006) (MT)
Rice	38,544	54,430[774]	197,030[775]
Pig meat	395	-	22,562[776]
Poultry meat	27,994	86,572[777]	381,906[778]

14.144 The United States does not challenge Brazil's calculations, nor the manner in which Brazil estimates the relevant price for each agricultural product. We would, on the basis of the evidence provided by Brazil, be ready to conclude that Brazil has made a *prima facie* case that the United States has applied export subsidies in the form of GSM 102 in a manner which has resulted in the circumvention of the US export subsidy reduction commitments for these three products.

14.145 Before doing so, however, we address one issue which has not been discussed by the parties in this dispute, but which the Panel must nevertheless resolve. This issue arises from the fact that the US Schedule of commitments indicates, with respect to the quantitative aspect of the US commitments, that "[a]ll quantity commitments are for the period 1 July 2002 through 30 June 2003 while budgetary outlay commitments are implemented on a fiscal year basis beginning 1 October 2002".[779]

14.146 Thus, while the evidence submitted by Brazil in support of its claims concerns the periods from 1 July to 30 September 2005 (the part of FY 2005 subsequent to the end of the implementation period) and from 1 October 2005 to 30 September 2006 (FY2006), the United States' subsidy commitments, expressed in quantity terms, run from the period 1 July to 30 June of each year.[780]

14.147 The evidence presented by Brazil concerning the period from 1 July to 30 September 2005 does not, in our view, raise any specific difficulty: the totality of the period covered by the evidence presented by Brazil falls within only one of the US "quantity commitment year" (Brazil's evidence

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13 October 2006 ERS/USDA "Rice Outlook." Exhibit Bra-552. For pig meat, FY 2006: average of October 2005 to August 2006 monthly unit values (total value/total quantity) of US pigmeat (HS 0203) from the "USITC Interactive Tariff and Trade DataWeb). Exhibit Bra-553. For poultry meat, July-September 2005: average of October 2004 to September 2005 monthly unit values (total value/total quantity) of US poultry meat (HS 0207), FOB, from the "USITC Interactive Tariff and Trade DataWeb". Exhibit Bra-554. FY 2006, poultry meat: average of October 2005 to August 2006 monthly unit values (total value/total quantity) of US poultry meat (HS 0207), FOB, from the "USITC Interactive Tariff and Trade DataWeb". Exhibit Bra-554.

[774] Exhibit Bra-552.

[775] Exhibit Bra-552.

[776] Exhibit Bra-553.

[777] Exhibit Bra-554.

[778] Exhibit Bra-554.

[779] United States Schedule XX, note 1.

[780] A somewhat similar issue arose in the original proceedings: before the original panel, Brazil made claims with respect to the period 30 June-1 July 2002 (the period corresponding to the United States' quantity reduction commitments), whereas US export credit guarantees activity was reported on the basis of the period running from 1 October to 30 September. See Panel Report, *US – Upland Cotton*, para. 7.878. The Panel did not address the issue of the partial overlap of the time periods, but the Appellate Body commented on the issue and indicated that the Panel should have sought to address it. See Appellate Body Report, *US – Upland Cotton*, para. 691.

covers the first three months of the US "quantity commitment year" running from 1 July 2005 to 30 June 2006)". But the evidence presented by Brazil with respect to FY 2006 (i.e. 1 October 2005 to 30 September 2006) only partially overlaps with the US "quantity commitment year", which runs from 1 July 2005 to 30 June 2006.[781] Explained differently, US exports of scheduled products during the period running from 1 July 2006 to 1 October 2006 should be computed as part of a different year for the purpose of determining whether the United States has respected its export subsidy reduction commitments (expressed in quantity terms).[782]

14.148 That being said, in the present case, we are satisfied that Brazil has, at the very least, made a *prima facie* case that the United States has circumvented its quantitative export subsidy commitments. This is because, for all three products, the quantity of exports having benefited from GSM 102 export credit guarantees exceeds the US quantity commitments by a large margin. The quantity of exports exceeds the United States' quantitative commitments by a factor of 5 in the case of rice, 57 in the case of pig meat and 14 in the case of poultry meat.[783] We could only conclude that Brazil has not proved (or at least made a *prima facie* case) that the United States has exceeded its quantity commitments if it were assumed, in the "best" case (rice), that 80 per cent of the exported quantity having benefited from subsidies was exported in the last three months of the year (from 1 July to 1 October 2006). Such an assumption would not be reasonable, nor has the United States presented any arguments that Brazil's demonstration with respect to "actual circumvention" under the *Agreement on Agriculture* is incorrect. We therefore conclude that Brazil has – at the very least – made *a prima facie* case that the United States exceeded its export subsidy reduction commitments for each of rice, poultry meat, and pig meat, during FY 2006.

14.149 As a result, the Panel **finds** that the United States has applied export subsidies in the form of GSM 102 export credit guarantees in a manner which has resulted in the circumvention of the US export subsidy reduction commitments for rice, poultry meat and pig meat during FY 2006 (1 October 2005 to 30 September 2006), and for rice and poultry meat in the period from 1 July to 30 September 2005.

14.150 The Panel also **finds**, as a consequence, that by acting inconsistently with Articles 10.1 and 8 of the *Agreement on Agriculture* the United States has failed to comply with the DSB recommendations and rulings. Specifically, the United States has failed to bring its measures into conformity with the *Agreement on Agriculture.*

[781] We note in passing that the two periods for which Brazil submits evidence fall within the same US "quantity commitment year".

[782] We also note that the issue does not arise with respect to unscheduled products: this is because Article 3.3 of the *Agreement on Agriculture* prohibits the United States from granting any subsidy whatsoever to exports of unscheduled products. Even if the United States' compliance with its obligation not to provide any export subsidies to these products was computed on the basis of the "period" for which it makes commitments in its Schedule, there would be "circumvention." This is because the period within which the United States' "budgetary outlay commitments" are to be assessed matches the period for which Brazil provides evidence (in both cases, the "year" runs from 1 October to 30 September). Because any quantity of exports benefiting from export subsidies necessarily corresponds to a budgetary outlay, no additional enquiry would be necessary to conclude that the United States has "circumvented" its export subsidy commitments with respect to unscheduled products.

[783] Expressed differently, the quantities of exports having benefited from exports subsidies exceed the United States' commitments by, respectively, 511 per cent, 5712 per cent, and 1379 per cent (compare the second and fourth columns of the table in para. 14.143, *supra*).

6. Claims that GSM 102 export credit guarantees are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*

14.151 Brazil claims that to the extent that export subsidies in the form of GSM 102 export credit guarantees are provided in a manner inconsistent with the *Agreement on Agriculture*, they are not shielded from challenge under Articles 3.1(a) and 3.2 of the *SCM Agreement*.[784] Brazil notes that the opening clause of Article 3.1 of the *SCM Agreement* provides that "subsidies contingent... upon export performance" are prohibited, "[e]xcept as provided in the Agreement on Agriculture...," meaning that Members are prohibited from granting or maintaining export subsidies to products covered by the *Agreement on Agriculture* except where the *Agreement on Agriculture* allows such subsidies. Brazil argues that for unscheduled products, the United States is not due the "safe harbor" afforded by the opening clause of Article 3.1 of the *SCM Agreement* at all, and that as a result, the prohibition on export subsidies in Articles 3.1(a) and 3.2 applies fully to the "GSM 102 export subsidy". With respect to rice, pig meat and poultry meat, Brazil argues that the United States' entitlement to the "safe harbor" is limited and that Articles 3.1(a) and 3.2 of the *SCM Agreement* apply to the extent that the quantities of products having benefited from GSM 102 export subsidies exceed the United States' quantitative export subsidy reduction commitments for these three products.

14.152 The United States has not specifically responded to Brazil's arguments in this respect.

14.153 Article 3.1 of the *SCM Agreement* reads as follows:

> "*Except as provided in the Agreement on Agriculture*, the following subsidies, within the meaning of Article 1, shall be prohibited:
>
> (a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I;" (footnotes omitted; emphasis added)

14.154 There is, in our view, no question that, to the extent that the GSM 102 export credit guarantees do not conform fully to the provisions of the *Agreement on Agriculture*, they are subject to the prohibition on export subsidies under Articles 3.1(a) of the *SCM Agreement*.[785] We have already concluded that GSM 102 export credit guarantees confer export subsidies under Article 10.1 of the *Agreement on Agriculture,* relying on item (j) of the Illustrative List as "context" to reach that conclusion. We see no reason to reach a different conclusion when considering whether GSM 102 export credit guarantees constitute export subsidies under the terms of Article 3.1(a) in itself, and not as "context" in an analysis under Article 10.1 of the *Agreement on Agriculture*.

14.155 As indicated in our findings in paras. 14.140 and 14.149, above, the United States has, since 1 July 2005, provided export subsidies with respect to unscheduled products (between 1 July and 30 September 2005, on exports of cotton, oilseeds – including soybeans/soybean meal, protein meals, fresh vegetables, hides/skins and tallow and in FY 2006, to exports of cotton, oilseeds, soybeans/soybean meal, protein meals, hides/skins, tallow and corn products) and has provided export subsidies in excess of its export subsidy reduction commitments to exports of scheduled products – rice, poultry meat and pig meat during FY 2006, and rice and poultry meat in the period from 1 July to 30 September 2005.

[784] Brazil's First Written Submission, paras. 457-460.

[785] We need not, in this case, address the question of whether, now that Article 13 of the *Agreement on Agriculture* (the Peace Clause) has lapsed, there may be a violation of Articles 3.1(a) and 3.2 of the *SCM Agreement* in respect of *all* exports (i.e. even those that conform to the disciplines of the *Agreement on Agriculture*). Brazil makes no claims to that effect.

14.156 The Panel therefore **finds** that the United States has acted inconsistently with Articles 3.1(a) and 3.2 of the *SCM Agreement* by providing export subsidies to unscheduled products since 1 July 2005 and by providing export subsidies to scheduled products in excess of its commitments under the *Agreement of Agriculture* since 1 July 2005.

14.157 The Panel also **finds**, as a consequence, that by acting inconsistently with Articles 3.1(a) and 3.2 of the *SCM Agreement* the United States has failed to comply with the DSB recommendations and rulings. Specifically, the United States has failed to comply with the DSB recommendation, adopted pursuant to Article 4.7 of the *SCM Agreement*, to "withdraw the prohibited subsidies" identified in paragraph 8.1(d)(i) of the report of the original panel.

D. CLAIMS WITH RESPECT TO LYSINE, LYOCELL AND WOOD PRODUCTS

14.158 As indicated above, Brazil initially included three products – lysine, lyocell and wood products – in the list of products concerned by its claims under Article 10.1 and 8 of the *Agreement on Agriculture*, and to the extent of the inconsistency with the *Agreement on Agriculture*, under Articles 3.1(a) and 3.2 of the *SCM Agreement*. After the United States pointed out that the products are not covered by the scope of the *Agreement on Agriculture*, Brazil indicated that it is not pursuing its claims under the *Agreement on Agriculture* with respect to these products.[786] We therefore need not decide whether these three products in fact fall outside the scope of the *Agreement on Agriculture*.

14.159 The United States contends that Brazil's claims under Articles 3.1 and 3.2 of the *SCM Agreement* are not properly before us. The United States submits that in its request for the establishment of a panel, Brazil presented claims under Articles 3.1 and 3.2 of the *SCM Agreement* "as a result and to the extent of the violation of Article 10.1 (and, as a consequence, Article 8) of the *Agreement on Agriculture*".[787] We therefore need to decide whether Brazil's claims concerning these three products under the *SCM Agreement* are properly before us.

[786] See Panel Question 50 and Brazil's Response thereon:

"Does Brazil maintain its claims with respect to the three unscheduled products (lyocell, lysine, wood products) identified by the United States as falling outside the scope of the Agreement on Agriculture? (see paragraph 83 of the United States' Rebuttal)
Brazil maintains its claims under Articles 3.1(a) and 3.2 of the SCM Agreement with respect to GSM 102 ECGs for lyocell, lysine and wood products. To the extent that these products fall outside the scope of the Agreement on Agriculture, the compliance Panel need not, before addressing Brazil's prohibited subsidy claims under the SCM Agreement, address whether the provision of GSM 102 ECGs for these products circumvents US agricultural export subsidy commitments."

[787] US Comments on Brazil's Response to Panel Question 50:
"In its response, Brazil appears to acknowledge that lyocell, lysine, and wood products fall outside the scope of the *Agreement on Agriculture.* By definition, therefore, the provision of GSM 102 export credit guarantees in respect of lyocell, lysine, and wood products cannot circumvent US agricultural export subsidy commitments under that agreement. In its request for establishment of a panel, Brazil presented claims under Articles 3.1 and 3.2 of the SCM Agreement "as a result and to the extent of [the alleged] violation of Article 10.1 (and, as a consequence, Article 8) of the *Agreement on Agriculture*." As there can be no "violation of Article 10.1 (and, as a consequence, Article 8) of the *Agreement on Agriculture*," there can be no claim under the *SCM Agreement* with respect to the GSM 102 export credit guarantees in respect of lyocell, lysine, and wood products under the express terms of Brazil's request for panel establishment. Where a claim is not set out in the request for panel establishment – as here – it is not part of the matter referred to the panel and falls outside the scope of a panel proceeding." (footnotes omitted)

14.160 The relevant parts of Brazil's request for the establishment of a panel read as follows:

> "(b) Inconsistency of measures taken to comply with the covered agreements
>
> 25. Brazil believes that the United States provides export subsidies (under Articles 1, 3.1(a) and 3.2 of the *SCM Agreement*, as well as under item (j) to the Illustrative List of Export subsidies included as Annex I to the *SCM Agreement* (the "Illustrative List")) through the GSM 102 and SCGP programs, and ECGs provided under these programs, and has applied those export subsidies subsequent to 1 July 2005 in a manner that results in circumvention of the United States' export subsidy commitments. In this respect, the United States' measures taken to comply are not consistent with Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*.
>
> 26. Specifically, and notwithstanding the US measures taken to comply cited as items (ii) and (iii) in Section B above, the GSM 102 and SCGP programs, and ECGs provided thereunder, are export subsidies under the *Agreement on Agriculture* and the *SCM Agreement*, based on the following two grounds:
>
> - The programs and ECGs provided thereunder provide and constitute financial contributions (loan guarantees) that confer benefits on recipients, within the meaning of Article 1 of the *SCM Agreement*, and that are contingent upon export performance, within the meaning of Article 3.1(a) of the *SCM Agreement*; and, separately and independently,
>
> - The programs do not levy premium rates adequate to cover the long-term operating costs and losses of the GSM 102 and SCGP programs, within the meaning of item (j) of the Illustrative List.
>
> 27. Further, subsequent to 1 July 2005, ECGs under the GSM 102 and SCGP programs have been applied to circumvent US export subsidy commitments, within the meaning of Article 10.1 of the *Agreement on Agriculture*. Brazil is concerned that ECGs under the GSM 102 and SCGP programs have been provided subsequent to 1 July 2005 to support the export of: upland cotton and other unscheduled products; and, rice, pigmeat and poultry meat, in excess of US reduction commitment levels for those products.[788]
>
> 28. As a result and to the extent of this violation of Article 10.1 (and, as a consequence, Article 8) of the *Agreement on Agriculture*, the GSM 102 and SCGP programs, and ECGs provided thereunder, are subject to the prohibition against export subsidies included in Articles 3.1 and 3.2 of the *SCM Agreement*. On the grounds cited in paragraph 26 above, Brazil believes that the GSM 102 and SCGP programs, and ECGs provided thereunder, are prohibited export subsidies, within the meaning of Articles 3.1(a) and 3.2 of the *SCM Agreement*."[789]

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[788] Exports that benefited from GSM 102 and SCGP ECGs subsequent to 1 July 2005 are currently reflected in the July 2005 and September 2005 (fiscal year end), as well as July 2006 "Monthly Summary of Export Credit Guarantee Activity," USDA FAS Online, available at http://www.fas.usda.gov/excredits/Monthly/ecg.html.

[789] WT/DS267/30, paras. 25-28.

14.161 The Panel agrees with the United States that Brazil's claims under Articles 3.1(a) and 3.2 of the *SCM Agreement* are contingent upon a finding by the Panel that the United States has applied export subsidies inconsistently with its obligations under the *Agreement on Agriculture,* and only to the extent of that inconsistency.

14.162 We note in particular that Brazil's request for the establishment of a panel uses the expression "in this respect" in the introductory paragraph of the section concerning Brazil's export credit guarantees claims. Read in conjunction with the immediately preceding sentence ("and has applied those export subsidies ... in a manner that results in circumvention of the United States' export subsidy commitments") and taking into consideration the fact that Brazil uses "circumvention of the United States' export subsidy commitments" to refer to a violation, by the United States, of its obligation under Article 10.1 of the *Agreement on Agriculture*[790], it is clear to the Panel that Brazil's claims of inconsistency with 3.1(a) and 3.2 of the *SCM Agreement* depend on a finding by the Panel that the export subsidies in question have resulted in the circumvention of the United States' export subsidy commitments.

14.163 In addition, paragraph 28 of Brazil's panel request, which explains in more details Brazil's claims, indicates that it is "[a]s a result" and "to the extent" of the violation of Articles 10.1 and 8 of the *Agreement on Agriculture* that the US export credit guarantee programmes in question are subject to the prohibition against export subsidies included in Articles 3.1 and 3.2 of the *SCM Agreement*.

14.164 As a result, the Panel considers that Brazil's claims under Articles 3.1(a) and 3.2 of the *SCM Agreement* with respect to lyocell, lysine and wood products are not covered by Brazil's request for the establishment of a panel and are therefore not part of its terms of reference.

XV. CONCLUSIONS AND RECOMMENDATION

15.1 In accordance with its mandate under Article 21.5 of the DSU, the Panel has examined the "existence or consistency with a covered agreement of measures taken" by the United States "to comply with the recommendations and rulings" adopted by the DSB in the original proceeding. The Panel concludes that:

With respect to the measure taken by the United States to comply with the DSB recommendations and rulings relating to the original panel's finding of inconsistency with Articles 5 and 6 of the SCM Agreement:

(a) The United States acts inconsistently with its obligations under Articles 5(c) and 6.3(c) of the *SCM Agreement* in that the effect of marketing loan and counter-cyclical payments provided to US upland cotton producers pursuant to the FSRI Act of 2002 is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement* in the world market for upland cotton constituting "present" serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement.* By acting inconsistently with Articles 5(c) and 6.3(c) of the *SCM Agreement* the United States has failed to comply with the DSB recommendations and rulings. Specifically, the United States has failed to comply with its obligation under Article 7.8 of the *SCM Agreement* "to take appropriate steps to remove the adverse effects or. ..withdraw the subsidy".

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[790] See the first sentence of para. 27 of Brazil's request:
"Further, subsequent to 1 July 2005, ECGs under the GSM 102 and SCGP programs have been applied to circumvent US export subsidy commitments, within the meaning of Article 10.1 of the *Agreement on Agriculture*."

(b) Brazil has not made a *prima facie* case that the effect of marketing loan and counter-cyclical payments provided to US upland cotton producers pursuant to the FSRI Act of 2002 is an increase in the US world market share in upland cotton as compared to the average US world market share during the previous period of three years and that this increase follows a consistent trend over a period when subsidies have been granted. Therefore, it has not been established that the United States acts inconsistently with Articles 5(c) and 6.3(d) of the *SCM Agreement*.

With respect to the measure taken by the United States to comply with the DSB recommendations and rulings relating to the original panel's findings of inconsistency with Articles 10.1 and 8 of the Agreement on Agriculture and Articles 3.1(a) and 3.2 of the SCM Agreement:

(c) Regarding GSM 102 export credit guarantees issued after 1 July 2005 the United States acts inconsistently with Article 10.1 of the *Agreement on Agriculture* by applying export subsidies in a manner which results in the circumvention of US export subsidy commitments with respect to certain unscheduled products[791] and certain scheduled products[792], and as a result acts inconsistently with Article 8 of the *Agreement on Agriculture*. Regarding GSM 102 export credit guarantees issued after 1 July 2005 the United States also acts inconsistently with Articles 3.1(a) and 3.2 of the *SCM Agreement* by providing export subsidies to unscheduled products[793] and by providing export subsidies to scheduled products[794] in excess of the commitments of the United States under the *Agreement on Agriculture*. By acting inconsistently with Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement* the United States has failed to comply with the DSB recommendations and rulings. Specifically, the United States has failed to bring its measures into conformity with the *Agreement on Agriculture* and has failed "to withdraw the subsidy without delay".

(d) With respect to certain export credit guarantees issued prior to 1 July 2005, Brazil has not established that the United States has failed to "withdraw the subsidy without delay".

15.2 The Panel considers that to the extent that the measures taken by the United States to comply with the recommendations and rulings adopted by the DSB in the original proceeding are inconsistent with the obligations of the United States under the covered agreements, these recommendations and rulings remain operative. In this regard, the Panel recalls that the recommendations and rulings that were adopted by the DSB in the original proceeding were as follows:

"(a) we recommend pursuant to Article 19.1 of the *DSU* that the United States bring its measures listed in paragraphs 8.1(d)(i) and 8.1(e) above into conformity with the *Agreement on Agriculture*;

(b) as required by Article 4.7 of the *SCM Agreement*, we recommend that the United States withdraw the prohibited subsidies in paragraphs 8.1(d)(i) and 8.1(e) above without delay. The time-period we specify must be consistent with the

[791] The unscheduled products at issue are (i) in the period 1 July-30 September 2005: cotton, oilseeds (including soybeans/soybean meal), protein meals, fresh vegetables, hides/skins and tallow; and (ii) in the period 1 October 2005–30 September 2006: cotton, oilseeds, soybeans/soybean meal, protein meals, hides/skins, tallow and corn products.

[792] The scheduled products at issue are: (i) in the period 1 July-30 September 2005: rice and poultry meat; and (ii) in the period 1 October 2005-30 September 2006: rice, poultry meat and pig meat.

[793] *Supra*, footnote 791.

[794] *Supra*, footnote 792.

requirement that the subsidy be withdrawn 'without delay'. In any event, this is at the latest within six months of the date of adoption of the Panel report by the Dispute Settlement Body or 1 July 2005 (whichever is earlier);

(c) pursuant to Article 4.7 of the *SCM Agreement*, we recommend that the United States withdraw the prohibited subsidy in paragraph 8.1(f) above without delay and, in any event, at the latest within six months of the date of adoption of the Panel report by the Dispute Settlement Body or 1 July 2005 (whichever is earlier); and

(d) we recall that, in respect of the subsidies subject to our conclusion in paragraph 8.1(g)(i) above, pursuant to Article 7.8 of the *SCM Agreement*:

> '7.8 Where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member within the meaning of Article 5, the Member granting or maintaining such subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy'.

Accordingly, upon adoption of this report, the United States is under an obligation to 'take appropriate steps to remove the adverse effects or ... withdraw the subsidy'".[795]

15.3 The Panel has set out above in para. 9.79 its views on the interpretation of the obligation under Article 7.8 of the *SCM Agreement* to "take appropriate steps to remove the adverse effects or ... withdraw the subsidy".

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[795] Panel Report, *US – Upland Cotton*, para. 8.3. As stated by the panel in *US – FSC (Article 21.5 – EC II)*, "once the DSB adopts a dispute settlement report, the findings and recommendations in that report become collective, operative DSB rulings and recommendations." *US – FSC (Article 21.5 – EC II)*, para. 7.35.

ANNEX A

FIRST WRITTEN SUBMISSIONS OF PARTIES AND THIRD PARTIES

ANNEX A-1

EXECUTIVE SUMMARY OF THE FIRST WRITTEN SUBMISSION OF BRAZIL

(Executive summary submitted on 24 November 2006)

1. This dispute results from the United States' failure to implement, in a timely and complete manner, the recommendations and rulings of the Dispute Settlement Body ("DSB") in *U.S. – Upland Cotton*. Brazil challenges both the *existence* and *consistency* of U.S. measures taken to comply with the "adverse effects"- and "export credit guarantee"-related recommendations and rulings of the DSB.

BRAZILIAN CLAIMS CONCERNING ADVERSE EFFECTS-RELATED RECOMMENDATIONS AND RULINGS OF THE DSB

2. In its adverse effects-related recommendations and rulings, the original panel, as affirmed by the Appellate Body, found that the price-contingent U.S. marketing loan program, counter-cyclical payment program and Step 2 program of the FSRI Act of 2002 caused significant price suppression in the world market for upland cotton, in violation of Articles 5(c) and 6.3(c) of the *Agreement on Subsidies and Countervailing Measures* ("*SCM Agreement*"). The panel found that "the United States is obliged to take action concerning its present statutory and regulatory framework as a result of our 'present' serious prejudice findings."[1] The Dispute Settlement Body adopted the panel and Appellate Body reports that obliged the United States to remove the adverse effects caused by the subsidies, or to withdraw the subsidies, by 21 September 2005.

3. The United States did not repeal or amend any of the three price-contingent subsidy programs until 1 August 2006, when it finally discontinued solely the Step 2 program. The far larger marketing loan and counter-cyclical payment programs have not been removed or amended to this day. Brazil asserts four claims related to adverse effects implementation.

4. ***First***, Brazil claims that between the expiry of the implementation period on 21 September 2005 and elimination of Step 2 payments on 1 August 2006, there did not "exist" any U.S. "measures taken to comply" with the adverse effects-related recommendations and rulings of the DSB.[2]

5. ***Second,*** Brazil claims that the non-repealed price-contingent U.S. marketing loan and counter-cyclical payment programs cause present serious prejudice in the form of significant price suppression in the world market for upland cotton, and an increase in the U.S. world market share, in violation of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*. In other words, Brazil claims that, to the extent measures taken to comply with the adverse-effects related recommendations and rulings of the DSB exist (*i.e.*, the repeal of Step 2 and the non-repeal of the marketing loan and counter-cyclical payment programs), those measures continue to result in inconsistencies with the covered agreements, within the meaning of Article 21.5 of the DSU.[3]

6. Brazil establishes serious prejudice to its interests based on data for the most recently completed marketing year ("MY") – MY 2005. Full-year data on marketing loan and counter-cyclical payments to U.S. upland cotton farmers for MY 2006 – the first year in which Step 2 is not provided –

[1] Panel Report, *U.S. – Upland Cotton*, para. 7.1501.
[2] *See* Section 6 of Brazil's First Written Submission.
[3] *See* Section 7 of Brazil's First Written Submission.

will not be available until September 2007. Nevertheless, the compliance Panel, like the original panel, can use a counter-factual analysis to evaluate the effects of marketing loan and counter-cyclical payments alone, and factor out any additional effects of Step 2 (or other subsidy) payments made in MY 2005.

7. As a preliminary step, Brazil establishes that the marketing loan and counter-cyclical payment programs of the FSRI Act of 2002 constitute subsidies that are specific, within the meaning of Articles 1 and 2 of the *SCM Agreement*.[4] In addition, upland cotton from Brazil continues to be a like product with subsidized U.S. upland cotton and there continues to be a world market and the A-index continues to constitute the world market price for upland cotton.[5]

8. To demonstrate a causal link between U.S. marketing loan and counter-cyclical payments and significant price suppression, within the meaning of Article 5(c) and 6.3(c) of the *SCM Agreement*, Brazil examines the same factors relied upon by the original panel.

9. As the largest exporter of upland cotton in the world, the United States remains the single most important market influencing world market prices. Changes in the volume of U.S. production, carry-over stocks, and exports have a significant impact on world market prices.[6] In addition, movements in U.S., Brazilian, A-Index and futures market prices continue to show a broad similarity and remain low relative to long term averages. [7]

10. The magnitude of marketing loan and counter-cyclical payments in MY 2005 was massive, amounting to $2.17 billion, or 42 percent of the market value of U.S. upland cotton production.[8] As the original panel found, the structure, design and operation of these subsidies continue to insulate U.S. upland cotton producers from market forces[9], leading to high levels of U.S. planted acreage, production and exports and, ultimately, suppressed world market prices.[10] Thus, there remains a discernable temporal coincidence between these subsidies and suppressed world market prices.[11]

11. Over the long term (six years), U.S. costs of production for upland cotton continue to greatly exceed market revenues. Without subsidies, the average acre planted to upland cotton between MY 2000-2005 would have lost $663, or $9.84 billion for all acres. However, when revenue from marketing loan and counter-cyclical payments is included with market revenue, the average acre would have made a total six-year profit of $127, or $1.44 billion in aggregate. These facts succinctly demonstrate that the effect of marketing loan and counter-cyclical payments is to sustain higher levels of output than would otherwise exist.[12]

12. Economic studies by leading academics show that marketing loan and counter-cyclical payments continue to stimulate U.S. production and exports and result in lower world market prices than would prevail in their absence. Professor Daniel Sumner finds that the world market price of upland cotton would have been between 9 and 11 percent higher in MY 2005 in the absence of these two U.S. subsidy programs. [13]

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[4] *See* Section 7.3 of Brazil's First Written Submission.
[5] *See* Section 7.4 of Brazil's First Written Submission.
[6] *See* Section 7.5 of Brazil's First Written Submission.
[7] *See* Section 7.6 of Brazil's First Written Submission.
[8] *See* Section 7.7 of Brazil's First Written Submission.
[9] *See* Section 7.8 of Brazil's First Written Submission.
[10] *See* Section 7.9 of Brazil's First Written Submission.
[11] *See* Section 7.10 of Brazil's First Written Submission.
[12] *See* Section 7.11 of Brazil's First Written Submission.
[13] *See* Section 7.12 of Brazil's First Written Submission.

13. In view of the size and nature of U.S. upland cotton subsidies and the commanding U.S. market share, the price suppression is unmistakably significant.[14] Any price-suppressing effects of Step 2 payments do not diminish the significant and independent price-suppressing effects of marketing loan and counter-cyclical payments. Indeed, the U.S. Congressional Budget Office concludes that counter-cyclical payments will be even larger in the absence of Step 2 payments. [15] Similarly, other non-subsidy factors that impact the world market price of upland cotton do not account for the price suppression caused by marketing loan and counter-cyclical payments.[16]

14. Brazil also claims that the U.S. marketing loan and counter-cyclical payments cause serious prejudice to the interests of Brazil by increasing the U.S. share of the world upland cotton market, within the meaning of Article 5(c) and 6.3(d) of the *SCM Agreement*. The U.S. world market share of upland cotton increased from an average of 19.32 percent in MY 2002-2004 to 20.85 percent in MY 2005, or from 16.98 percent in MY 2002-2004 to 17.44 percent in MY 2005, depending on approach used to measure supply. The same effects from marketing loan and counter-cyclical payments that stimulate excessive U.S. production and exports and lower world market prices – despite high costs and low market revenue and prices – also causes the increase in U.S. world market share.[17]

15. In sum, Brazil requests the compliance Panel to find that the U.S. measure eventually taken to comply, *i.e.*, the amendment of the FSRI Act of 2002 to repeal Section 1207(a), providing for Step 2 payments, is insufficient to ensure compliance with the recommendations and rulings of the DSB, because the resulting basket of measures is inconsistent with Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*.

16. ***Third,*** Brazil claims that despite the repeal of the Step 2 program, the marketing loan and counter-cyclical payments mandated under the FSRI Act of 2002 to be made in MY 2006, and beyond, cause a *threat* of serious prejudice to the interests of Brazil, within the meaning of Articles 5(c) and 6.3(c), as well as footnote 13 of the *SCM Agreement*. Brazil again claims that, to the extent measures taken to comply with the adverse-effects related recommendations and rulings of the DSB exist (*i.e.*, the repeal of the Step 2 program and the non-repeal of the marketing loan and counter-cyclical payment programs), those measures are deficient, and result in inconsistencies with the covered agreements, within the meaning of Article 21.5 of the DSU. Brazil notes that this claim is contingent on the compliance Panel not being able to find that the marketing loan and counter-cyclical payment programs cause present serious prejudice (Brazil's second adverse effects-related claim).

17. Key evidence supporting Brazil's threat claim includes the fact that the two remaining subsidy programs – the marketing loan and counter-cyclical payment programs – are mandatory, result in guaranteed high levels of U.S. planted acreage, production and exports and have caused significant price suppression throughout the history of the FSRI Act of 2002. With the repeal of the Step 2 program and the resulting lower *domestic* market prices in the United States, the effects of the remaining two price-contingent U.S. subsidy programs will be, if anything, bigger in MY 2006, and beyond. In fact, USDA and FAPRI projections regarding U.S. subsidy outlays under these programs, upland cotton production, exports, prices and developments in U.S. cost of production for upland cotton support a finding of a threat of serious prejudice from the U.S. marketing loan and counter-cyclical payments for upland cotton. These two subsidy programs under the FSRI Act of 2002 constitute a continuing threat of significantly suppressed world market prices for Brazilian and other developing country producers that will continue until these measures are repealed or significantly

[14] *See* Section 7.13 of Brazil's First Written Submission.
[15] *See* Section 7.14 of Brazil's First Written Submission.
[16] *See* Section 7.15 of Brazil's First Written Submission.
[17] *See* Section 7.17 of Brazil's First Written Submission.

amended. Indeed, these subsidies caused serious prejudice during the first four years of the FSRI Act of 2002, continue to cause present serious prejudice, and continue to cause a threat thereof.[18]

18. ***Fourth,*** Brazil claims, on a contingent basis, that during the period 21 September 2005 to 31 July 2006, all three of the price-contingent subsidy programs of the FSRI Act of 2002, mentioned above, have caused serious prejudice to Brazil. Brazil requests that the compliance Panel address this claim only if it rejects Brazil's first, second and third claim, as outlined above. Brazil claims that the failure of the United States to take any measures to remove the adverse effects or withdraw the three price-contingent subsidy programs during this period has caused serious prejudice to the interests of Brazil, in violation of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*.[19]

19. In sum, with respect to the adverse effects-related recommendations and rulings of the DSB, Brazil requests the compliance Panel to conclude that the original recommendation adopted by the DSB – to "remove the adverse effects or [to] the subsidy" under Article 7.8 of the *SCM Agreement* – remains in effect, and applies to the full extent of the findings requested by Brazil in these Article 21.5 proceedings.[20]

BRAZILIAN CLAIMS CONCERNING EXPORT CREDIT GUARANTEE-RELATED RECOMMENDATIONS AND RULINGS OF THE DSB

20. The DSB recommended that the United States withdraw the three export credit guarantee ("ECG")subsidies maintained by the U.S. Commodity Credit Corporation ("CCC") – the GSM 102, GSM 103 and SCGP programs – and otherwise bring itself into compliance with its obligations by the implementation deadline of 1 July 2005. To implement the DSB's recommendations and rulings, the United States announced, on 1 July 2005, that CCC would no longer take applications for ECGs under GSM 103, which underwrote credit for 3- to 10-year periods, and amended the fee schedules for ECGs issued under the GSM 102 and SCGP programs.[21] Brazil raises two claims with respect to the U.S. measures taken to comply with the ECG-related recommendations and rulings of the DSB.

21. ***First***, with respect to ECGs issued under the GSM 102, GSM 103 and SCGP programs prior to 1 July 2005, but still outstanding subsequent to 1 July 2005, the United States has taken no action whatsoever to withdraw the subsidy and otherwise bring itself into conformity with its obligations. In regard to these outstanding ECGs, Brazil claims that measures taken to comply do not exist.[22]

22. ***Second***, with respect to ECGs issued subsequent to 1 July 2005, they continue to be export subsidies, and continue to be provided in a manner that results in circumvention of the United States' export subsidy commitments. In this regard, the United States' measures taken to comply are not consistent with Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*.[23]

23. Since 1 October 2005 – the beginning of FY 2006 – the United States has not issued any SCGP ECGs. Nor have any GSM 103 ECGs been issued since 1 July 2005, the implementation deadline. Thus, Brazil's second claim, of continued inconsistency with the *Agreement on Agriculture* and the *SCM Agreement*, applies solely to GSM 102, and not to GSM 103 or SCGP.[24]

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[18] *See* Section 8 of Brazil's First Written Submission.
[19] *See* Section 9 of Brazil's First Written Submission.
[20] *See* Section 10.3.3 of Brazil's First Written Submission.
[21] *See* Section 10.2 of Brazil's First Written Submission.
[22] *See* Section 10.3.1 of Brazil's First Written Submission.
[23] *See* Section 10.3.2 of Brazil's First Written Submission.
[24] *See* Section 10.3.2 of Brazil's First Written Submission.

24. GSM 102 ECGs guarantee the repayment of credit made available to finance commercial exports of U.S. agricultural products. The guarantees cover 98 percent of the principal and a portion of the interest, and have a duration of 30 days to three years. GSM 102 operates solely in circumstances where a foreign bank could not, without the U.S. government's assistance, secure the credit necessary to on-lend to its customer, the purchaser of U.S. agricultural exports.[25]

25. Using the context of Articles 1 and 3.1(a) of the *SCM Agreement*, GSM 102 ECGs constitute export subsidies for the purposes of Article 10.1 of the *Agreement on Agriculture*. Specifically, GSM 102 ECGs (i) are "financial contributions" (ii) that confer "benefits", and (iii) are contingent in law on export performance.[26]

26. With respect to the *first element*, Article 1.1(a)(1)(i) of the *SCM Agreement* includes as a "financial contribution" "potential direct transfers of funds or liabilities (*e.g.* loan guarantees)." GSM 102 ECGs fall squarely within this definition. The *third element* is similarly straightforward. Article 3.1(a) of the *SCM Agreement* prohibits "subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance …." GSM 102 ECGs are expressly conditioned on the export of eligible U.S. agricultural products.[27]

27. Turning to the *second element*, Article 1.1(b) of the *SCM Agreement* provides that a "benefit" must be conferred by virtue of the financial contribution. The appropriate standard for determining the existence of a benefit is whether the financial contribution has left the recipient better off than it would otherwise have been. In the case of loan guarantees, panels have adopted two approaches to applying this standard. Under either approach, GSM 102 and GSM 102 ECGs are provided on terms that constitute "benefits."[28]

28. The first approach seeks to determine whether the government guarantee improves the terms of the underlying loan compared to the terms that could have been secured without the government guarantee. This approach builds on the benefit valuation principle in Article 14(c) of the *SCM Agreement*. Article 14(c) calls for an examination focused on the difference between the amount paid on a loan guaranteed by the government, compared to the amount that would have to be paid on a comparable commercial loan, absent the government guarantee. Article 14(c) presumes, of course, that a commercial loan could be secured by a recipient in the absence of the government guarantee. If *no loan* would be available without the government guarantee – as U.S. regulations establish is the case with transactions covered by the GSM 102 program – a benefit exists *per se*. This is in keeping with Article 1.1(b) of the *SCM Agreement*, because if a "financial contribution" enables the recipient to obtain a commercial loan that could not be otherwise obtained, an advantage beyond what is available in the marketplace, or in other words, a "benefit", is conferred.[29]

29. The second approach builds on Article 1.1(b) of the *SCM Agreement*, and seeks to determine whether the government guarantee is available on terms better than a market-based guarantee.[30] Brazil compares GSM 102 fees with fees for comparable instruments offered by the Export-Import Bank of the United States ("ExIm Bank"), the official export credit agency of the United States. Although ExIm bank is not a commercial operator, and indeed, assumes risk the private sector is unable or unwilling to assume, the exercise offers a useful set of comparison points. Of the 1071 comparison points generated by the benchmarking exercise, GSM 102 fees were below comparable ExIm Bank fees 98 percent of the time. ExIm Bank fees exceeded GSM 102 fees by an

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[25] *See* Section 10.3.2.1 of Brazil's First Written Submission.
[26] *See* Section 10.3.2.2 of Brazil's First Written Submission.
[27] *See* Section 10.3.2.2.1 of Brazil's First Written Submission.
[28] *See* Section 10.3.2.2.1 of Brazil's First Written Submission.
[29] *See* Section 10.3.2.2.1.1 of Brazil's First Written Submission.
[30] *See* Section 10.3.2.2.1.2 of Brazil's First Written Submission.

average of 112 percent for transactions involving annual repayment of principal, and 97 percent for transactions involving semi-annual repayment of principal. Accordingly, by comparison with fees charged by ExIm Bank for comparable products, GSM 102 ECGs provide a considerable "benefit," under Article 1.1(b) of the *SCM Agreement*.[31]

30. A further examination of GSM 102 ECGs shows that they are not *designed* to charge fees that are consistent with market. The CCC does not take account of the full costs of all of the risks it bears in a GSM 102 transaction. In fact, by USDA's own admission, CCC is unable to do so given the one-percent fee cap mandated by U.S. law. The CCC is limited by the program's structure and design from taking full account of the risks that would be factored into pricing decisions by market-based guarantors. It is, therefore, no surprise that the fees for GSM 102 ECGs are provided on terms better than could be secured by recipients were they to look for similar protection in the market.[32]

31. In sum, using the context of Articles 1 and 3.1(a) of the *SCM Agreement*, GSM 102 ECGs constitute export subsidies for the purposes of Article 10.1 of the *Agreement on Agriculture*.

32. Brazil notes that in the original proceedings, both the panel and the Appellate Body relied on the context offered by item (j) of the Illustrative List to inform the interpretation of the term "export subsidies" in Article 10.1 of the *Agreement on Agriculture*. As was the case before the original panel, GSM 102 fees continue to be insufficient to cover the long-term operating costs and losses of the program.[33] Brazil requests that the compliance Panel only consider this alternative claim under item (j) if it finds that GSM 102 ECGs are not export subsidies by virtue of the fact that they are "financial contributions" that confer "benefits" and that are export contingent, under Articles 1.1 and 3.1(a) of the *SCM Agreement*.

33. Although GSM 102 ECGs issued in Fiscal Years (FY) 2006 and 2007 are subject to the amended GSM 102 fee schedule, the United States nevertheless projects that the CCC will suffer losses by the time the 2006 and 2007 "cohorts" – or class of GSM 102 ECGs issued in those years – close. Specifically, CCC projects losses of USD 125 million and USD 114 million, respectively, for GSM 102 ECGs issued in FY 2006 and FY 2007 (before accounting for the costs of administering the program). In other words, the United States itself does not believe that the new GSM 102 fee schedule will result in income sufficient to absorb total losses incurred on the ECGs to which that fee schedule applies.

34. Brazil notes, moreover, that fees for GSM 102 ECGs fall below the minimum premium rates ("MPRs") provided in the Organization for Economic Co-operation and Development's ("OECD") Arrangement on Officially Supported Export Credits (the "Arrangement"). Brazil calculates 1064 comparison points between GSM 102 fees and MPRs. In 1063 of those 1064 comparisons, GSM 102 fees fall below the Arrangement's MPRs. The Arrangement's MPRs are on average 106 percent greater than GSM 102 fees, meaning that GSM 102 fees are strikingly "inadequate to cover long-term operating costs and losses associated with the provision of export credits".

35. Finally, for the same reasons indicated in the previous "benefit" analysis (see paragraph 30), Brazil contends that the structure, design and operation of the GSM 102 program under its amended fee schedule are such that fees remain inadequate to cover long-term operating costs and losses.

36. Having shown that GSM 102 ECGs are export subsidies, Brazil demonstrates that the United States has applied these export subsidies in a manner that results in circumvention of its export subsidy commitments. Brazil demonstrates that circumvention has occurred with respect to all

[31] *See* Section 10.3.2.2.1.2.1 of Brazil's First Written Submission.
[32] *See* Section 10.3.2.2.1.2.2 of Brazil's First Written Submission.
[33] *See* Section 10.3.2.2.2 of Brazil's First Written Submission.

unscheduled products and three scheduled products – rice, pig meat and poultry meat – in violation of Article 10.1 of the *Agreement on Agriculture*.[34]

37. In sum, Brazil demonstrates that the GSM 102 program, as maintained by the United States subsequent to 1 July 2005, is inconsistent with the *Agreement on Agriculture*. As a result, the United States is not due the full protection of the safe harbor accorded by the exception in the opening clause of Article 3.1 of the *SCM Agreement*, and the prohibition in Articles 3.1(a) and 3.2 applies.[35]

38. For the same reasons that the GSM 102 program and GSM 102 ECGs constitute export subsidies under the *Agreement on Agriculture*, they similarly constitute prohibited export subsidies under Articles 3.1(a) and 3.2 of the *SCM Agreement*. Brazil requests that the compliance Panel so find.

39. In sum, with respect to the ECG-related recommendations and rulings of the DSB, Brazil requests the compliance Panel to conclude that the original recommendation adopted by the DSB – to "withdraw the subsidy without delay" under Article 4.7 of the *SCM Agreement* – remains in effect, and applies to the full extent of the findings requested by Brazil in these Article 21.5 proceedings.[36]

[34] *See* Section 10.3.2.3 of Brazil's First Written Submission.
[35] *See* Section 10.3.3 of Brazil's First Written Submission.
[36] *See* Section 10.3.3 of Brazil's First Written Submission.

ANNEX A-2

EXECUTIVE SUMMARY OF THE FIRST WRITTEN SUBMISSION AND REQUEST FOR PRELIMINARY RULINGS OF THE UNITED STATES

(Executive Summary submitted on 22 December 2006)

1. The United States requests that the Panel reject Brazil's claims and find that the United States has complied with the DSB's recommendations and rulings and, further, that the U.S. measures taken to comply are not inconsistent with the *SCM Agreement* or the *Agreement on Agriculture*. The Step 2 program for users and exporters of U.S. cotton, worth *hundreds of millions of dollars* annually, was not the only program that the United States ceased to operate. It also ceased issuing guarantees under two export credit guarantee programs, namely, the GSM 103 program and the Supplier Credit Guarantee Program ("SCGP") program, under which the United States had been issuing applications for guarantees covering *hundreds of millions of dollars* of export transactions; the United States now issues *no* guarantees under either of the two programs. The third export credit guarantee program at issue in the underlying proceeding, the GSM 102 program, has been substantially modified and does not constitute an export subsidy. Further, the United States requests the Panel to make a preliminary ruling (as explained below) that certain measures and claims relating to export credit guarantees are not within the scope of this proceeding.

2. With respect to the Dispute Settlement Body's ("DSB") recommendations and rulings on actionable subsidies, the panel's finding of "present" serious prejudice in the original proceeding applied to a package of *payments* made under the Step 2, marketing loan, and counter-cyclical payment programs in marketing years ("MY")1999-2002. Those *payments* were, thus, the only measures subject to the DSB's recommendation under Article 7.8 of the *SCM Agreement* that the United States "take appropriate steps to remove the adverse effects or . . . withdraw the subsidy." Brazil submits no evidence whatsoever as to the present effects, if any, of the payments that were subject to the original panel's finding and thus appears to concede that these payments no longer have any effect. The United States requests the Panel to make preliminary rulings (as explained below) that certain measures and claims relating to certain U.S. *programs* are not within the scope of this proceeding. Without prejudice to those requests, the United States demonstrates that Brazil's claims with respect to U.S. programs also fail to withstand scrutiny.

3. **Export credit guarantees – GSM 102 guarantees have been provided subsequent to 1 July 2005 consistently with U.S. WTO obligations.** Brazil fails to make a *prima facie* case that GSM 102 export credit guarantees were provided subsequent to 1 July 2005 in a manner inconsistent with Articles 3.1 and 3.2 of the *SCM Agreement.* Article 3.1(a) of the *SCM Agreement* prohibits "subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I." Item (j) of the Illustrative List of Export Subsidies in Annex I "illustrates" or "makes clear" the conditions under which export credit guarantees may be considered export subsidies within the meaning of Article 3.1(a). Item (j) was the basis of the DSB's recommendations and rulings with respect to the U.S. export credit guarantee programs and, thus, it was the provision of the *SCM Agreement* that provided guidance to the United States in determining how to implement the DSB's recommendations and rulings. Item (j) is also the item that most directly addresses the issue in this dispute. Accordingly, in this case, it is item (j) that provides the basis for assessing whether or not GSM 102 export credit guarantees are export subsidies within the meaning of Articles 3.1(a) and 3.2 of the *SCM Agreement*.

4. The approach advocated by Brazil – to assess whether GSM 102 guarantees are export subsidies within the meaning of item (j) in the "alternative," only if the Panel finds that they are not 'financial contributions' that confer 'benefits' and that are export contingent under Articles 1.1 and 3.1(a) of the *SCM Agreement* – would lead to the fatally flawed result that a measure that was specifically found to fall *outside* the definition of an export subsidy could then be found to be an export subsidy.

5. In addition to ceasing to issue guarantees under the GSM 103 and SCGP, the United States has taken a number of steps to ensure that the graduated risk-based fee structure of the GSM 102 program covers the program's long-term operating costs and losses. Fees for the program now increase with both risk category and tenor (the length of the loan). The United States also reclassified into an ineligible risk category a large number of countries previously eligible under the programs. These changes made to implement the DSB's recommendations and rulings bolster other disciplines already in place.

6. The U.S. budget accounting data that has become available since the original proceeding show that, for all programs, for the fourteen-year period commencing with fiscal year 1992, the export credit guarantee programs received hundreds of millions of dollars more in premia and interest than required to pay out in operating costs and losses, including interest. These numbers indicate that the United States earned a substantial *profit* on its programs *even under the fee structure preceding the changes implemented on July 1, 2005*. With respect to the GSM 102 program, alone, the budget data also reflects that for every fiscal year cohort since 1992 the net lifetime re-estimates have been negative. Given that the programs charged premium rates *more than* adequate to cover the long-term operating costs and losses of the programs even before any changes were made to implement the DSB's recommendations and rulings, the changes can only result in even more favorable financial results.

7. Brazil's emphasis on the original subsidy estimates for the 2006 and 2007 cohorts in the U.S. budget data – and the alleged "guaranteed loan subsidy" for the GSM 102 program – cannot be credited. The original "subsidy" estimate is made well before virtually any activity in the program has occurred in the fiscal year and begins with a historically overly-optimistic projection of actual use of the program. The requirement to use government-wide estimation rules – including mandated risk assessment country grades – without regard to the actual experience specific to the CCC export credit guarantee programs routinely results in initial overestimation of both utilization of the programs and a corresponding overestimation of guaranteed loan subsidy estimates.

8. There is also no textual basis for Brazil's suggestion that an appropriate method of assessing "benefit" under Article 1.1(b) of the *SCM Agreement* is simply to compare fees of different guarantees, and it ignores the myriad reasons why fees might be different for different guarantees. A difference in fees does not necessarily reflect that any "benefit" is being conferred. Brazil's comparison of GSM 102 fees to Ex-Im Bank fees is flawed, all the more so given that Brazil has not even taken into account *other* guarantees available in the marketplace.

9. **– The United States has not provided export credit guarantees under the GSM 102 program inconsistently with Articles 10.1 and 8 of the *Agreement on Agriculture*.** Article 10.1 of the *Agreement on Agriculture* prohibits the provision of export subsidies (other than those listed in Article 9.1) "in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments." While Article 1(e) of the *Agreement on Agriculture* defines "export subsidies" as "subsidies contingent upon export performance," there is no further elaboration as to the kinds of measures that meet this definition. Accordingly, the panel in the original proceeding found that the *SCM Agreement* – which also includes provisions dealing with export subsidies – could provide useful "contextual guidance." The fact that the GSM 102 export credit guarantees are not export subsidies within the meaning of item (j) is relevant to the question under the *Agreement on*

Agriculture, and supports a finding that GSM 102 guarantees are not export subsidies for purposes of Articles 8 and 10.1 of that Agreement.

10. **– The United States has "taken action" to withdraw the subsidy with respect to GSM 102, GSM 103, and SCGP export credit guarantees issued prior to 1 July 2005.** There are no export credit guarantees "still outstanding" under the SCGP program. To the extent there are any export credit guarantees outstanding under the GSM 102 and GSM 103 programs, the United States has "taken action" with respect to them by changing the cost and fee structure of the entire portfolio of programs of which they are part. The United States ceased to provide "export credit guarantee . . . programs at premium rates which are inadequate to cover the long-term operating costs and losses of the programs" and, thus, withdrew the subsidy with respect to these export credit guarantees regardless of when they were issued.

11. **Actionable Subsidies – Brazil fails to substantiate its arguments that the effects of eliminating the Step 2 program are "relatively modest."** Brazil fails to substantiate its claims that the elimination of the Step 2 program is insufficient to meet the U.S. obligation "to remove the adverse effects [of]" the subsidy found to cause serious prejudice in the original proceeding. Brazil's primary argument is that the counter-cyclical payment rate will increase due to a drop in U.S. farm prices following elimination of the Step 2 program. However, Brazil cannot show that this will happen in the current marketing year (*i.e.*, in the year that is relevant for Brazil's "present" serious prejudice claims). To the contrary, the season average farm price is projected to be below the marketing loan threshold of 52 cents/lb in the current marketing year (and would likely have been below the threshold even if the Step 2 program were in effect). In these circumstances, the marketing loan rate – and not the season average farm price – is factored into the calculation of the counter-cyclical payment rate and no drop in the season average farm price (whether due to elimination of the Step 2 program or any other reason) will result in any change in the counter-cyclical payment rate. Moreover, even in future years, any possible increase is likely to be small and less than the price effect of the elimination of the Step 2 program.

12. Brazil also fails to explain that elimination of the Step 2 program likely has caused *lower* marketing loan program payments because of a resulting increase in world prices and, thus, also in the adjusted world price (or "AWP") that is calculated on the basis thereof. Since marketing loan payments are calculated as the difference between the AWP and the 52 cents/lb marketing loan threshold, an increase in the AWP results in a concurrent *decrease* in payments under the marketing loan program. Thus, elimination of the Step 2 program is likely to *minimize* any adverse effects that Brazil claims are being caused by the marketing loan program. Any positive effect of reducing the amount of marketing loan payments, in turn, further amplifies the impact on the market of eliminating the Step 2 program.

13. In addition, Brazil argues that the effect of eliminating the Step 2 program is allegedly "relatively modest" because the program is smaller in size than the counter-cyclical payment program and marketing loan program. However, Brazil has acknowledged before that the focus of the serious prejudice analysis is on the effect of the challenged subsidy, not its size (and that size does not necessarily say anything about effect). Indeed, in the original proceeding, Brazil considered that the Step 2 program had the second largest impact on world prices and exports, even though payments were smaller under that program than others. Brazil also ignores its own earlier arguments that the "production effects" of the Step 2 program are only one way in which, in Brazil's view, Step 2 payments could have affected world market prices. Brazil fails to take into account the other effects it alleged in the original proceeding, including the alleged "export-enhancing" nature of the program. Moreover, to the extent that it is even possible to draw conclusions from the data available for the first three months of MY 2006, the data do not appear to support Brazil's conclusion that elimination of the Step 2 program has had "relatively modest" effects on production, exports, and world prices.

14. **Brazil does not demonstrate that the marketing loan or counter-cyclical payment program mandate a breach of U.S. obligations under Articles 5(c) and 6 of the *SCM Agreement*.** Brazil appears to be challenging, as such, the U.S. marketing loan and counter-cyclical payment *programs*, which the United States understands to be the legal/regulatory provisions for the grant or maintenance of the subsidies. As Brazil has recognized both in this dispute and others, it is established under WTO law that a Member can only challenge measures of another Member *per se* (i.e., "as such") if such measures mandate a violation of the WTO Agreement. Brazil has not shown that the legal/regulatory provisions for the grant or maintenance of marketing loan and counter-cyclical payments mandate a breach of Articles 5(c) and 6.3(c) or 6.3(d) of the *SCM Agreement*.

15. **Brazil fails to make a *prima facie* case of WTO-inconsistency under Articles 5(c) and 6.3(c) of the *SCM Agreement*.** Brazil fails to make a *prima facie* case that "the effect" of the marketing loan and counter-cyclical payment programs is "significant price suppression" within the meaning of Article 6.3(c) of the *SCM Agreement*. That is, therefore, not a basis for a finding of serious prejudice within the meaning of Article 5(c) of the *SCM Agreement*.

16. **– Evidence regarding the structure, design, and operation of the counter-cyclical and marketing loan payment programs do not support Brazil's claims.** Although Brazil asserts that "the nature" of the counter-cyclical payment program, in terms of its structure, design and operation, provides evidence of a causal link between the program and the alleged present "significant price suppression," Brazil fails to take into account the recent empirical research finding that there is no evidence that counter-cyclical payments are the cause of any significant changes in plantings. This empirical research was not available at the time the original panel reviewed the counter-cyclical payment program.

17. There also continues to be substantial evidence showing that decoupled payments, such as counter-cyclical payments, are capitalized into land values and land rents. Where land is rented – and the data show that a substantial portion (almost half) of all U.S. farmland was rented in 2005 – some amount of the value of decoupled payments is transferred from operators (to whom the payments are actually made) to the owners of base acres in the form of higher rents and sales values, thereby minimizing further any possible effects that counter-cyclical payments may have on production.

18. The empirical research regarding the minimal production effects of the counter-cyclical payment program is bolstered by data that show that traditional U.S. cotton farms receiving cotton counter-cyclical payments planted *approximately 40 percent fewer cotton acres* over MY 2002-2005 than they had in the period used to calculate cotton base acres. This decline in cotton planted acres on traditional U.S. cotton farms reflects the fact that other factors, such as weather and competing crops drive planting, not counter-cyclical payments.

19. In the case of marketing loan payments, Brazil has acknowledged (through its economist) that whether marketing loan payments have any effect on production depends on, *inter alia*, producers' *expectations at the time of planting* both as to prices for the harvested crop and of payments. Despite this, to support its arguments about the effects of the marketing loan program, Brazil points to data showing that the *actual* AWP rates in MY 1999-present have been below the loan rate in a number of years. Since farmers did not know at the time of planting what the *actual* AWP would be during the marketing year commencing up to seven months later, however, a comparison of the *actual* AWP to the loan rate says nothing about whether the marketing loan program actually affected farmers' planting decisions from MY 1999 to the present. An examination of the planting decisions made by U.S. producers in the light of the actual conditions as they existed as of the time of planting shows that in many of the marketing years since MY 1999 – including the present marketing year (MY 2006) – *expected prices were higher than the loan rate*. Under these conditions, it cannot be said that the marketing loan distorted U.S. producers' production decisions. Even in other years, however – in which marketing loan payments could possibly have had an effect on planting –

information about actual planting decisions show that they were, in fact, shaped by market factors, not the expectation of marketing loan payments.

20. Brazil's emphasis on what it terms variously the "large," "very large," "huge," and "massive" government outlays under the marketing loan and counter-cyclical payments programs is misplaced. The size of government outlays alone says nothing about their effect, if any, on world market prices. Moreover, Brazil's allegations of the "advantage" given by the counter-cyclical payment and marketing loan payment programs to U.S. producers and exporters to lower their prices and increase their market share are unsubstantiated and do not support Brazil's claim of significant price suppression.

21. **– The facts demonstrate that U.S. producers and exporters have reacted to market signals and are not "insulated" by the marketing loan and counter-cyclical payment programs.** The facts do not support Brazil's argument that the marketing loans and counter-cyclical payment programs "fuel" plantings and production by "insulating" U.S. producers and exporters from normal market signals. To the contrary, U.S. share of world production has been *stable* over the life of the FSRI Act. This reflects the fact that U.S. production has increased and decreased in much the same way as production elsewhere in the world. Similarly, U.S. share of world *exports* has been stable over the life of the Farm Security and Rural Investment Act of 2002 ("the FSRI Act"). Even the increase in U.S. share of world market exports that occurred between MY 1999 and MY 2002 is the result of market conditions (primarily, the decline in U.S. mill use and corresponding increase in consumption elsewhere), not "the effect" of the counter-cyclical payment and marketing loan payment programs. Thus, neither U.S. production nor U.S. export behavior supports the claim that U.S. producers and exporters are insulated from market forces as Brazil alleges.

22. Contrary to Brazil's assertions, Brazil does not demonstrate a "strong link" between the counter-cyclical payment and marketing loan payment programs, on the one hand, and world market prices, on the other, through its attempts to show the *absence* of a "link" between "prices" and U.S. planted acreage, production, and exports. Brazil's argument about the absence of such a link seems to be inconsistent with its arguments elsewhere that the U.S. market is the "single most important market" in *influencing* cotton prices. Moreover, Brazil's analysis of the sensitivity of U.S. planted acreage, production, and exports to prices is flawed.

23. First, Brazil's comparison of planted acreage to New York futures prices for cotton *alone* ignores the fact that the cotton futures prices is *not* the sole basis for a farmer's planting decision; other factors including, *inter alia*, the futures prices of competing crops are important considerations. Second, Brazil's comparison of U.S. upland cotton production to actual prices again assumes, incorrectly, that planting decisions could be explained through an examination of cotton prices alone. It also assumes incorrectly that U.S. farmers *know* at the time that they plant (in January-March of a given year) what the actual farm price will be in the upcoming marketing year, which does not even start until August. Third, Brazil's comparison of upland cotton exports and farm price fails to take into account the market conditions – for example, important developments in the U.S. textile and apparel industry – that were responsible for the changes in U.S. export patterns in the period MY 1998 to 2002. It also fails to address the fact that *since the FSRI Act came into effect*, U.S. share of world exports has been fairly stable, showing that U.S. exporters have reacted to market conditions in the same general way as foreign exporters.

24. – "Absolute" increases in U.S. production are "the effect" of improvements in yields, not the marketing loan and counter-cyclical payment programs. Brazil argues erroneously that an increasing "*absolute*" volumes of U.S. production of upland cotton from MY 2002-2005 are indicative of alleged trade-distortive effects of the U.S. marketing loan and counter-cyclical payment program. The increasing *absolute* volumes of production were the result of *record U.S. yields* in the period from MY 2002 though 2004, not the counter-cyclical payment and marketing loan payment programs.

There is no basis for Brazil's argument that any increase due to yield improvements should nonetheless be attributed to the counter-cyclical payment and marketing loan payment programs.

25. – **Brazil fails to demonstrate a "temporal coincidence" between marketing loan payments and counter-cyclical payments and the alleged price suppression.** Contrary to Brazil's assertions, it does not identify facts that "reinforce" the original panel's finding of a discernable temporal coincidence between U.S. subsidies and price suppression. Instead, consideration of each of the factors reviewed by the original panel in coming to this conclusion demonstrate that there is no such temporal coincidence now. First, U.S. planted acreage has been stable for the entire period that the FSRI Act has been in effect and is lower now than in the period examined in the original proceeding; there has been no "overall increase" in plantings similar to that observed by the panel in the original proceeding. Second, U.S. share of production has *not* increased over the period of the FSRI Act, as it appeared to do between MY 1998 and MY 2002, the period examined by the original panel. Third, the U.S. prices received by U.S. upland cotton producers have not decreased since the FSRI Act came into effect. Fourth, while the A-Index in MY 2002-2005 was lower than the 1980-2001 average, this is not evidence of price *suppression*. Moreover, the fact that the A-Index has trended downwards for more than 25 years – from well before the FSRI Act came into effect – and that the A-Index has gone *up* from the levels that prevailed *before* the FSRI Act came into effect would tend to suggest that, to the extent there is any price *suppression*, it is not "the effect" of the marketing loan and counter-cyclical payment programs. Fifth, while the absolute volume of U.S. exports went up over the period of the FSRI Act, U.S. share of world exports did *not* increase. This shows that U.S. export behavior is shaped by the same market forces that shape the behavior of foreign producers and exporters, not by "U.S. subsidies." Sixth, there have been low levels of U.S. cotton imports for decades; this has little to do with the programs under the 2002 FSRI Act. In short, none of these factors support a finding of a "temporal coincidence" now with respect to the marketing loan and counter-cyclical payment programs.

26. **– Brazil does not demonstrate that U.S. producers would "switch to alternative crops" in the absence of payments under the marketing loan and counter-cyclical payment programs.** Brazil fails to show that "but for" the marketing loan and counter-cyclical payment programs, many upland cotton producers would have had to discontinue growing upland cotton and switch to alternative crops. Brazil's argument is based on the incorrect assumption that decisions about whether to plant cotton or an alternative crop are made by reference to the "long-term total costs of production" of upland cotton. That assumption is inconsistent with the accepted principle in agricultural economics that the measure producers use when deciding what crops to grow is *variable costs* of production, not "long-term total costs of production." The data show that, in the period MY 2002 to 2005, U.S. producers have not only covered variable costs but in almost all years have covered most if not all of their total costs of growing cotton as well.

27. Total costs may be relevant, for example, to such long-term decisions as whether to continue or exit cotton farming. However, those decisions are not made on the basis of a segmented cotton-only analysis of costs and returns that Brazil presents in its first written submission. Rather, those types of whole-farm decisions will be made taking into consideration whole-farm costs and returns, including, for example, costs and revenue generated from other crops that have been (or may be) grown as well as off-farm revenues. Brazil has provided no analysis of whole farm costs and revenues that would support its conclusion that, absent payments under the marketing loan and counter-cyclical payment programs, certain cotton producers in the United States would exit cotton farming altogether.

28. Brazil's analysis also ignores entirely the substantial number of producers who do not receive payments. Moreover, Brazil does not address the possibility that any exit of high-cost U.S. producers would be offset by the expansion of the production of more efficient lower-cost U.S. producers, leaving U.S. plantings and production at the same levels overall.

29. **– Brazil attempts to attribute the price effects of other factors to the marketing loan and counter-cyclical payment programs.** Brazil's claim that the U.S. marketing loan and counter-cyclical payment programs are "fueling" U.S. planting, production, and exports and thereby significantly suppressing world market prices is also premised on an overly-simplistic view of the world cotton market. Brazil ignores – and, in fact, attempts to attribute to the marketing loan and counter-cyclical payment programs – the effects of other factors, including, importantly, China's trade in cotton. While Brazil fails to provide evidence that the United States "drives" world market prices for upland cotton, there is substantial evidence of a close correlation between China's net trade in cotton and the A-Index. Thus, contrary to Brazil's assertions, the United States is not the most important market influencing cotton prices throughout the world, nor the "driver" of the world market price. Brazil's attempts to ascribe price-suppressive effects to the marketing loan and counter-cyclical payment programs on the basis of these representations – without properly addressing and distinguishing the effects of such other factors as the impact of China's net trade and trade policies – are untenable.

30. Indeed, what Brazil believes is the measure of the "world price" itself – the A-Index – has been changed to reflect the importance of China in the world cotton market. The A-Index is now no longer calculated on the basis of prices of cotton delivered to Northern Europe. Rather, the A-Index is now calculated on the basis of cotton delivered *to Far East ports*. This is not a mere "technical change," as Brazil alleges. The fact that such a shift was necessary to allow proper measurement of "international cotton price movements" and that this shift was driven primarily by the impact on the market of a single country – China – confirms what the market reports overwhelmingly recognize: the price trends for upland cotton cannot be explained except by accounting for China's influence on the market.

31. Moreover, contrary to Brazil's assertions, downward pressure on prices results from uncertainty about the reliability of China's supply and demand statistics as well as ***ad hoc*** **changes in government policies. Uncertainty leads to increased price volatility and risk to world market participants. These** effects are reflected in prices. This is even confirmed by the market reports that Brazil itself submits.

32. **– The econometric modeling cited by Brazil is flawed and greatly exaggerates any effects of removing the programs.** Even based on a preliminary review of the econometric model submitted by Brazil, it is apparent that the model relies on a series of flawed economic assumptions that grossly overstate any possible effect of removing the marketing loan and counter-cyclical payment programs. Contrary to Brazil's assertions, the important parameters used in the model are not commonly used by U.S. Department of Agriculture ("USDA") or Food and Agricultural Policy Research Institute ("FAPRI") economists. Indeed, the parameters in Brazil's new model are even more exaggerated than the parameters used in what Brazil termed was the "FAPRI-like" model presented in the original proceeding. Brazil now ascribes to the marketing loan and counter-cyclical payment programs almost the *same* price effects that it had previously ascribed to *six* programs (the marketing loan and counter-cyclical payment programs plus four others). The marketing loan and counter-cyclical payment programs have not changed; what has changed are the assumptions that Brazil makes to produce the more egregious effects.

33. The United States demonstrates that, when certain "key elasticities" and some other basic assumptions are re-calibrated to *actually* reflect FAPRI and other well-established parameters, the price effects predicted by Brazil's new model decline sharply (ranging, for example, from only 0.96 percent to 1.52 percent over the period MY 2006-2008). More detailed analysis and re-calibration would presumably reduce the price effects even more. Both this model and the World Bank study to which Brazil also cites greatly exaggerate any possible impact of removing the marketing loan and counter-cyclical payment programs. They are, thus, also inconsistent with other recent studies showing only minimal price impacts from removing those programs.

34. **– Brazil has not demonstrated that "the effect" of the marketing loan and counter-cyclical payment program is "significant" price suppression.** The *SCM Agreement* does not define "significant" price suppression. The ordinary meaning of significant, however, is "important, notable; consequential," which suggests that any price suppression must reach a level at which it is important, notable, and consequential in order to be inconsistent with Article 6.3(c). Brazil does little more than cite back to the same arguments it makes in its causation discussion to attempt to show "significant" price suppression. In so doing, Brazil effectively writes "significant" out of Article 6.3(c) altogether. Brazil does not explain how any of the arguments it makes in its causation discussion demonstrate that the *degree* of the alleged price suppression is "important, notable; consequential."

35. – **Brazil fails to make a *prima facie* case of WTO-inconsistency under Articles 5(c) and 6.3(d) of the *SCM Agreement*.** Brazil fails to make a *prima facie* case that the United States is causing "serious prejudice" to Brazil's interests within the meaning of Articles 5(c) of the *SCM Agreement* because "the effect" of U.S. marketing loan and counter-cyclical payment programs under the FSRI Act is an increase in the U.S. world market share within the meaning of Article 6.3(d) of the *SCM Agreement*. Even leaving aside the lack of legal basis for Brazil's claims against the programs, as such, Brazil does not demonstrate that all of the elements of Article 5(c) and 6.3(d) are satisfied.

36. In the original proceeding, the panel interpreted "world market share" under Article 6.3(d) to mean "share of the world market supplied by the subsidizing Member of the product concerned." Brazil has proposed two different measures of "supply" – either production in a marketing year or production plus beginning stocks in a marketing year. It is not necessary for the Panel to decide, for purposes of this proceeding, which is the more appropriate measure because *Brazil's claim fails under either approach*. First, while Brazil asserts its claim in respect of MY 2005, Brazil fails to segregate from the adverse effects it alleges any effects of the Step 2 program. Second, Brazil fails to demonstrate that the slight increase in share of world production or production plus beginning stocks over the average share in MY 2002-2004 "follows a consistent trend over a period when subsidies have been granted." To the contrary, the data show clearly that it is a part of the ordinary fluctuations in U.S. share of world production. This is true no matter how far back in time one looks. There is, therefore, no basis for Brazil's claim under Articles 5(c) and 6.3(d) of the *SCM Agreement*.

37. **Requests For Preliminary Rulings – Brazil's claims relating to GSM 102 guarantees in respect of exports of pig meat and poultry meat are outside the scope of this proceeding.** GSM 102 guarantees in respect of exports of pig meat and poultry meat have never been found to be WTO-inconsistent nor been subject to any DSB recommendation. Under these circumstances, the GSM 102 guarantees in respect of exports of pig meat and poultry meat are not measures taken to comply with the recommendations and rulings of the DSB and are not measures within the scope of this proceeding. Further, Brazil's claims under Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement* are outside the scope of this proceeding to the extent that they relate to GSM 102 guarantees in respect of exports of pig meat and poultry meat. There is no merit to Brazil's argument that it is entitled to re-assert its claims in respect of these GSM 102 guarantees because it "successfully appealed" the panel's findings regarding the GSM 102 guarantees in respect of exports of pig meat and poultry meat. Even though the original panel's findings were reversed, that changes nothing about the fact that the Appellate Body did not complete the legal analysis and, thus, made no finding of WTO-inconsistency against the measures (and the DSB also issued no rulings and recommendations addressed to them).

38. – **Brazil's claims in respect of the marketing loan and counter-cyclical payment programs are outside the scope of this proceeding.** To the extent that Brazil's claims of serious prejudice and threat of serious prejudice are against the marketing loan and counter-cyclical payment *programs* under the FSRI Act, the claims are outside the scope of this proceeding. The original panel made only one actionable subsidy finding – with respect to Brazil's claim of "present" serious

prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement* against certain *payments* made in MY 1999-2002. The marketing loan and counter-cyclical payment *programs* were not subject either to a finding of WTO-inconsistency or any DSB rulings and recommendations. They are, therefore, not measures within the scope of this proceeding. Moreover, Brazil's claims relating to these programs under Articles 5 and 6 of the *SCM Agreement* are not within the scope of this proceeding.

39. **– Brazil's claims against the marketing loan program and the counter-cyclical program are outside the scope of this dispute because these measures were not "taken to comply" under DSU Article 21.5.** Brazil's claims against the marketing loan and counter-cyclical payment programs are also outside the scope of these proceedings because the programs have not been changed in response to DSB recommendations and rulings or otherwise. Brazil may not renew in an Article 21.5 proceeding claims made in the original proceeding against a measure which is the same measure as in the original proceeding. In the present case, Brazil may not raise again the claims of serious prejudice or threat of serious prejudice under Article 5(c) and 6.3(c) and (d) of the *SCM Agreement* against the marketing loan payment program and the counter-cyclical program. These claims are outside the scope of this Article 21.5 proceeding.

40. – **Brazil's claims that there were no measures taken to comply in a past period are not within the scope of the proceeding.** Brazil claims that the United States failed to take measures to comply with the DSB's actionable subsidy-related recommendation in a timely fashion and seeks a finding that there was a period in the past (21 September 2005 to 31 July 2006) in which no measure taken to comply existed. However, as Brazil does not dispute that measures taken to comply exist, there is no "disagreement" (as required by Article 21.5) over the "existence" of measures taken to comply. There is also no textual basis for an exercise such as the one Brazil is seeking and it would seem contrary to the statement in DSU Article 3.7 that "the aim of the dispute settlement mechanism is to secure a positive solution to a dispute." Thus, Brazil's claim that there were no U.S. measures taken to comply between 22 September 2005 and 31 July 2006 is not within the scope of this proceeding.

ANNEX A-3

THIRD PARTY SUBMISSION OF ARGENTINA

(5 January 2007)

TABLE OF CONTENTS

I. INTRODUCTION

1. Argentina is grateful for this opportunity to give its views as a third party in this dispute. It will be making a series of comments on some of the arguments put forward by Brazil and the United States in their respective written submissions of 7 November and 15 December, without prejudice to any further comments at the meeting of the Panel with the parties and third parties.

2. Argentina will be referring to the following matters in particular:

(a) Deficiency of the measures taken by the United States to implement the DSB's recommendations and rulings regarding the actionable subsidies found to be inconsistent with the WTO Agreements.

(b) Inadequacy of the measures taken by the United States to implement the DSB's recommendations and rulings regarding the prohibited subsidies found to be inconsistent with the WTO Agreements.

II. ARGUMENTS

A. DEFICIENCY OF THE UNITED STATES' MEASURES REGARDING ACTIONABLE SUBSIDIES

3. Argentina agrees with Brazil that the United States has not fulfilled its obligation under Article 7.8 of the SCM Agreement in respect of the price-contingent subsidy programmes for upland cotton implemented under the Farm Security and Rural Investment (FSRI) Act of 2002, since the programmes have been neither withdrawn nor significantly changed.

4. Argentina agrees with Brazil that the measures taken by the United States are deficient in that, although the user marketing (Step 2) payments programme has been repealed, the marketing loan and counter-cyclical payments programmes remain intact.

5. In this regard, a recent document of the Congressional Research Service is enlightening in its statement that "... additional permanent modifications to US farm programs may still be needed to fully comply with the 'actionable subsidies' portion of the WTO ruling."[1]

6. Brazil produced conclusive evidence that the marketing loans and counter-cyclical programmes continue to have adverse effects on the interests of Brazil and other cotton-producing countries, such as Argentina, in the form of serious prejudice caused by significant price suppression.

7. Furthermore, following Brazil's assertion that withdrawal of the Step 2 programme could result in higher payments under the marketing loan and counter-cyclical programmes, in July 2005 Keith Collins, Chief Economist of the USDA, suggested that "... ending the Step 2 program would result in slightly lower domestic prices – by two to three cents per pound – and higher export prices for US cotton. […] that declines in producer prices would be likely to trigger an increase in counter-cyclical payments (CCP) to US cotton farmers that would offset losses from lower prices".[2]

8. Consequently, Argentina is of the view that the United States is not implementing the DSB's recommendation regarding the measures identified as actionable subsidies.

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[1] Congressional Research Service, RS22552, December 11, 2006, "Agricultural Issues in the 110th Congress", Ralph M. Chite, Specialist in Agricultural Policy Resources, Science, and Industry Division.

[2] Congressional Research Service, RS22187, September 8, 2006, "U.S. Agricultural Policy Response to WTO Cotton Decision". Randy Schnepf Specialist in Agricultural Policy Resources, Science, and Industry Division.

B. INADEQUACY OF THE UNITED STATES' MEASURES REGARDING PROHIBITED SUBSIDIES

9. In its written submission[3], the United States asserts that export credit guarantees have been provided under the GSM-102 programme subsequent to 1 July 2005, *consistently* with the United States' WTO obligations.

10. Argentina demurs: as Brazil held[4], the United States' "measures taken to comply" fail to implement adequately the recommendations and rulings of the DSB.

11. Argentina would point out that the original Panel found (and its finding was later confirmed by the Appellate Body) that the export credit guarantee programmes maintained by the US Commodity Credit Corporation (CCC) – the General Sales Manager 102 (GSM-102), General Sales Manager and the Supplier Credit-Guarantee (SCGP) programmes (GSM-103) – pertaining to exports of upland cotton and other agricultural products not included in the Schedule of Commitments supported under the programmes and one scheduled commodity (rice), are export subsidies applied in a manner which results in circumvention of the United States' export subsidy commitments within the meaning of Article 10.1 of the Agreement on Agriculture, and are therefore inconsistent with Article 8 of that Agreement. The Panel further found that such programmes constitute *per se* export subsidies prohibited by Article 3.1(a) and 3.2 of the SCM Agreement.

12. On the strength of those findings the DSB recommended that the United States *withdraw* the prohibited subsidies *without delay* in accordance with Article 4.7 of the SCM Agreement, and by 1 July 2005 at the latest.

13. Argentina's first observation is that although the United States was under an obligation to withdraw them "without delay" the programmes were still intact at 1 July 2005. Furthermore, the GSM-102, GSM-103 and SCGP programmes have still not been withdrawn in the strict sense of the term.

14. It is Argentina's understanding that, properly construed, the rule in question requires the United States not only to "withdraw" the prohibited subsidies but also to take steps to that end "without delay"; so for the obligation here, fulfilment is subject to a time factor. Argentina therefore believes that the time taken to implement "withdrawal" of the measure cannot be overlooked in assessing compliance with the above-mentioned requirements.

15. Secondly, Argentina points out that despite the DSB's recommendations and the provisions of Article 4.7 of the SCM Agreement, as concerns the GSM-103 and SCGP programmes the United States merely announced that no more applications would be accepted under the programmes as from 1 July 2005 and 1 October 2005 respectively. In Argentina's view, to stop there would be a lowering of standards in terms of the obligation laid down in Article 4.7 of the SCM Agreement which expressly prescribes "withdrawal" of the measure and not merely "non-acceptance of new applications", which appears to be the United States' interpretation judging from its assumption that by not accepting new applications it would be complying with the above-mentioned rule and with the DSB's recommendations.[5]

16. In Argentina's view, the negative consequences of allowing that assumption need to be stressed, since the prohibited subsidy still exists and so too, therefore, does its inconsistency with WTO rules.

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[3] First Written Submission of the United States, point V.A. (page 30).
[4] First Written Submission of Brazil, point 10 (page 130).
[5] First Written Submission of the United States, pages 2, 8 and 66.

17. The Appellate Body's observation in *Brazil – Aircraft* (Article 21.5 – Canada) is enlightening in this regard:

> "Turning to the ordinary meaning of 'withdrawal', we observe first that this word has been defined as 'remove' or 'take away', and as 'to take away what has been enjoyed; to take from'. This definition suggests that 'withdrawal' of a subsidy, under Article 4.7 of the *SCM Agreement*, refers to the 'removal' or the 'taking away' of that subsidy. ... In our view, to continue to make payments under an export subsidy measure found to be prohibited is not consistent with the obligation to 'withdraw' prohibited export subsidies, in the sense of 'removing' or 'taking away'".[6]

18. In Argentina's view, it needs to be made clear that although in the dispute cited above payments continued to be made under an export subsidy measure found to be prohibited and in the present dispute the United States has announced that it will not continue to grant export credit guarantees, this does not exempt the United States from complying properly and without delay with the obligation laid down in Article 4.7 of the SCM Agreement.

19. In short, for Argentina, withdrawal of the measure as meant by the Panel in its recommendation implies <u>terminating the programme</u> and not merely suspending payments or refusing new applications.

20. Thirdly, Argentina agrees with Brazil that the changes introduced by the United States in the GSM-102 programme are insufficient to comply with the Panel's recommendation to *withdraw* the prohibited subsidies *without delay*, and are moreover *inconsistent* with Articles 10.1 and 8 of the Agreement on Agriculture and Article 3.1(a) and 3.2 of the SCM Agreement.

21. The GSM-102 programme constitutes a "financial contribution" "contingent upon export performance" which confers a "benefit" on the recipients, despite the changes in rates introduced by the United States, as Brazil shows in its written submission.[7] Consequently, the GSM-102 programme constitutes an export subsidy within the meaning of Articles 1 and 3.1(a) of the SCM Agreement, circumvention of the United States' reduction commitments under Article 10.1 of the Agreement on Agriculture in respect of upland cotton and other unscheduled agricultural products and in respect of certain products in the Schedule of Commitments (particularly rice), as well as a breach of Article 8 of the Agreement on Agriculture.

22. Furthermore, Argentina does not share the United States' interpretation in its assertion that GSM-102 export loan guarantees are not export subsidies under Articles 8 and 10.1 of the Agreement on Agriculture.[8]

23. Argentina accordingly considers that the United States is not complying with the DSB's recommendation to "withdraw without delay" the above-mentioned programmes identified as prohibited subsidies.

III. CONCLUSION

24. In the light of the foregoing, Argentina considers that the United States has not fully and properly complied with the DSB's recommendations, particularly: (a) the recommendations regarding the actionable subsidies, because the measures adopted are deficient; and (b) the recommendations regarding the prohibited subsidies, because the measures applied by the United States, are inadequate.

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[6] Report of the Appellate Body in *Brazil – Aircraft* (Article 21.5 – Canada), paragraph 45.
[7] First Written Submission of Brazil, point 10.3.2.2.1.
[8] First Written Submission of the United States, point V.A.2.

ANNEX A-4

THIRD PARTY SUBMISSION OF AUSTRALIA

(5 January 2007)

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TABLE OF CASES

Short Title	Full Case Title and Citation
Australia – Salmon (Article 21.5 - Canada)	Panel Report, *Australia – Measures Affecting Importation of Salmon – Recourse to Article 21.5 by Canada*, WT/DS18/RW, adopted 20 March 2000, DSR 2000:IV, 2031
Brazil – Aircraft (Article 21.5 – Canada I)	Appellate Body Report, *Brazil – Export Financing Programme for Aircraft –Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/AB/R, adopted 4 August 2000, DSR 2000:VIII, 4067
Brazil – Aircraft (Article 21.5 – Canada I)	Panel Report, *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW, adopted 4 August 2000, as modified by the Appellate Body Report, WT/DS/46/AB/R, DSR 2000:IX, 4093
Canada – Aircraft (Article 21.5 - Brazil)	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/AB/RW, adopted 4 August 2000, DSR 2000:IX, 4299
Chile – Price Band System (Article 21.5 - Argentina)	Panel Report, *Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products - Recourse to Article 21.5 of the DSU by Argentina*, WT/DS207/RW, 8 December 2006
EC – Bed Linen (Article 21.5 - India)	Appellate Body Report, *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by India*, WT/DS141/AB/RW, adopted 24 April 2003, DSR 2003:III, 965
Korea - Vessels	Panel Report, *Korea – Measures Affecting Trade in Commercial Vessels*, WT/DS273/R, adopted 11 April 2005
US – Softwood Lumber IV (Article 21.5 – Canada)	Appellate Body Report, *United States - Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada - Recourse by Canada to Article 21.5 of the DSU*, WT/DS257/AB/RW, adopted 20 December 2005
US – FSC	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"* WT/DS108/AB/R, adopted on 20 March 2000, DSR 2000: III, 1619
US – FSC (Article 21.5 – EC II)	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Second Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW2, 14 March 2006
US – Shrimp (Article 21.5 - Malaysia)	Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse to Article 21.5 of the DSU by Malaysia*, WT/DS58/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6481
US – Upland Cotton	Appellate Body Report, *United States – Subsidies on Upland Cotton*, WT/DS267/AB/R, adopted 21 March 2005
US – Upland Cotton	Panel Report, *United States – Subsidies on Upland Cotton*, WT/DS267/R, and Corr.1, adopted 21 March 2005, modified by Appellate Body Report, WT/DS/267/AB/R

INTRODUCTION

1. Australia considers that these proceedings under Article 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (DSU) raise a number of issues of systemic importance and legal interpretation, which Australia will address in this written submission. These issues are:

(a) The scope of Article 21.5 proceedings, in relation to the United States requests for preliminary rulings;

(b) the order of analysis concerning Articles 1.1 and 3.1(a) and item (j) of the Illustrative List of the *Agreement on Subsidies and Countervailing Measures (SCM Agreement)*, in relation to the prohibited subsidies claims, including whether an *a contrario* interpretation of item (j) is permissible; and

(c) in relation to the actionable subsidies claims, whether the United States, by repealing the Step 2 payment programme, but maintaining the two other price-contingent subsidies (payments under the marketing loan and counter-cyclical payment programmes), has taken appropriate steps to remove the adverse effects of the subsidies or to withdraw the subsidies, within the meaning of Article 7.8 of the *SCM Agreement* in accordance with the recommendations and rulings of the Dispute Settlement Body (DSB) with respect to those subsidies**.**

Australia reserves the right to raise other issues in the third-party hearing with the Panel.

A. SCOPE OF ARTICLE 21.5 PROCEEDINGS – REQUESTS FOR PRELIMINARY RULINGS

2. The United States, in its First Written Submission, requests a number of preliminary rulings that raise important systemic issues concerning the scope of Article 21.5 proceedings and require careful consideration of relevant jurisprudence of the Appellate Body and Article 21.5 Panels.

3. Australia recalls that Article 21.1 expressly provides that "prompt compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of disputes to the benefit of all Members." Thus, one of the objectives of Article 21.5 is to "avoid a complaining Member having to initiate dispute settlement proceedings afresh when an original measure found to be inconsistent has not been brought into conformity with the recommendations and rulings of the DSB."[1] Australia submits that were the United States requests for preliminary rulings to be granted, Brazil would be forced to initiate dispute settlement proceedings afresh in respect of claims which properly would fall within the scope of these Article 21.5 proceedings.

4. Australia recalls that the scope of proceedings under Article 21.5 is to determine "the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings" of the DSB. The use of the disjunctive 'or' makes clear that Article 21.5 proceedings can address two different situations. The first is the 'existence' of measures taken to comply with DSB recommendations and rulings. Accordingly, a panel may consider a claim that a Member has not taken measures to comply. The second is the 'consistency' with a covered agreement of measures taken to comply with DSB recommendations and rulings. Accordingly, a panel may consider a claim that implementing measures taken by a Member are inconsistent with a covered agreement.[2]

[1] *US - Softwood Lumber IV (Article 21.5 – Canada)*, para. 72.
[2] *See EC – Bed Linen (Article 21.5 - India)*, para. 79.

5. In considering the phrase 'measures taken to comply', the Appellate Body in *Canada – Aircraft (Article 21.5 – Brazil)* expressed the view that:

> … the claims, arguments and factual circumstances which are pertinent to the "measure taken to comply" will not, necessarily, be the same as those which were pertinent in the original dispute. Indeed, the utility of the review envisaged under Article 21.5 of the DSU would be seriously undermined if a panel were restricted to examining the new measure from the perspective of the claims, arguments and factual circumstances that related to the original measure, because an Article 21.5 panel would then be unable to examine fully the "consistency with a covered agreement of the measures taken to comply", as required by Article 21.5 of the DSU.[3]

6. Moreover, a Panel constituted under Article 21.5 of the DSU should consider the new measure "in its totality."[4] The fulfilment of this task requires that a panel consider both the measure itself and the measure's application provided that the specific claim has been made by the complainant when the matter is referred by the DSB for an Article 21.5 proceeding.[5]

7. The Appellate Body has identified situations where measures fall outside the scope of Article 21.5 proceedings. It has held that:

> [i]t would be incompatible with the function and purpose of the WTO dispute settlement system if a claim could be reasserted in Article 21.5 proceedings after the original panel or the Appellate Body has made a finding that the challenged aspect of the original measure is not inconsistent with WTO obligations, and that report has been adopted by the DSB.[6]

1. Request relating to GSM 102 programme in respect of pig meat and poultry meat

8. Taking this jurisprudence into account, Australia submits that Brazil's claims relating to General Sales Manager (GSM) 102 guarantees issued by the United States Commodity Credit Corporation in respect of exports of pig meat and poultry meat may properly be considered by the Panel.

9. Australia does not agree with the United States' submission that because there is neither a finding that GSM 102 guarantees in respect of pig meat and poultry meat are WTO-inconsistent nor that they are the subject of a DSB recommendation, that Brazil's claims concerning the application of the new measure in respect of pig meat and poultry meat fall outside the scope of Article 21.5 proceedings.[7]

10. The situation in the present case is not that of a measure that was not challenged in the original proceedings or, if challenged, was addressed in those proceedings and not found to be WTO-inconsistent.[8] The claim specifically made by Brazil in its request for establishment of this Panel relates to the WTO-consistency of a new measure – guarantees issued under the revised GSM 102

[3] *Canada – Aircraft (Article 21.5 – Brazil)*, para. 41. *See also US - FSC (Article 21.5 – EC II)*, para. 93.
[4] *US - Shrimp, (Article 21.5 - Malaysia)*, para. 87.
[5] *Ibid.*
[6] *EC –Bed Linen (Article 21.5 - India)*, para. 98.
[7] United States First Written Submission, paras. 27 and 28.
[8] Compare with *Chile – Price Band System (Article 21.5 – Argentina)*, in which the Panel, at para. 7.141, set out the conditions under which an Article 21.5 panel may consider new claims which were not raised before the original panel.

programme – the revisions to which, as the United States acknowledges, were implemented in response to the rulings and recommendations of the DSB.[9] Brazil is entitled to request, and the Article 21.5 Panel is required to consider, the new measure in its totality, including the measure's application. Thus, while Brazil alleges that it is "entitled to re-assert" its claim concerning actual circumvention with respect to pig meat and poultry meat, in effect Brazil's claim relates to the WTO consistency of a new measure (the revised GSM 102 programme) implemented in response to the DSB rulings and recommendations which was not before the original panel.[10]

11. Australia therefore submits that the United States' request that the Panel reject Brazil's claims relating to GSM 102 guarantees in respect of exports of pig meat and poultry meat should be refused.

2. Request concerning Brazil's claims against the marketing loan and counter-cyclical payment programmes

12. The United States also seeks a preliminary ruling that Brazil's claims against the marketing loan and counter-cyclical payment (CCP) programmes fall outside the scope of the Article 21.5 proceedings on two grounds – that the two programmes were not subject to any finding of WTO-inconsistency or any DSB recommendations, and those programmes were not "measures taken to comply" within the meaning of Article 21.5.

13. The United States argues that the marketing loan and the counter-cyclical payment programmes are not measures to which the DSB recommendations and rulings were addressed since those recommendations and rulings concerned the programmes as applied and not as such, and therefore that Brazil's claims in relation to those programmes fall outside the scope of Article 21.5 proceedings.

14. Australia agrees that the Panel's findings of WTO inconsistency contained in paragraph 8.1(g)(i) of its Report related to the "mandatory price-contingent United States subsidy measures – marketing loan programme payments, user marketing (Step 2) payments, MLA [marketing loan assistance] payments and CCP payments" rather than to the programmes *as such.*[11]

15. However, Australia does not agree with the United States that Brazil is seeking to challenge the marketing loan and counter-cyclical payment programmes *per se*. Australia is of the view that the focus of the case under Articles 5 and 6 of the *SCM Agreement* is the continuing effects of the unamended programmes (that is, payments made under the programmes) rather than the programmes *as such.* Australia submits that it is impossible to analyze the price-contingent subsidy measures (marketing loan programme payments and CCP payments) still in existence in isolation from the programmes that govern those measures. In so far as a consideration of those programmes is necessary to determine whether the continuing price-contingent subsidy measures cause significant price suppression causing serious prejudice to Brazil's interests, then Australia submits that such programmes may properly be considered by the Article 21.5 Panel.

16. Australia further submits that the fact that the marketing loan and counter-cyclical payments programmes have not changed does not prevent them from being considered by an Article 21.5 Panel in the context referred to above, when determining the existence or consistency of measures taken to

[9] United States First Written Submission, para. 72.

[10] Compare with *Canada – Aircraft (Article 21.5 - Brazil),* paras. 36-37.

[11] In an exercise of judicial economy, the Panel did not address Brazil's *per se* claims relating to the measures [allegedly mandatory legislative provisions and implement regulations providing for the payment of Step 2 payments, marketing loan programme payments, direct payments, counter-cyclical payments and crop insurance payments] under Articles 5(c) and 6.3(c) and (d) of the *SCM Agreement* and Articles XVI:1 and XVI:3 of the *GATT 1994*: *US – Cotton*, para. 7.1511.

comply with the recommendations and rulings concerning payments made under those programmes (the measures at issue in the original proceedings).

17. Australia therefore submits that the United States' requests concerning the marketing loan and counter-cyclical payment programmes should be refused.

3. Request concerning Brazil's claims that there were no measures taken to comply between 21 September 2005 and 31 July 2006

18. The United States seeks a preliminary ruling to the effect that Brazil's claims that there were no measures taken to comply in a past period (21 September 2005 to 31 July 2006) are not within the scope of these Article 21.5 proceedings. The United States argues that "DSU Article 21.5 does not provide that the task of the Panel is to decide – or, rather, declare – whether measures were taken to comply 'in a timely fashion.' In fact, DSU Article 21.5 does not refer to the issue of "timeliness" of implementation at all."[12]

19. Australia notes that the role of an Article 21.5 Panel is to examine the existence or consistency of measures taken to comply, and submits that an examination of "existence" of measures taken to comply can encompass a finding that no measures taken to comply exist within the meaning of Article 21.5 of the DSU. Such a finding was made by the Panel in *Australia – Salmon (Article 21.5 – Canada)*. In that case, the Panel found that because the date of entry into force of measures taken to comply by Australia occurred subsequent to the date upon which the reasonable period of time for implementation expired, for the period of time that the new measures did not apply subsequent to that date, "no measures taken to comply existed … in the sense of Article 21.5."[13]

20. Australia submits that a preliminary ruling cannot be granted in a way that would void rights under Article 22 of the DSU. This is because Article 3.2 of the DSU makes clear that "recommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements." Pursuant to Article 1.2 of the DSU, the rules and procedures of the DSU, including those contained in Article 22, apply to disputes brought under the covered agreements "subject to such special or additional rules and procedures on dispute settlement … as are identified in Appendix 2." Australia notes that both Articles 7.8 and 7.9 of the *SCM Agreement* are listed in Appendix 2 to the DSU as "special or additional rules and procedures" on dispute settlement contained in the covered agreements. These Articles do not preclude the application of Article 22 of the DSU. Indeed, Article 22 rights would logically ensue from findings of inconsistency with Articles 7.8 and 7.9 of the *SCM Agreement*,[14] which are findings that are entirely within the Panel's mandate to make.

21. Australia therefore submits that the Panel should refuse the request of the United States for preliminary rulings with respect to Brazil's claim concerning the United States' failure to take measures to comply within the period 21 September 2005 – 1 August 2006, as this could diminish Brazil's rights under Article 22 of the DSU.

[12] United States First Written Submission, para. 51.

[13] *Australia – Salmon (Article 21.5 - Canada)*, para. 7.30.

[14] Australia notes that this position is consistent with the actions of both Brazil and the United States with respect to Brazil's request for authorization to take countermeasures pursuant to Article 22.2 of the DSU and Article 7.9 of the SCM (WT/DS267/26) and the United States' request for arbitration under Article 22.6 of the DSU and Article 7.10 of the *SCM Agreement* (WT/DS267/27).

B. CLAIMS CONCERNING EXPORT CREDIT GUARANTEES (EXPORT SUBSIDIES)

22. Brazil alleges that despite changes introduced by the United States on 1 July 2005 to the General Sales Manager 102 (GSM 102) export credit guarantee programme, that programme and the guarantees issued thereunder continue to constitute export subsidies under Articles 1, 3.1(a) and 3.2 of the *SCM Agreement*, as well as under item (j) of the Illustrative List of Export Subsidies included as Annex 1 to the *SCM Agreement* ("Illustrative List"). Further, since 1 July 2005, Brazil alleges that the United States has applied those export subsidies in a manner that results in circumvention of the United States' export subsidy commitments for unscheduled products and three scheduled products – rice, pig meat and poultry meat, in violation of Articles 10.1 and 8 of the *Agreement on Agriculture*.[15] Brazil argues that the Panel should only consider its claim under item (j) in the Illustrative List in the alternative, if the Panel finds that GSM 102 export credit guarantees are not export subsidies under Articles 1.1 and 3.1(a) of the *SCM Agreement*. The United States argues that the analysis of the revised GSM 102 programme should proceed from item (j) of the Illustrative List.

23. Australia submits that as the complaining party, Brazil has the right to identify a measure as an export subsidy according to a particular definition (for example, pursuant to Articles 1.1 and 3.1(a) of the *SCM Agreement)* and then to argue under another definition "in the alternative". Australia therefore submits that the Panel should address the argument made by Brazil relating to item (j) "in the alternative" after the principal claim under Articles 1.1 and 3.1(a) of the *SCM Agreement*.[16]

24. Australia further submits that even if the United States' approach were to be adopted, a finding by the Panel that the GSM 102 programme, as amended, did not fall within the terms of item (j) of the Illustrative List would not necessarily be determinative of whether the GSM 102 programme otherwise constituted an export subsidy under the relevant provisions of the *SCM Agreement*. In other words, an *a contrario* interpretation of item (j) is not permissible[17], and the Panel would not be precluded by such a finding from examining the consistency of the revised GSM 102 with Articles 1.1 and 3.1(a) of the *SCM Agreement.*[18] As has been recognized in a number of proceedings, the Illustrative List is just that – it is a purely illustrative list and does not, as the United States acknowledges, purport to be an exhaustive list of export subsidies.[19]

C. CLAIMS CONCERNING ACTIONABLE SUBSIDIES

25. Australia submits that in relation to Brazil's actionable subsidies claims, the Panel should consider whether the United States, by repealing the Step 2 payment programme, but maintaining the two other price-contingent subsidies (payments under the marketing loan and counter-cyclical payment programmes), has taken appropriate steps to remove the adverse effects of the subsidies or to withdraw the subsidies, within the meaning of Article 7.8 of the *SCM Agreement* in accordance with the DSB's recommendations and rulings with respect to those subsidies**.**

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[15] Brazil First Written Submission, paras. 348-350.

[16] In *US – FSC*, the Appellate Body at para. 89 found no legal error in the Panel adopting the order in which the European Communities as claimant had presented its arguments under Articles 1 and 3 of the *SCM Agreement*, and rejected the United States' assertion that the analysis should have proceeded from footnote 59 to item (e) of the Illustrative List.

[17] *Korea – Vessels*, para. 7.207. In that case, the Panel found that Korea had failed to demonstrate that item (j) was applicable as an affirmative defence for those measures that were found to be in violation of Article 3.1(a) of the *SCM* Agreement: *Ibid.* para. 7.202. In reaching its conclusions, the Panel adopted the approach taken by the Panel in *Brazil – Aircraft (Article 21.5 - Canada I)* at paras. 6.37 *ff.*

[18] In *Brazil – Aircraft (Article 21.5 – Canada I),* the Panel acknowledged that it was legally possible that there existed prohibited export subsidies within the meaning of Article 3.1(a) that did not fall within the scope of Annex I: *see* para. 6.30.

[19] *Ibid.*

26. Australia recalls that the Panel found that:

> the effect of the mandatory price-contingent United States subsidy measures – marketing loan programme payments, user marketing (Step 2) payments, MLA [marketing loan assistance] payments and CCP [counter-cyclical payment] payments – is significant price suppression in the same world market within the meaning of Articles 6.3(c) of the *SCM Agreement* constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement.*[20]

27. In the light of this conclusion, the Panel recalled that, pursuant to Article 7.8 of the *SCM Agreement* "upon adoption of this report, the United States is under an obligation to 'take appropriate steps to remove the adverse effects or … withdraw the subsidy'".[21]

28. Australia notes that the United States eliminated the Step 2 payments in response to the DSB's recommendations and rulings. The other two "mandatory price-contingent United States subsidy measures" that were the subject of the Panel's findings remain in existence. Australia therefore submits that in so far as these measures still exist, the Panel may properly consider whether the United States has fulfilled its obligations under Article 7.8 of the *SCM Agreement.*

29. Australia recalls that in making the findings referred to above, the original Panel examined each price-contingent subsidy measure in turn[22] and made a number of findings relating to the effect of each measure individually, before considering the collective operation of those measures. It is clear from the Panel's analysis that each of the price-contingent measures individually were found to have a trade-distorting effect.[23] With respect to the marketing loan programme payments, the Panel stated that:

> We have no doubt that the payments stimulate production and exports and result in lower world market prices than would prevail in their absence. Moreover, the text of the measure indicates that the payments are mandatory, where certain market conditions prevail.[24]

The Panel further found that:

> … the structure, design and operation of the marketing loan programme has enhanced production and trade-distorting effects. The payments stimulate production and exports and result in lower world market prices than would prevail in their absence.[25]

On counter-cyclical payments, the Panel concluded that:

> … CCPs may influence production decisions indirectly by reducing total and per unit revenue risk associated with price variability in some situations … We have confirmed a strong positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production. Moreover, the payments are mandatory, under certain market conditions.[26]

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[20] *US – Cotton*, para. 8.1(g)(i); *see also* para. 7.1416.
[21] *Ibid.*, para. 8.3(d).
[22] *Ibid.*, para. 7.1290.
[23] *Ibid.,* paras. 7.1290–1303.
[24] *Ibid.*, para. 7.1291 (footnote omitted).
[25] *Ibid.*, para. 7.1295.
[26] *Ibid.*, para. 7.1302.

Australia submits that these findings remain relevant to the present proceedings.

30. Australia therefore submits that the present Panel should, as part of its consideration of whether the United States has complied with its obligations under Article 7.8, determine whether the continued existence of the two price-contingent subsidy measures that were the subject of the original Panel's finding cause significant price suppression constituting serious prejudice to the interests of Brazil.

31. In other words, the Panel should examine whether repeal of the Step 2 programme together with the continued existence of the other two price-contingent subsidy measures resulted in full compliance with the United States' obligation to remove the adverse effects or withdraw the subsidies found by the Panel to exist with respect to all three price-contingent subsidies. Australia submits that this is consistent with the approach that Brazil has taken in this dispute.

CONCLUSION

A. Scope of Article 21.5 proceedings - Requests for preliminary rulings

32. For the reasons set out in this submission, Australia requests that the Panel:

(a) refuse the United States' request that the Panel reject Brazil's claims relating to GSM 102 guarantees in respect of exports of pig meat and poultry meat;

(b) refuse the United States' requests for preliminary rulings concerning the marketing loan and counter-cyclical payment programmes; and

(c) refuse the request of the United States for preliminary rulings with respect to Brazil's claim concerning the United States' failure to take measures to comply within the period 21 September 2005 – 1 August 2006.

B. Claims concerning export credit guarantees (export subsidies)

33. For the reasons set out in this submission, Australia submits that the Panel should address the argument made by Brazil relating to item (j) "in the alternative" after the principal claim under Articles 1.1 and 3.1(a) of the *SCM Agreement*.

34. If, however, the Panel were to adopt the order of analysis proposed by the United States, a finding by the Panel that the GSM 102 programme, as amended, did not fall within the terms of item (j) of the Illustrative List would not preclude the Panel from examining the consistency of the revised GSM 102 with Articles 1.1 and 3.1(a) of the *SCM Agreement.*

C. Claims concerning actionable subsidies

35. For the reasons set out in this submission, Australia submits that in so far as the price-contingent subsidy measures still exist, the Panel may properly consider whether the United States has fulfilled its obligations under Article 7.8 of the *SCM Agreement*. As part of its consideration of whether the United States has complied with its obligations under Article 7.8, Australia further submits that the Panel should determine whether the continued existence of the two price-contingent subsidies that were the subject of the original Panel's finding cause significant price suppression constituting serious prejudice to the interests of Brazil.

ANNEX A-5

THIRD PARTY SUBMISSION OF CANADA

(5 January 2007)

TABLE OF CONTENTS

I. EXECUTIVE SUMMARY

1. Canada agrees with Brazil that the United States has failed to fully implement the recommendations and rulings of the Dispute Settlement Body (DSB), and that the United States continues to provide subsidies that cause and threaten to cause serious prejudice within the meaning of Articles 5 and 6 of the *Agreement on Subsidies and Countervailing Measures* (*SCM Agreement*) and Article XVI:1 of the *General Agreement on Tariffs and Trade 1994* (GATT 1994).

2. Canada makes submissions with respect to two issues: the U.S. contention that marketing loan and counter-cyclical payment programmes should not properly be the subject of this proceeding; and the standard for threat of serious prejudice under Article 5(c) and footnote 13 of the *SCM Agreement*, and Article XVI:1 of the GATT 1994.

3. On the first issue, the United States argues that as an Article 21.5 proceeding applies only to "measures taken to comply with the recommendations and rulings" of the DSB, the panel cannot consider unchanged measures. This fails to recognize that a panel in an Article 21.5 proceeding is required to consider the context, and not merely individual measures, when determining compliance. The Panel here cannot properly evaluate U.S. compliance without considering the effect of the U.S. failure to do anything about the marketing loan and counter-cyclical payment programmes.

4. On the question of "threat", Canada submits that the ordinary meaning of the term, read in the context of the *SCM Agreement* and considered in the light of that agreement's object and purpose, supports this finding. By contrast, there is nothing in the *SCM Agreement* to support the U.S. contention that "a clearly foreseen and imminent likelihood of future serious prejudice", such as that required in Article 15.7 of the *SCM Agreement*, is *required* for a finding of threat of serious prejudice under Article 5(c) and footnote 13. The notion of threat is a flexible one, sufficiently flexible to address programmes that give rise to a constant and high probability of support to U.S. farmers, which in turn constitutes a permanent threat of serious prejudice.

II. INTRODUCTION AND BACKGROUND

5. Canada appreciates the opportunity to participate in this proceeding under Article 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (DSU), having participated in previous proceedings before the original panel and Appellate Body.[1]

A. FINDINGS OF THE PANEL AND APPELLATE BODY

6. On 3 March 2005, the Appellate Body upheld the original panel's finding, *inter alia*, that particular U.S. measures set out in the *Farm Security and Rural Investment Act of 2002* (*FSRI Act*) were subsidies causing adverse effects, contrary to Articles 5 and 6 of the *SCM Agreement*.

7. Specifically, the Appellate Body upheld the original panel's finding in respect of so-called "price-contingent subsidies".[2] These subsidies – marketing loan programme payments, user marketing (Step 2) payments, marketing loss assistance payments and counter-cyclical payments – were found to result in significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*, and thus constitute serious prejudice within the meaning of Article 5(c).

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[1] *United States – Subsidies on Upland Cotton,* Report of the Panel, WT/DS267/R, adopted 21 March 2005 ["*United States – Upland Cotton*, Panel Report"] and *United States – Subsidies on Upland Cotton*, Report of the Appellate Body, WT/DS267/AB/R, adopted 21 March 2005 ["*United States – Upland Cotton*, Appellate Body Report"].

[2] *United States – Upland Cotton,* Appellate Body Report, at para. 763(c)(i).

B. MEASURES TAKEN BY THE UNITED STATES

8. The United States claims that it has complied with the recommendations and rulings of the DSB. On 8 February 2006, the United States announced the repeal, effective as of 1 August 2006, of the Step 2 payment programme for upland cotton, one of the programmes found to be causing serious prejudice. This is the only measure the United States has taken to comply with the recommendations and rulings respecting serious prejudice.[3] The United States argues that the original panel was considering the collective effect of these payments and not the programmes in themselves. As a result, the United States argues, Brazil's claim that U.S. measures taken to comply in some respects do not exist, and to the extent they do exist, are not consistent with the *Agreement on Agriculture* and the *SCM Agreement*, are without basis.[4]

III. ARGUMENT

9. Brazil argues that the U.S. counter-cyclical and marketing loan payment programmes have an ongoing, pernicious effect on the world cotton market, which arises in part from the threat that these programmes will provide seemingly-unlimited support to U.S. cotton producers. At issue is whether these programmes (under which payments made were found to be mandatory price-contingent subsidies causing significant price suppression, thus constituting serious prejudice)[5] threaten to cause serious prejudice simply by virtue of their existence.

10. The standard to be applied for a determination of threat of serious prejudice is not necessarily, as the United States has argued, a "clearly foreseen and imminent likelihood of future serious prejudice" akin to that in Article 15.7 of the *SCM Agreement*.[6] Canada submits that there is no single test for establishing the existence of a "threat". Rather, "threat" may be analyzed both as a temporal concept as in Article 15.7, *and* as a probability of occurrence. Certain subsidy programmes, by their very nature, give rise to a constant likelihood of support that results in a permanent threat of serious prejudice. This stems from the fact that when certain economic conditions exist – conditions that we know *will* re-occur simply by virtue of the vagaries of the market and fact that the United States itself may at its discretion set the threshold for payments – the subsidies will necessarily be distributed.

11. In this regard, there is no uncertainty. The marketing loan and counter-cyclical programmes create a constant likelihood of support for U.S. farmers, thus having the very real potential to distort international trade. These programmes were found by the original panel and the Appellate Body to be subsidies causing serious prejudice. And these programmes *must* pay to producers when certain conditions exist. If such programmes do not constitute a threat of serious prejudice, it is difficult to conceive of any subsidy that could have the potential to distort international trade and constitute a threat of serious prejudice to the interests of other Members.

[3] *Deficit Reduction Act of 2005*, U.S. Public Law 109-171, Section 1103, online: http://www.access.gpo.gov/nara/publaw/109publ.html. See also First Written Submission of the United States (21.5), 15 December 2006, at paras. 1-11 ["U.S. First Written Submission (21.5)"].

[4] U.S. First Written Submission (21.5), at paras. 3-10.

[5] *United States – Upland Cotton*, Appellate Body Report, at para. 763(c)(i), upholding the original panel's finding, at para. 8.1(g)(i).

[6] Second Written Submission of the United States, September 30, 2003, ["U.S. Second Written Submission"] at para. 115.

IV. LEGAL ANALYSIS

A. SCOPE OF PROCEEDING

12. The United States argues that the programmes are outside the scope of this proceeding because Article 21.5 applies only to "measures taken to comply with the recommendations and rulings" of the DSB. As the United States admits that it has not taken any measures to change these programmes, "Brazil may not in these Article 21.5 proceedings again make these claims against unchanged measures".[7]

13. The U.S. reading of Article 21.5 ignores the fact that the scope of an Article 21.5 proceeding mandates scrutiny of the overall effect of the measures taken to comply. A panel must "assess measures taken to comply in their full context, including how such measures are introduced into, and how they function within, the particular system of the implementing Member".[8] That context here necessarily includes the continued existence of measures the original panel and Appellate Body found to be causing serious prejudice.

14. Significantly, the Appellate Body has also found that measures at issue in an Article 21.5 proceeding could encompass not only positive acts, but also *omissions*.[9] The United States admits that it has done nothing respecting marketing loan payment and counter-cyclical payment programmes to remove the adverse effects or withdraw these subsidies, but that the repeal of Step 2 has been sufficient to constitute compliance with the serious prejudice recommendations and rulings of the DSB.[10] The United States argues that the original panel was considering the collective effect of U.S. subsidy programmes, and that it need do nothing with respect to the marketing loan payment and counter-cyclical payment programmes. Yet Article 7.8 of the *SCM Agreement* states that a finding of serious prejudice requires the non-complying Member to take appropriate steps to remove the adverse effect or withdraw the subsidy. The United States bears the burden of demonstrating that the adverse effects no longer exist as a result of taking no action to modify or withdraw the two programmes at issue and this Panel has clear authority to consider this lack of action in determining whether there is indeed compliance under Article 21.5.

B. ORDINARY MEANING OF "THREAT" IN PART III OF THE *SCM AGREEMENT*

15. Article 5 of the *SCM Agreement* prohibits adverse effects to the interests of other Members through the use of a subsidy; one such adverse effect is serious prejudice. Footnote 13 in turn specifies that "'serious prejudice to the interests of another Member' is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of the GATT 1994, *and includes threat of serious prejudice*" (emphasis added). Article XVI:1 makes clear that a Member can cause, and also threaten, serious prejudice.

16. While the concept of threat may be expressed in various ways, it concerns an indication of something undesirable coming.[11] The use of the verb "threaten" in Article XVI:1 of the GATT 1994 indicates that the very existence of a programme, and not necessarily its application, could constitute an infringement of that provision. As the Appellate Body in this case has observed, the ordinary

[7] U.S. First Written Submission (21.5), at para. 48.

[8] *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada, Recourse by Canada to Article 21.5*, Report of the Appellate Body, WT/DS257/AB/RW, adopted 20 December 2005, at para. 67.

[9] *Ibid.*, at para. 67.

[10] *See* U.S. First Written Submission (21.5), at paras. 1-11.

[11] *Shorter Oxford English Dictionary*, 5th ed., W.R. Trumble, A. Stevenson (eds.) (Oxford University Press, 2002, at 3251 ("threat").

meaning of "threaten" does not connote certainty, but relates to the likelihood of something happening in the future.[12]

17. Further analysis of the text of the *SCM Agreement* supports this ordinary meaning. Article 5 prohibits the use of a subsidy to the extent that such use causes, or threatens to cause, serious prejudice to the interests of another Member. "Subsidy" is defined in Article 1 of the *SCM Agreement*; a subsidy is deemed to exist if "a government practice involves […] *potential* direct transfers of funds or liabilities (e.g., loan guarantees)" and a benefit is thereby conferred.[13] In other words, the existence of a programme that has the *potential* to transfer funds, whether or not an actual transfer occurs, constitutes a subsidy pursuant to Article 1 of the *SCM Agreement*.[14] It follows that such a potential transfer could constitute a threat of serious prejudice.

18. The opening phrase of Article XVI:1 of the GATT 1994, refers to "any contracting party [that] grants or maintains any subsidy". As that article makes clear, it is not only the actual grant of a subsidy that allows for serious prejudice to be found. Merely *maintaining a programme* that mandates payments deemed to be a subsidy causing adverse effects may therefore cause serious prejudice, and indeed *will* cause serious prejudice when the specified market conditions arise.

19. Considering this, the U.S. proposition that the standard for threat of serious prejudice should be imported from Article 15.7 cannot be correct. Article 15.7 of the *SCM Agreement* concerns a different legal concept, namely the threat of material injury. Where a standard from another article or other agreement is to be used, the *SCM Agreement* identifies that standard.

20. This is evident through an examination of the notes to Article 5. Footnote 11 in Article 5(a), for example, states that "[t]he term 'injury to the domestic industry' is used here in the same sense as it is used in Part V". Footnote 12 in paragraph (b) states that "[t]he term 'nullification or impairment' is used in this Agreement in the same sense as it is used in the relevant provisions of GATT 1994, and the existence of such nullification or impairment shall be established in accordance with the practice of application of these provisions". Footnote 13, as quoted above, also incorporates a definition from the GATT 1994 into the *SCM Agreement*.

21. Neither Article 5 or 6 of the *SCM Agreement* set out a specific standard that is to be applied in an analysis of threat of serious prejudice. In other WTO agreements, as with Article 15.7, the standard applied when considering whether a threat of a particular deleterious result exists is set out in clear terms. For example, threat of serious injury in Article 4(1)(b) of the *Safeguards Agreement* means "serious injury that is clearly imminent […] based on facts and not merely on allegation, conjecture or remote possibility". The *Antidumping Agreement* specifies that "[a] determination of a threat of material injury shall be based on facts and not merely on allegation, conjecture or remote possibility. The change in circumstances which would create a situation in which the dumping would cause injury must be *clearly foreseen and imminent*" (emphasis added).

22. These examples support the conclusion that one must look to the specific language and context of an agreement to determine the standard to be applied to a given analysis. What is clear is that the scope of the term "threat" in Articles 5 and 6 of the *SCM Agreement* may be considerably broader than that contemplated in Article 15.7.

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[12] *United States - Upland Cotton*, Appellate Body Report, at para. 704.

[13] *SCM Agreement*, subparagraph 1.1(a)(1)(i) [emphasis added].

[14] As we understand the U.S. measures at issue, the terms of the "potential direct transfer" will necessarily result in a benefit to the recipient because that recipient would receive a financial contribution on terms more favourable than would otherwise be available to the recipient in the market. The nature of this benefit may vary, but could take the form of financial security provided by the very existence of the programmes.

23. This is consistent with the interpretation given by panels and the Appellate Body to other "threats". The Appellate Body reviewed the meaning of "threat of circumvention" in the context of the *Agreement on Agriculture* in this case.[15] It found that while "threaten" had a variety of possible meanings, Article 10.1 of the *Agreement on Agriculture* "is concerned not with injury, but rather with 'circumvention'". Given the ordinary meaning of "threaten", the phrase 'threaten[] to lead to ... circumvention' would imply that the export subsidies are applied in a manner that is 'likely to' lead to circumvention of a WTO Member's export subsidy commitments.[16] The Appellate Body did not import the standard of "clearly foreseen and imminent" into the standard for "threat" in the *Agreement on Agriculture*.[17] In fact, it emphasized that "threat" did not connote a sense of certainty and refers only to a likelihood of something happening.

24. That the meaning of threat is flexible is supported by two decisions concerning the consistency of the EC's sugar programme with Article XVI of the GATT 1994. In both *EC – Sugar (Australia)* and *EC – Sugar (Brazil)*, the panels found that the EC had structured its sugar programme so as to constitute a permanent source of uncertainty in world sugar markets, which given the facts of those cases, gave rise to a threat of serious prejudice in the sense of Article XVI:1.[18] Key to these findings was the lack of pre-established limitations on production, price or the amounts of exports in the Community system, very similar problems faced here by competitors to U.S. cotton farmers.[19]

25. It is not only the terms of the *SCM Agreement* read in context, but also the Agreement's very object and purpose that demonstrates that the standard for threat of serious prejudice may be distinct from that of threat in the case of material injury. In *Canada – Aircraft*, the panel noted that the object and purpose of the *SCM Agreement* could be summarised as "the establishment of multilateral disciplines 'on the premise that some forms of government intervention distort international trade, [or] have the *potential* to distort [international trade]'".[20]

26. As noted, the marketing loan and counter-cyclical programmes have the very real potential to distort international trade, and preventing the serious prejudice that will be caused when payments are made under these programmes is precisely what was intended by including Article 5 in the *SCM Agreement*. In its report, the original panel found that Part III of the *SCM Agreement* and Article XVI:1 of the GATT 1994 "expressly provides Members with a right to take action against serious prejudice which may not yet have occurred".[21] Further, the original panel found nothing in the text indicating that the right to take action against serious prejudice that may not yet have occurred is limited to a window of subsidies provided in the past but which cause serious prejudice in the future. If a Member were unable to bring an action against subsidies until these were *actually paid*, the Panel

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[15] *United States – Upland Cotton*, Appellate Body Report, at paras. 696-719.

[16] *Ibid*., at para. 704.

[17] Similarly, in *India – Quantitative Restrictions on Imports of Agricultural, Textile and Industrial Products*, Report of the Panel, WT/DS90/R, adopted 22 September 1999, India argued that the "threat of […] a serious decline in [a Member's] monetary reserves" in the context of Article XVIII:9 of GATT 1994 did not require an *imminent* threat of a serious decline in reserves, as does Article XII:2(a). In this regard, the Panel stated at para. 5.197 that their interpretation would not "introduce an additional condition to Article XVIII:9", by introducing the condition of imminence into the concept of "threat" in that Article.

[18] *See European Communities – Refunds on Exports of Sugar*, GATT Panel Report, adopted 6 November 1979, BISD 26S/290, at para. (h) of conclusion ["*EC – Sugar Exports I (Australia)*"] and *European Communities – Refunds on Exports of Sugar – Complaint by Brazil*, GATT Panel Report, adopted 10 November 1980, BISD 27S/69, at para. (h) of conclusion ["*EC – Sugar Exports (Brazil)*"].

[19] Brazil, in Section 8 of its First Written Submission, explains how those same factors are present in the U.S. programmes at issue and results in a permanent source of uncertainty in the world cotton market. Canada agrees with that analysis.

[20] *Canada – Measures Affecting the Export of Civilian Aircraft*, Report of the Panel, WT/DS70/R, adopted 20 August 1999, at para. 9.119 [emphasis added].

[21] *United States – Upland Cotton*, Panel Report, at para. 7.191.

reasoned, it would undermine the object in Part III of *preventing* adverse effects to a Member's interests.

27. The subsidy programmes at issue are mandatory when certain events take place, in this case when upland cotton prices reach a certain level. If a Member were obliged to wait until a payment was actually made to bring a complaint, then the adverse effects of the subsidy could never be prevented and the ability to defend against a "threat" of serious prejudice would be rendered inutile. The original panel's finding, that Part III of the *SCM Agreement* and Article XVI of the GATT 1994 must allow a Member to prevent the serious prejudice caused by the application of programmes such as marketing loan and counter-cyclical payments, is consistent with the inclusion of the words "maintain" in GATT Article XVI:1 and "potential" in Article 1.1(a)(1)(i) of the *SCM Agreement*.[22]

28. Whether as a consequence of the very architecture of the *SCM Agreement* – Part III concerns the adverse effects of subsidies in the context of multilateral action by Members, whereas Part V concerns the actions of domestic investigating authorities in countervailing duty actions – it is clear on its face that the standard for threat of serious prejudice in Part III is not circumscribed by a "clearly foreseen and imminent" standard.[23] And, in Canada's view, that "clearly foreseen and imminent" standard should not and indeed cannot legally be imputed to Part III simply because the word "threat" appears there.

V. CONCLUSION

29. Accordingly, Canada respectfully requests that the Panel find that the United States continues to use subsidies that threaten to cause serious prejudice, through its marketing loan and counter-cyclical programmes, in violation of Articles 5 and 6 of the *SCM Agreement*.

[22] *See* paras. 17-18 above on the use of "potential" and "maintain" in these articles.

[23] A legal term may be set out in various places in a WTO agreement without having the same meaning. See, for example, the Appellate Body's analysis of the term "like products" in *European Communities – Measures Affecting the Prohibition of Asbestos and Asbestos-Containing Products*, Report of the Appellate Body, WT/DS135/AB/R, adopted 5 April 2001. The Appellate Body reasoned at paras. 88-89 that as a term must be interpreted in light of the context and of the object and purpose of the provision at issue, it follows that the meaning of "like products" in Article III:4 need not be identical to, e.g., the meaning given the same term in Article III:2.

ANNEX A-6

THIRD PARTY SUBMISSION OF CHAD

(5 January 2007)

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TABLE OF CASES

Short Title	Full Case Title and Citation
US – Upland Cotton or the "Appellate Body Report"	Appellate Body Report, *United States – Subsidies on Upland Cotton*, WT/DS267/AB/R, adopted 21 March 2005.
US – Upland Cotton or the "Panel Report"	Panel Report, *United States – Subsidies on Upland Cotton*, WT/DS267/R, and Corr.1, adopted 21 March 2005, modified by Appellate Body report, WT/DS267/AB/R
Brazil – Aircraft (Article 21.5 – Canada)	Panel Report, *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW, adopted 4 August 2000, as modified by the Appellate Body Report, WT/DS46/AB/RW, DSR 2000:IX, 4093
Canada – Aircraft	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377
Canada – Aircraft (Article 21.5 – Brazil)	Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/RW, adopted 4 August 2000, as modified by the Appellate Body Report, WT/DS70/AB/RW, DSR 2000:IX, 4315
EC – CVDs on DRAMs	Panel Report, *European Communities – Countervailing Measures on Dynamic Random Access Memory Chips from Korea*, WT/DS299/R, adopted 3 August 2005
Mexico – Corn Syrup (Article 21.5 – US)	Appellate Body Report, *Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States – Recourse to Article 21.5 of the DSU by the United States*, WT/DS132/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6675
United States – Oil Country Tubular Goods Sunset Reviews (Article 21.5 – Argentina)	Panel Report, *United States – Sunset Reviews of Anti-Dumping Measures on Oil Country Tubular Goods from Argentina – Recourse by Argentina to Article 21.5 of the DSU*, WT/DS268/RW [not yet adopted]
US – Softwood Lumber VI (Article 21.5 – Canada)	Appellate Body Report, *United States – Investigation of the International Trade Commission in Softwood Lumber from Canada – Recourse by Canada to Article 21.5 of the DSU*, WT/DS277/AB/RW, adopted 9 May 2006

> *[O]ur countries are not asking for charity, neither are we requesting preferential treatment or additional aid. We solely demand that, in conformity with WTO basic principles, the free market rule be applied. Our producers are ready to face competition on the world cotton market – under the condition that it is not distorted by subsidies.*
>
> H.E. President Blaise Compaoré of Burkina Faso[1]

I. INTRODUCTION

A. BACKGROUND

1. On 21 March 2005, the Dispute Settlement Body (the "DSB") adopted the reports of the panel and the Appellate Body in the dispute *United States – Subsidies on Upland Cotton*.[2] These reports concerned a case brought by Brazil regarding various subsidies granted to United States cotton producers. In accordance with the findings in these reports and the DSB's recommendations and rulings, the United States was obliged, *inter alia*, under Article 7.8 of the Agreement on Subsidies and Countervailing Measures (the "*SCM Agreement*") either to withdraw subsidies that were found to cause serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement* or to remove the adverse effects caused by those subsidies.[3]

2. On 18 August 2006, pursuant to Article 21.5 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (the "DSU"), Brazil requested that the DSB establish a panel to determine whether the United States had complied with the rulings and recommendations of the DSB. The Panel was established upon Brazil's second request on 28 September 2006, and composed by the Director-General on 25 October 2006.[4] Argentina, Australia, Canada, Chad, China, the European Communities, India, Japan, New Zealand, and Thailand reserved their rights to participate in the Panel's proceedings as third parties.[5]

3. Chad appreciates the opportunity to present its views to the Panel in this written submission and at the meeting of the Panel with third parties, currently scheduled for 27 February 2007.

B. CHAD'S INTEREST IN THESE PROCEEDINGS

4. Chad is one of the very few least-developed countries ("LDCs") to have participated in a WTO dispute settlement proceeding since the organization was established in 1995. Chad participated in the original dispute in this case, and continues to participate in these proceedings, because of the critical importance of the cotton sector to Chad's economy and the ongoing damage to that sector caused by U.S. subsidies.

5. Chad notes that this dispute has arisen in the broader context of the commitment of WTO Members in the July Framework and reiterated at the Hong Kong Ministerial Conference to address cotton "ambitiously, expeditiously and specifically" with a view to achieving more ambitious

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[1] Address to the Trade Negotiations Committee, 10 June 2003, www.wto.org.
[2] Panel Report; Appellate Body Report.
[3] Panel Report, paras. 8.2(g)(i), 8.3(d).
[4] WT/DS267/31.
[5] *Ibid.*

reductions of trade-distorting domestic subsidies for cotton production.[6] While that commitment was made without prejudice to actions of the Dispute Settlement Body, it provides important context to guide the Panel's consideration of the issues before it. The protection of Chad's cotton industry is also consistent with the fulfilment of many of the Millennium Development Goals, in that it can assist in reducing poverty, improving health and reducing child mortality, and developing a global partnership for development, based on a rules-based trading system that addresses the special needs of least-developed countries, such as Chad.

6. As Chad has reiterated in the context of its Trade Policy Review to be held on 22-24 January 2007, cotton production in Chad affects approximately 3 million people, out of a total population of about 8.1 million.[7] The cotton-producing region of Chad is located in the southern part of the country, in an area covering about 127,000 square kilometres. Cotton is generally grown on small farms of usually no more than one or two hectares by farmers who rely on rain for irrigation and animals for traction when working the cotton fields during the sowing season.[8] Cotton exports are Chad's third largest export, accounting for 5 per cent of GDP, and representing 60 per cent of all non-oil export earnings.[9] Cotton is, therefore, one of Chad's main sources of income, and sustains the livelihood of a large portion of its population.[10]

7. As Chad explained in its report for its forthcoming Trade Policy Review, cotton is a strategic product that contributes not only to economic development but also social development.[11] Produced rurally on small farms, its positive effects on reducing poverty are felt most in those regions. Thus, cotton is "not only a source of revenue for these rural regions but also a tool for modernisation, diversification, and the financing of social activities and other needs of rural peasant societies".[12] These observations corroborate the findings of the Overseas Development Institute, which notes that:

> In a low-income economy where most of the poor live in rural areas, income from export crops is one of the best short-term measures to alleviate poverty. Smallholder cash-crop producers … spread [ ] the benefits to other poor households. Cotton is relatively labour intensive and may also generate employment. In African countries,

[6] *See* Doha Work Programme – Ministerial Declaration Adopted on 18 December 2005, WT/MIN(05)/DEC, para. 11.

[7] Trade Policy Review of Chad, Report by Government, WT/TPR/G/174, 11 December 2006, para. 28. According to the World Bank, there are roughly 400,000 farm households in the cotton-producing areas of Chad, of which about 60 per cent grow cotton. An average farm household has 5 to 6 people. *See* World Bank, *Chad Cotton Sector Reform: A Case Study on Poverty and Social Impact Analysis*, available at http://poverty.worldbank.org/files/13138_chadcottonreform.pdf.

[8] See Third Party Submission of Benin and Third Party Submission of Chad, Annex E-4 to the Panel Report.

[9] Trade Policy Review of Chad, Report by Government, WT/TPR/G/174, 11 December 2006, para. 28. See also P. Fortucci, *The Contributions of Cotton to Economy and Food Security in Developing Countries*, Food and Agriculture Organization of the United Nations (July 2002).

[10] As the WTO Secretariat has recently reported, "[a]griculture, mainly livestock breeding and cotton, is an activity of vital importance for Chad". Trade Policy Review of Chad, Report by the Secretariat, WT/TPR/S/174, 11 December 2006, pp. ix – x. Similarly, a United States agency has acknowledged the vital role played by cotton in Chad's agro-based economy: "over 80% of Chad's population relies on subsistence farming and livestock raising for its livelihood… Cotton, cattle, and gum arabic provide the bulk of Chad's non-oil export earnings". See The World Factbook, available at https://www.cia.gov/cia/publications/factbook/geos/cd.html.

[11] Trade Policy Review, Report of Chad, WT/TPR/G/174, 11 December 2006, para. 28.

[12] *Ibid*. (unofficial translation from the French).

> cotton production is concentrated in poorer regions so higher cotton incomes contribute to poverty reduction.[13]

8. Chad is one of the poorest countries in the world. In the United Nations Development Programme's Human Development Report of 2005, Chad is ranked as the 173rd out of 177 countries based on human development indicators that include life expectancy at birth, the infant mortality rate, and the maternal mortality ratio.[14] In these circumstances, it is imperative that the cotton farmers of Chad reap the benefits of the implementation of the DSB's rulings and recommendations in this dispute by the United States. Proper compliance would stabilise and increase the incomes of Chad's cotton farmers and help to develop the economy of Chad as a whole.

9. Full implementation by the United States of the DSB's recommendations and rulings in this case would have very significant benefits for Chad and the other Sub-Saharan African cotton-producing countries (Chad, Benin, Mali and Burkina Faso together comprise the "Cotton Four" or "C-4" countries). For example, a recent World Bank project study by Kym Anderson and Ernesto Valenzuela titled "WTO's Doha Cotton Initiative: A Tale of Two Issues"[15] specifically estimates what is at stake in terms of cotton production, trade, and economic welfare in Sub-Saharan Africa were the United States to comply *fully* with the rulings and recommendations of the DSB and remove the adverse effects of the non-repealed programmes.[16] The study finds that the removal of *all* cotton subsidies and import tariffs would boost global economic welfare by $283 million per year and would raise the price of cotton in international markets by almost 13 per cent. The authors note that:

> what is striking about the welfare effects is their distribution among developing countries… [e]specially noteworthy is the relatively large benefit bestowed on Sub-Saharan Africa of $147 million per year. This is driven by an estimated increase in Sub-Saharan African cotton output and value added of nearly one-third, and in the real value of the region's cotton exports of more than 50 per cent… That would raise Sub-Saharan Africa's share of global cotton exports from 12 to 17 per cent, and the share of all developing countries from 52 to 72 per cent.[17]

10. The potential impact of these welfare effects on incomes for cotton farmers in Chad cannot be understated: "[c]rucially they would rise by a huge 30 per cent in Sub-Saharan Africa and around 40 per cent in West Africa in particular – more than three-quarters of which is due to cuts in domestic support programs".[18] The World Bank Trade Note 27 of 30 March 2006 suggests that similar effects would be expected in the specific context of US compliance with the panel and Appellate Body Reports, stating that "the national welfare gains and boost to cotton farmers' incomes from partial reform are still concentrated in Sub-Saharan Africa and Central Asia".[19]

11. At the International Conference on Cotton: The Next Steps for Africa held in Washington D.C. on 26 October 2006[20], Professor Daniel Sumner presented findings regarding the

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[13] Overseas Development Institute (ODI) Annual Report 2005, page 10, available at http://www.odi.org.uk/annual_report/ar2005/ODI_AR2005.pdf

[14] Human Development Report 2005, published for the United Nations Development Programme.

[15] Kym Anderson and Ernesto Valenzuela, "WTO's Doha Cotton Initiative: A Tale of Two Issues", Development Research Group, World Bank, Washington DC, February 2006 (the "Anderson and Valenzuela study").

[16] *Ibid.*, pages 1–2.

[17] *Ibid.*, page 7.

[18] *Ibid.*, page 9.

[19] World Bank Trade Note 27, 30 March 2006, page 4.

[20] Daniel Sumner, Farm Programs and the Economies of LDC Cotton, Slide Show presented at the International Conference on Cotton: The Next Steps for Africa, Washington, D.C., 26 October 2006. Available

impact of the US subsidies on the C-4 countries. He found that the average gain from elimination of US subsidies on cotton would be a world price increase of about $0.05 per pound, which he calculates would "raise an annual revenue of about $75 to $100 million or more in the C-4 countries alone".[21] A World Bank economist has concluded that "the price prospects for cotton (and consequently the export shares of low-cost producers, including many African countries, could be improved considerably if developed countries substantially reduced or eliminated support and if the benefits of world price changes are fully transmitted to producers . . ."[22]

12. All of these changes would have an extremely positive effect on both the cotton sector and the economy as a whole in the C-4 countries. The C-4 countries' share of world cotton exports decreased from 10.05 per cent in 1998 to 8.57 per cent in 2002. It has continued to decrease since the original panel rulings to 7.35 per cent in 2005.[23] Chad's own share of cotton exports shows a similar trend, decreasing from 1.23 per cent in 1998 to 0.99 per cent in 2002 and 0.74 per cent in 2005.[24] These trends are in stark contrast to the United States' continuing *increasing* share of world cotton exports, which has grown from 18.27 per cent in 1998 to 39.24 per cent in 2002 and 39.72 per cent in 2005.[25]

13. Gobind Nankani, World Bank Vice President of the African Region, confirmed in a presentation at the October conference that after the difficult 2004/5 season, initial World Bank staff estimates for the 2005/6 ginning season show that production in the C-4 fell by 15 per cent, producer pricers fell by an average of 18 per cent, and the cotton sector's deficits remained at an estimated US$68 million for the four C-4 countries.[26]

14. At that same conference, the International Cotton Advisory Committee stated that:

> From the perspective of cotton producers in Africa and other developing countries, the key issue at hand is trade distorting agricultural subsidies that continue depressing world cotton prices, hurting millions of cotton farmers in Africa and elsewhere. The losses in income, employment, and foreign revenues far outnumber all of the assistance committed so far.[27]

15. The United Nations Development Programme's Human Development Report for 2005 highlights the effect of subsidies on cotton producers in poor countries, and concludes that in 2005, "the 20 000 cotton farmers in the United States will receive government payments in 2005 equivalent

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at: http://www.agritrade.org/events/speeches/CottonConference/Sumner.ppt (the "Sumner Presentation"). For full materials of the conference, see: http://www.ideascentre.ch/ConferenceWashington.htm

[21] Sumner Presentation, at slide 19.

[22] John Baffes, "The Cotton Problem," *World Bank Research Observer* 20(1): 109-44, Spring 2005, at page 132.

[23] Daniel Sumner, "U.S. Farm Programs and African Cotton: Discussion Paper Prepared for the 'International Conference on Cotton: The Next Steps for Africa' Washington, D.C., October 26, 2006", International Food & Agricultural Trade Policy Council Discussion Paper, Washington, DC. (forthcoming) (the "Sumner Discussion Paper"), Table 2 (sourced from: USDA FAS Production, Supply and Distribution Database, available at: http://www.fas.isda.gov/psdonline/psdDownload.aspx)

[24] *Ibid.*

[25] *Ibid.*

[26] Gobind Nankani, World Bank Vice President of the African Region, Development of the Cotton Sector in West and Central Africa, Slide Show at the International Conference on Cotton: The Next Steps for Africa, Washington, D.C., 26 October 2006, available at http://www.agritrade.org/events/speeches/CottonConference/Nankani.ppt.

[27] International Cotton Advisory Committee, The Importance of Cotton in Africa, presentation at the International Conference on Cotton: The Next Steps for Africa, Washington, D.C., 26 October 2006, available at http://www.agritrade.org/events/speeches/CottonConference/Townsend.pdf

to the market value of the crop and more than US aid in Sub-Saharan Africa."[28] The report also notes that "subsidies [of the order of the US subsidies] are reminiscent of the state planning systems that characterized the former Soviet Union".[29]

16. In these circumstances, it is evident that the proper implementation of the DSB's recommendations and rulings is of paramount importance to Chad and its fellow C-4 countries, which are some of the most vulnerable economies in the world. It is of critical importance to these countries and, indeed, to the multilateral trading system as a whole, that this compliance Panel carefully and stringently review the measures taken by the United States to comply with those recommendations and rulings to ensure that the rules governing the provision of subsidies are properly applied and followed.

17. As explained in this submission, and in more detail in Brazil's first written submission[30], the United States subsidies at issue in this dispute have had and continue to cause significant price suppression. This price suppression has an adverse impact on Chad's cotton farmers and on Chad's economy as a whole. And, as Brazil argues in its first submission, and Chad maintains below, the United Sates has not properly implemented the DSB recommendations and rulings regarding the adverse effects of these subsidies.

18. In assessing the impact of these subsidies on Chad, and the arguments that Chad makes in these proceedings, Chad requests that the Panel take note of Article 24 of the DSU, which states that: "[a]t all stages of the determination of the causes of a dispute, and of dispute settlement procedures involving a least-developed country Member, particular consideration shall be given to the special situation of least-developed country Members". For the reasons explained above, Chad's reliance on its cotton industry to generate exports and fight poverty constitutes just such a special situation. The Panel should give due consideration to this special situation by making recommendations and rulings that will lead to a competitive world cotton market that is not distorted by WTO-inconsistent subsidies.

II. LEGAL ARGUMENT

A. THE UNITED STATES HAS NOT TAKEN STEPS TO IMPLEMENT THE RULINGS AND RECOMMENDATIONS OF THE DSB

19. The original panel found that the effect of several mandatory price-contingent U.S. subsidy programmes, including user marketing (or "Step 2") payments, marketing loan payments and counter-cyclical payments, caused significant price suppression in the world market for upland cotton, and thereby caused adverse effects to Brazil, in violation of Articles 5(c) and 6.3(c) of the *SCM Agreement*.[31] In its implementation of the DSB recommendations and rulings, however, the United States merely discontinued the Step 2 programme as of August 2006, while leaving unchanged the marketing loan and counter-cyclical payments.[32] As explained in more detail below, however, the

[28] Human Development Report 2005, page 132.

[29] *Ibid.*, page 131.

[30] First Written Submission of Brazil to the Panel, 17 November 2006 ("First Written Submission of Brazil").

[31] Panel Report, para. 8.1(g)(i).

[32] See Exhibit Bra-435 (Deficit Reduction Act of 2005, U.S. Public Law 109-171, Section 1103, available at http://www.access.gpo.gov/nara/publaw/109publ.html). The United States Congress bill that repeals the Step 2 subsidy program for upland cotton was signed into law on 8 February 2006, and took effect on 1 August 2006. See Minutes of DSB Meeting, WT/DSB/M205, 17 February 2006, para. 92 and Exhibit Bra-441 ("House approves Byrd repeal, elimination of step 2 cotton program", Inside US Trade, 3 February 2006).

Step 2 programme accounted for, at most, one seventh of the aggregate subsidies to U.S. cotton production. Hence, the vast majority of the benefits of implementation were expected to come from the termination of the domestic support programmes.

20. Chad recalls that Article 7.8 of the *SCM Agreement* requires that the "Member granting or maintaining [any subsidy that has resulted in adverse effects to the interest of another Member] shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy".

21. Chad submits by simply ending Step 2 payments and leaving in place the other programmes found to cause adverse effects, the United States cannot be found either to have withdrawn the subsidies or to have removed the adverse effects thereof.

1. The United States has not properly implemented the panel's findings regarding the Marketing Loan and Counter-Cyclical Payment Programmes

22. It is undisputed that the marketing loan and counter-cyclical payment programmes have not been withdrawn. To the contrary, the United States argues that these programmes were not subject either to a finding of WTO inconsistency or any DSB recommendations.[33] The United States requests the Panel to find that the marketing loan and counter-cyclical payment programmes are not measures to which the recommendations and rulings of the DSB were addressed and, therefore, that these measures are not within the scope of the present proceedings.[34]

23. Chad disagrees with the United States' interpretation of the original panel's findings and the DSB recommendations and rulings. The original panel found that "the effect of the mandatory price-contingent measures" was significant price suppression within the meaning of Article 6.3(c) that constituted serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*.[35]

24. The panel clearly described the measures at issue as including the "legislative and regulatory provisions currently providing for the payment of measures" including marketing loan and counter-cyclical programme payments.[36]

25. In its analysis of Brazil's claims under Articles 6.3(c) and 5(c) of threat of serious prejudice regarding the same measures, the panel also stated that there were "two main measures providing for the payment of the United States subsidies in question," which it described as the "FRSI Act of 2002 and implementing regulations" and "legislation providing for crop insurance subsidies prior to and since MY 2002."[37] The panel explained the consequences of its findings of present serious prejudice regarding these measures as follows:

> Because the Panel's 'present' serious prejudice findings include findings of inconsistency that deal with the FSRI Act of 2002 and subsidies granted thereunder in MY 2002, the *United States is obliged to take action concerning its present statutory and regulatory framework as a result of our 'present' serious prejudice finding.* We recall that, pursuant to Article 7.8 of the *SCM Agreement*, the United States is under

[33] First Submission and Request for Preliminary Rulings of the United States of America, 15 December 2006 (the "U.S. First Submission"), para. 37.
[34] *Ibid.*, para. 44.
[35] Panel Report, paras. 7.14.16, 8.1(g)(i).
[36] *Ibid.*, para. 7.1107(ix).
[37] *Ibid.*, para. 7.1498.

> an obligation to 'take appropriate steps to remove the adverse effects or … withdraw the subsidy.'[38]

26. Thus, the panel clearly considered that its findings regarding "present" serious prejudice applied not just to payments, but to the statutory and regulatory framework of the FSRI Act of 2002 and its implementing regulations.

27. Moreover, the panel relied on the scope of its findings regarding "present" serious prejudice to decline to address Brazil's claims of threat of serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*:

> We consider that, upon *required implementation by the United States of this Panel's prohibited subsidy findings and present serious prejudice findings*, the basket of measures in question may be so significantly transformed or manifestly different from the measures that are currently in question that it is not necessary or appropriate to address Brazil's claims of threat of serious prejudice.[39]

28. Thus, the original panel clearly considered that its findings included not simply the payments themselves under the marketing loan and counter-cyclical payment programmes, but also the statutory and regulatory measures under which those payments were mandated.

29. The United States' arguments that the statutory and regulatory aspects of these measures were not covered by the Panel's findings are twofold. First, the United States argues that the panel's findings in paragraph 8.1(g)(i) of its report referred to "payments" not "programs" in the phrase between dashes. The United States' argument ignores that the panel described the payments at issue as "mandatory." This description necessarily implies that the measure at issue was not limited to the actual payments themselves, but included the statutory and regulatory framework that made those payments "mandatory." Accordingly, Chad does not consider the panel's failure to use the word "programmes" in paragraph 8.1(g)(i) of its report to be sufficient grounds to ignore the panel's description of the measures at issue and the Panel's explanation of what steps it considered necessary to implement quoted above.

30. Second, the United States argues that the panel did not address Brazil's *per se* or "as such" claims regarding these programmes, or Brazil's claims regarding threat of serious prejudice, and, therefore, the Panel's findings were strictly limited to the payments themselves. However, Brazil is not precluded from pursuing before this compliance panel claims regarding the threat of serious prejudice that the original panel declined to address.[40] These claims raise substantially the same issues regarding the statutory and regulatory framework for these programmes as Brazil's claims regarding the implementation of the panel's findings regarding present serious prejudice.

31. The United States' argument appears to confuse the issue of whether a statutory provision is challenged "as such" with the altogether separate issue of whether a statutory provision mandating certain payments can be found to cause serious prejudice. Brazil's claims before the original panel were that these payments, including the "legislative and regulatory provisions currently providing for the payment[s]" were actually causing serious prejudice. In other words, these claims were "as applied" claims regarding measures that included legislative and regulatory provisions. The distinction sometimes made in WTO proceedings between "as such" and "as applied" claims does not

[38] *Ibid.*, para. 7.1501 (original footnote omitted) (emphasis added).

[39] *Ibid.*, para. 7.1503 (emphasis added).

[40] See, *e.g.*, Panel Report, *United States – Oil Country Tubular Goods Sunset Reviews (Article 21.5 – Argentina)*, paras. 7.90-7.94.

mean that statutory or regulatory provisions cannot be challenged on an "as applied" basis or that "as applied" claims are necessarily limited to the payments themselves to the exclusion of measures mandating those payments. Where a party includes statutory or regulatory measures in an "as applied" claim, as Brazil did before the original panel, implementation of the panel's findings with respect to that claim cannot be limited to one aspect of the measure (the payments) to the exclusion of other aspects (the governmental mechanisms whereby the payments are made).

32. For these reasons, the Panel should reject the United States' arguments that the marketing loan and counter-cyclical payment programmes are not within the scope of this proceeding.

33. The United States' failure to take implementing measures regarding the marketing loan and counter-cyclical payment programmes is within the scope of these proceedings. As explained above, the original panel's findings covered those programmes. Article 21.5 review includes both measures taken to implement and a *failure* to implement. In *U.S. – Softwood Lumber VI (21.5),* the Appellate Body confirmed that "[t]he word "existence" suggests that measures falling within the scope of Article 21.5 encompass not only positive acts, but also *omissions*."[41] Thus, where an implementing Member fails to adopt "measures taken to comply" within the implementation period, it has made a failure or omission enabling a panel under Article 21.5 to conclude that no measures "exist" to implement the recommendations and rulings of the DSB.

34. As the only action undertaken by the United States was the repeal of the Step 2 programme on 1 February 2006 with effect from August 2006, it is clear that the United States has not withdrawn or amended the marketing loan or counter-cyclical payment programmes found to be inconsistent with the United States' WTO obligations.

2. The United States has not removed the adverse effects of the Marketing Loan and Counter-Cyclical Payment Programmes

35. As noted above, the United States has not taken any steps to address the adverse effects caused by the marketing loan and counter-cyclical payments.

36. Moreover, the withdrawal of the Step 2 payments cannot be said to have removed the adverse effects of the marketing loan and counter-cyclical payments.

37. The vast majority of the price suppression and adverse effects caused by the impugned U.S. programmes was and continues to be caused by the marketing loan and counter-cyclical payment programmes, rather than the Step 2 payments. The Anderson and Valenzuela study discussed above confirms this.[42] The study underlines that the repeal of the Step 2 programme is equivalent, at best, to "a one-seventh reduction in the aggregate subsidy to US cotton production" and, if the support were re-instrumented to direct production subsidies, "there would effectively be no global market impact of the repeal".[43] In contrast, if the counter-cyclical payment and marketing loan programmes were to be counted as part of the US amber box measures, they would be required to be cut by US$1 billion, which would be "more than twice the amount associated with repealing the Step 2 program".[44]

38. These findings accord with those of Daniel Sumner who has also provided estimates of the effects of individual programmes. He notes that the Step 2 programme alone accounts for only about 15 per cent of the total subsidy impact, however "the major farm bill programs, marketing loans and

[41] See Appellate Body Report, *U.S. – Softwood Lumber VI (Article 21.5 -- Canada)*, para. 67.
[42] Anderson and Valenzuela study, page 10.
[43] *Ibid.*
[44] *Ibid.*

counter-cyclical payments, account for most of the remaining subsidy effect".[45] Professor Sumner concludes that if the US were to implement fully the recommendations and rulings of the DSB by removing these programmes, LDCs would benefit from substantial price and production increases would be available to least-developed countries.[46]

39. Thus, the US domestic support programmes, rather than export subsidies under the Step 2 programme, are most detrimental to Chad. Using the GTAP database and model, the Anderson and Valenzuela study demonstrates that over 80 per cent of the benefits from removal of all cotton subsidies and import tariffs will come from cutting domestic support programmes rather than export subsidies which will "contribute almost none of the global benefits of reform".[47]

40. Chad submits that in addition to the effect of the subsidies on Brazil, the US subsidies continue to cause adverse effects within the meaning of Article 5(c) and 6.3 of the *SCM Agreement* on the world market for upland cotton, and, consequently, to the interests not just of Brazil of Chad and other cotton-producing African countries.

41. The original panel has already found that:

> [T]he effect of the mandatory price-contingent United States subsidy measures – marketing loan programme payments, user marketing (Step 2) payments, MLA payments and CCP payments – is significant price suppression in the same world market within the meaning of Article 6.3(c) of the *SCM Agreement* constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*.[48]

42. Chad submits that the findings and analysis of the original panel continue to be relevant to this analysis because these proceedings are part of a "continuum of events".[49] The Appellate Body in *United States – Softwood Lumber VI (21.5)* stated that a panel operating under Article 21.5 of the DSU cannot perform its task of "in abstraction from the measure that was the subject of the original proceedings",[50] and that "doubts could arise about the objective nature of an Article 21.5 panel's assessment if, on a specific issue, that panel were to deviate from the reasoning in the original panel report in the absence of any finding in the underlying evidence."[51] As the Appellate Body stated:

> Article 21.5 panels can be expected to refer to their original panel reports, in particular, when matters before them are closely related to the matters before original panels.[52]

43. This reasoning also applies to this dispute. The claims of serious prejudice in this dispute as they relate to the marketing loan and counter-cyclical payments involve the same subsidy programmes that were at issue before the original panel. As the United States has not changed those measures that

[45] Sumner Discussion Paper, page. 20.

[46] *Ibid.*

[47] "[E]xport subsidy removal would contribute almost none of the global benefits of reform, and cotton tariff removal would account for only one-nineth of the global gain, with the other eight-nineths due to cutting domestic support programs", p. 8. See also World Bank Trade Note 27, 30 March 2006, p. 2.

[48] Panel Report, para. 8.1(g)(i).

[49] See Appellate Body Report, *Mexico – Corn Syrup* (Article 21.5 – US), para. 121.

[50] Appellate Body Report, *United States – Softwood Lumber VI (21.5)*, para. 102.

[51] *Ibid.*, para. 103.

[52] *Ibid.*, para. 105. See also Appellate Body Report, *Mexico – Corn Syrup* (Article 21.5 – US), para. 121

were found to cause serious prejudice by the original panel, this Panel should rely on the factual and legal conclusions concerning the existence, nature and potential for price suppression of those measures in the original panel report. Chad refers the Panel to the relevant findings of the original panel on those matters.[53]

44. As noted above, the marketing loan and counter-cyclical payments account for the *vast majority* of the adverse effects identified by the original panel. The failure to implement the original panel's findings with regard to these subsidies has therefore deprived cotton exporters such as Chad of the benefits of the panel's findings and has resulted in the ongoing harm to a critically-important sector of Chad's vulnerable economy described above. In these circumstances, taking note of Chad's special situation, this Panel should follow the reasoning of the original panel and find that the adverse effects continue, and have not changed. Chad, therefore, supports the arguments of Brazil that the marketing loan and counter-cyclical payment programmes under the FSRI Act of 2002 *alone* cause present serious prejudice and requests the Panel to find accordingly.[54]

45. Moreover, as explained above in paragraphs I.B.12 and I.B.13, and as Brazil notes in its first written submission to the Panel, the price effects of the U.S. subsidies have continued and, indeed, gotten worse since the original panel's rulings. Chad and the other C-4 countries have continued to lose market share in cotton exports, even while the United States' market share continues to increase. In addition, C-4 cotton production and producer prices have continued to decrease substantially, by 15 and 18 per cent respectively in 2005/05. Brazil observes that, West and Central African countries' share of world production declined from 5.15 per cent in MY 2002 to 3.85 per cent in MY 2005 – a 25 per cent decrease.[55] The region's share of world exports declined from 13.51 per cent in MY 2002 to 11.10 per cent in MY 2005. Indeed, the West and Central African countries share of world exports in MY 2005 was the lowest that it has been in the past 10 years.[56]

46. For these reasons, therefore, Chad supports Brazil's claim that the "non-repealed price-contingent U.S. marketing loan and counter-cyclical payment programs under the FSRI Act of 2002 cause present serious prejudice in the form of significant price suppression in the world market for upland cotton, and an increase in the U.S. world market share, in violation of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*", and requests the Panel to find accordingly.[57]

3. Payments to be made in Marketing Year 2006 threaten to cause serious prejudice

47. Chad also supports Brazil's claim that despite the repeal of the Step 2 program, the marketing loan and counter-cyclical payments mandated under the FSRI Act of 2002 to be made in MY 2006, and beyond, cause a threat of serious prejudice within the meaning of Articles 5(c) and 6.3(c) as well as footnote 13 of the *SCM Agreement*.

48. As established by the original panel, the marketing loan and counter-cyclical payment programs are mandatory, have guaranteed high levels of U.S. planted acreage, production and exports and have caused significant price suppression. The continued granting of these subsidies, which is

[53] See Panel Report, paras. As read with the Appellate Body Report, para.

[54] First Written Submission of Brazil, para. 47 *et seq*.

[55] Compare West and Central Africa production (Exhibit Bra-450 ("Cotton: World Statistics," ICAC, September 2006, p. 26 and p. 28) with world upland cotton production (Exhibit Bra-447 (Upland Cotton Supply and Use)).

[56] Compare West and Central Africa exports (Exhibit Bra-450 ("Cotton: World Statistics," ICAC, September 2006, p. 56 and p. 58) with world upland cotton exports (Exhibit Bra-447 (Upland Cotton Supply and Use)).

[57] First Written Submission of Brazil, para. 6.

mandated by law, constitutes a continuing threat of significantly suppressed world market prices for developing country cotton producers, and will continue until these subsidy programs are repealed or significantly amended.

49. Chad refers to Brazil's arguments and supporting evidence on this claim, and asks the Panel to find that these subsidies cause present serious prejudice, and cause a threat thereof, in violation of Articles 5(c), 6.3(c) and footnote 13 of the *SCM Agreement*.

B. THE PANEL SHOULD ANALYSE THE EXPORT CREDIT GUARANTEE PROGRAMMES UNDER ARTICLE 1.1(B) OF THE *SCM AGREEMENT*

50. Chad also supports the arguments of Brazil regarding the United States' implementation of the recommendations and rulings of the DSB regarding the export credit guarantee programmes ("ECGs") maintained by the Commodity Credit Corporation.[58]

51. Chad considers that it is particularly important that this Panel interpret strictly the provisions of the *SCM Agreement* and the *Agreement on Agriculture* governing ECGs. As a practical matter, only developed country governments can effectively provide ECGs to promote their exports. As a previous panel has noted:

> [T]hrough export credit guarantees, governments can effectively make their borrowing rates available to borrowers. However, the borrowing rates for developed country governments are generally lower than those of developing country governments. As a result, developing country Members . . . could never meet the financing terms secured by developed country Members through government guarantees.[59]

52. That observation applies *a fortiori* to a LDC such as Chad. An ECG from an AAA-rated government enables exports from that country to be made on financing terms normally available to borrowers with a AAA credit risk. Thus, the purchasers of goods backed by U.S. ECGs benefit from the United States government's credit rating, giving a competitive advantage to U.S. exporters. In addition, ECGs are a relatively inexpensive means for developed countries to support their exports in that they involve no immediate cash outlay.

53. In contrast, countries like Chad do not have strong enough credit ratings to be able to provide competitive ECGs. They also lack the resources to be able to provide ongoing funding for such programmes. Thus, developing country Members, and particularly LDCs, face permanent structural disadvantages compared to developed country Members in providing export credit.

54. ECGs are subject to the disciplines of the *SCM Agreement*. Panels and the Appellate Body have found that ECGs may be inconsistent with the *SCM Agreement* if: (a) a government ECG is offered on terms better than those available to the recipient for an equivalent guarantee that could have been obtained in the marketplace (thereby conferring a benefit within the meaning of Article 1.1(b) of the *SCM Agreement*)[60]; (b) a government ECG improves the terms of an underlying loan compared to the terms that could have been secured in the marketplace without the government ECG (based on Article 14(c) of the *SCM Agreement*)[61]; and (c) a government ECG program charges

[58] First Written Submission of Brazil, page 130 *et seq.*

[59] Panel Report, *Brazil – Aircraft (Article 21.5 – Canada),* footnote 98. See also Panel Report, *Canada – Aircraft (Article 21.5 -- Brazil),* para. 5.136.

[60] Panel Report, *EC – CVDs on DRAMs*, para. 7.189.

[61] *Ibid.*

premium rates that are inadequate to cover the long-term operating costs and losses of the programmes (based on item (j) of the Illustrative List of Export Subsidies included as Annex I to the *SCM Agreement*).[62]

55. The structural disadvantages faced by Chad and other LDCs with respect to ECGs do not, of course, affect the right of other WTO Members to provide ECGs consistent with the disciplines described above. However, the special situation of LDCs as a result of these disadvantages should provide important factual context for the current Panel in its interpretation of the relevant provisions of the *SCM Agreement* and its evaluation of the United States' measures.

56. In particular, the Panel should not limit its review of the U.S. ECGs to the question of whether the rates at which ECGs are provided are inadequate to cover the long-term operating costs and losses of the programme within the meaning of item (j) of the Illustrative List. In addition, the Panel should carefully review whether the U.S. ECGs confer a "benefit" within the meaning of Article 1.1(b) of the *SCM Agreement* as interpreted by the Appellate Body in *Canada – Aircraft*.[63]

III. CONCLUSION

57. As Chad has stated above, the Panel should, under DSU Article 24, consider the interests of LDCs such as Chad in this proceeding. Such consideration is particularly appropriate where, as here, WTO-inconsistent measures taken by an affluent developed country WTO Member continue to cause serious harm to an important subsistence farming sector in the economy of some of the very least-developed countries in the world.

58. In requesting the Panel's careful consideration of the special situation of Chad and its fellow C-4 countries in this proceeding, Chad does not ask the Panel in any way to bend the rules of the WTO agreements to suit Chad. Instead, to paraphrase former WTO Deputy Director-General Dr. Kipkorir Rana, Chad simply asks the Panel to ensure, through a careful review of the evidence and rigorous application of the law, that the relevant WTO rules and disciplines are fully applied to the cotton sector so that a fair and market-oriented system can prevail, thereby eliminating wasteful subsidies that cause substantial harm to the poorest WTO Members.[64]

59. In Chad's view, Brazil has produced compelling arguments and evidence to show that the United States price-contingent subsidy programs supporting upland cotton under the FSRI Act have not been withdrawn or changed in any significant way. Brazil has also shown that overproduction and excess exports, along with significantly suppressed world market prices for upland cotton, have continued following the adoption of the reports of the original panel and the Appellate Body in this dispute. As explained above, Chad's own experience confirms the evidence submitted by Brazil.

60. Accordingly, Chad requests that the Panel make the findings requested in paragraph 462 of Brazil's First Submission and the recommendations requested in paragraph 463 of that submission.

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[62] See, *e.g.*, Appellate Body Report, paras. 672 and 674; Panel Report, paras. 7.867 and 7.869.

[63] Appellate Body Report, *Canada –Aircraft*, paras. 152 *et seq.*

[64] "[Benin, Burkina Faso, Mali and Chad] do not ask for aid, which is the World Bank's remit, nor do they make political appeals that belong to the United Nations. They have just asked that WTO rules and disciplines apply also in sectors of interest to the poor – that a fair and market-oriented system be established in agriculture and that rich countries' wasteful export and production subsidies be abolished and cease to undermine their comparative advantage." Former WTO Deputy Director-General Dr. Kipkorir Rana, Address given to the Second East African Business Summit, "The Multilateral Trading System: Why East Africa Must Remain Engaged" 18-21 September 2003, www.wto.org.

ANNEX A-7

THIRD PARTY SUBMISSION OF PEOPLE'S REPUBLIC OF CHINA

(5 January 2007)

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1. INTRODUCTION

1. China appreciates this opportunity to present its views on implementation measures by the United States (the US) in accordance to the ruling and recommendations adopted by the Dispute Settlement Body ("DSB") in the original proceedings.

2. Pursuant to Article 10 of *Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU"),* China hereby makes its Third Party Submission.

3. In this submission, China will focus on the following issues:

1) Whether the item (j) of the Illustrative List of SCM Agreement constitutes the complete basis for analysis of GSM102 as amended;

2) Whether the ML/CCP payment "programs" are outside the scope of this proceeding;

2. ARGUMENTS

2.1 Whether the item (j) of the Illustrative List of SCM Agreement constitutes the complete basis for analysis of GSM102 as amended

4. In its submission, Brazil demonstrates that under Article 1.1 and 3.1(a) of the SCM Agreement, GSM 102 ECGs are "financial contributions" that confer "benefits", and that these subsidies are contingent in law on export performance.[1] Furthermore, Brazil submits a alternative claim under item (j) that the program continues to constitute an export subsidy, since fees continue to be insufficient to cover the long-term operating costs and losses of the program.[2]

5. The US rebuts Brazil's approach by claiming it would lead to the fatally flawed result that a measure that was specifically found to fall outside the definition of an export subsidy could then be found to be an export subsidy. The US asserts that "it is item (j) that provides the basis for assessing whether or not GSM-102 export guarantees are export subsidies within the meaning of Article 3.1(a) and 3.2 of the SCM Agreement."[3] In addition, the US appears to claims that, "in the case of measures identified in the Illustrative List, it is the specific provisions of the Illustrative List – and not the general subsidy provisions in the Articles 1.1 and 3.1(a) – that govern when the measures may be considered export subsidies."[4] In sum, it appears that the US argued a *contrario* interpretation of item (j) in order to justify its amended GSM-102 program.

6. In this regard, China believes that the finding of the panel in *Korea-Measures Affecting Trade in Commercial Vessels* can provide useful guidance. In discussions concerning the item (j) defense, the panel pointed out that "Item (j) contains no such affirmative statement. Item (j) merely describes certain circumstances in which particular programs shall constitute export subsidies. Since item (j) therefore falls outside the scope of footnote 5, item (j) does not provide a basis on which to find that measures do not constitute prohibited export subsidies".[5] The panel further concluded that "on its face, item (j) defines certain circumstances in which export credit guarantee programs <u>are</u> export subsidies. Item (j) simply does not address export guarantee programs that <u>do</u> cover their long-term

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[1] Brazil First written Submission, para. 361.
[2] Brazil First written Submission, para. 362.
[3] *See* First Submission and Request For Preliminary Rulings of The United States of America, para. 66.
[4] *Ibid*, para. 65.
[5] Panel Report on *Korea-Measures Affecting Trade in Commercial Vessels*, para. 7.178

operating costs and losses."[6] Accordingly, the panel found that *a contrario* interpretation of item (j) was not permissible.

7. Hence, item (j) is only a shortcut to determine an export credit guarantee constitutes an export subsidy when the guarantee does not cover its long-term operating costs and losses. However, it is not a defense clause. When a guarantee does cover its long-term operating costs and losses, it is still possible that the guarantee constitutes an export subsidy. Namely, if requirements of item (j) are not met by a measure, the panel still needs to examine whether or not the measure is consistent with Article 1 and 3 of SCM, specifically, whether it constitutes a financial contribution that confers benefits. In China's view, the scope of export subsides in the meaning of Article 1 and 3 of SCM is broader than scope of item (j) of the illustrative list. The complainant may raise a *prima facie* case of export subsidy either by claiming an illustrative list violation or Article 1 and 3 of SCM violations. Nevertheless, non-existence of the illustrative list violation does not mean that it also consistent with obligations under Article 1 and 3 of SCM.

8. Thus, in the opinion of China, the US's approach of proceeding from item (j) is incomplete. It is the provisions in the Agreement of Agriculture and SCM Agreement *plus* item (j) in the Illustrative List rather than the item (j) itself only can be taken as the complete basis for analyzing the nature of GSM 102 programs. Even if the US could prove GSM 102 programs' premium could cover the long-term operating costs and losses of the programs, it still has to prove that it is consistent with the discipline of export subsidy specified in the Articles 1 and 3.1(a) of SCM Agreement and the relevant provisions in AoA.

2.2 Whether the ML/CCP payment "programs" are outside the scope of this proceeding

9. Brazil requests that the compliance panel to determine that the US has failed to comply fully with its obligation, under Article 7.8 of SCM Agreement, to "withdraw the subsidy" or to "remove the adverse effects" with respect to the US price-contingent subsidy programs.[7] Brazil believes that the new basket of measures providing support to the US upland cotton producers (*i.e.*, the marketing loan and counter-cyclical payment) continue to cause serious prejudice as well as a threat of serious prejudice to the interests of Brazil.

10. On the other hand, the U.S. argues that ML/CCP *Programs* are outside the scope of this proceeding.[8] In the opinion of the U.S., (1) "the marketing loan and counter-cyclical payment *programs* were not subject either to any finding of WTO-inconsistency or any DSB recommendations",(emphasis added)[9] since "Brazil clearly distinguished between claims against *programs per se* and claims against *specific payments under the programs*."(emphasis added)[10]; and (2) since ML/CCP Programs have not been changed, in response to DSB recommendations and rulings or otherwise, they are not "measures taken to comply".[11]

11. China can not endorse the position of the US that the US needs to do nothing concerning the ML and CCP programs.

12. In the first place, contrary to what the US asserted in its Submission, DSB did make rulings and recommendations in respect to ML/CCP programs in many occasions in the Panel Report, (1) the

[6] Panel Report on *Korea-Measures Affecting Trade in Commercial Vessels*, para. 7.203
[7] *Ibid*, para. 29
[8] *See* U.S. First Written Submission, para. 44.
[9] *Ibid*, para. 37.
[10] *Ibid*, para. 32.
[11] *Ibid*, para. 45.

panel found as one of the "measure at issue" the "legislative and regulatory provisions currently providing for the payment of measures," including that of ML and CCP.[12] This shows that "legislative and regulatory provisions" of ML/CCP are measures subject to rulings/findings by the panel. (2) in discerning the specificity of the measures at issue, the panel found that "a textual analysis of 'the legislation pursuant to which the granting authority operates' leads us to conclude that such subsidies are 'specific' within the meaning of Article 2.1(a)."[13] This clarifies that the panel did make findings to some extent regarding to the legislation authorizing ML/CCP subsidies. (3) in establishing the causal links between the US subsidies and the significant price suppression, the panel found that marketing loan program payments and CCP payments, among others, are *directly linked to* world prices for upland cotton, thereby insulating US producers from low prices, and that *the structure, design and operation of these measures* constitute evidence supporting a causal link with significant price suppression.[14] These are explicit descriptions of the ML/CCP programs in the sense that "directly linked to world price" is a mechanism by which a subsidy payment is to be made, rather than the payment per se, and that the phrase "*structure, design and operation of these measures*" is clearly synonymous to the programs. In short, these findings clearly show that the original panel had made rulings on the ML/CCP programs.

13. In addition, in regard to its findings on "threat of" serious prejudice, the Panel concluded by ruling explicitly that the United States is obliged to take action concerning its *present statutory and regulatory framework* as a result of our 'present' serious prejudice finding."(emphasis added)[15] In making its findings on Brazil's "claims of per se inconsistency", the original Panel found that "In light of our findings above in Sections VII:E, F, G and H, we do not believe that it is necessary to address *Brazil's per se claims relating to these measures* under Articles 5(c) and 6.3(c) and (d) of the SCM Agreement and Articles XVI:1 and XVI:3 of the GATT 1994."(emphasis added)[16] The quotations show that the panel assumed the statutory and regulatory framework of the US should be changed and refrained itself from make further elaboration in this regard.

14. One step backwards, assuming that the original panel did not make any recommendations in respect to ML/CCP *programs* on the basis that it adopted judicial economy on Brazil's per se claim, the US still needs to take measures to remove adverse effects caused by those subsidies including ML and CCP programs.

15. Another claim by the US with regard to scope of these compliance proceedings is that "Brazil may not in these Article 21.5 proceedings again make these claims against unchanged measures."[17] In this regard, China recalls that in paragraph 8.1(g)(i) of its report, the original panel found that " the effect of the mandatory price-contingent United States subsidy measures – marketing loan program payments, user marketing (Step 2) payments, MLA payments and CCP payments – is significant price suppression in the same world market within the meaning of Article 6.3(c) of the *SCM Agreement* constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*." The recommendations and rulings of the DSB obliged the United States, under Article 7.8 of the *SCM Agreement*, to remove the adverse effects caused by these subsidies, or to withdraw the subsidies.[18]

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[12] Panel Report on *U.S. – Upland Cotton*, para. 7.1107.
[13] *Ibid*, para. 7.1146.
[14] *Ibid*, para. 7.1349.
[15] *See* Panel Report, *U.S. – Upland Cotton*, para. 7.1501.
[16] Panel Report, *U.S. – Upland Cotton*, para. 7.1511.
[17] US First Submission, para. 48.
[18] Panel Report, *U.S. – Upland Cotton*, para. 8.3(d). Brazil recalls that the Panel and Appellate Body reports were adopted by the DSB on 21 March 2005.

16. As submitted by Brazil and admitted by the US, the only change made by the US concerning the actionable subsidies is repeal of Step 2 program. Nevertheless, the terms of reference of a compliance panel is not limited to what the responding party claims to be the measures taken to comply. It is clear that the US shall take measures to withdraw all three subsidies or remove the adverse effects caused by these subsidies. In views of China, since the compliance panel is obliged to examine whether the measures taken by the US is consistent with the covered agreement, it is necessary for the panel to examine whether or not the remaining two programs (ML and CCP programs) are still causing serious prejudice.

3. CONCLUSIONS

17. To conclude, China requests the compliance panel to find that:

1) it is the set of provisos in the Agreement of Agriculture(especially the Articles 10.1 and 8) and SCM Agreement (particularly Articles 1, 3.1(a) and 3.2) *plus* item (j) in the Illustrative List that constitutes the complete basis for analyzing the nature of SGM 102 programs.

2) ML/CCP payment programs are within the scope of this compliance proceeding.

18. China reserves its right to address new arguments, and further develop the arguments set out herein, in its oral statement to the third party session of the first substantive meeting.

ANNEX A-8

THIRD PARTY SUBMISSION OF THE EUROPEAN COMMUNITIES

(5 January 2007)

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Australia – Automotive Leather	*Australia – Subsidies Provided to Producers and Exporters of Automotive Leather,* WT/DS126/R, adopted on 16 June 1999.
Canada – Aircraft (Article 21.5)	*Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU,* WT/DS70/AB/RW, adopted on 4 August 2000.
Guatemala – Cement I	*Guatemala – Anti-Dumping Investigating Regarding Portland Cement from Mexico*, WT/DS60/AB/R, adopted on 25 November 1998.
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US – Shirts and Blouses	*United States – Measures Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R, adopted on 23 May 1997.
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US-Zeroing	*United States – Laws, Regulations and Methodology for Calculating Dumping Margins ("Zeroing")*, WT/DS294/AB/R, adopted on 9 May 2006.

I. INTRODUCTION

1. The European Communities welcomes this opportunity to present its views on the legal claims by Brazil and the United States in relation to alleged non-compliance with the Dispute Settlement Body ("DSB") Recommendations and Rulings in "*United States – Subsidies on Upland Cotton*".

2. In the original panel proceedings the European Communities decided to intervene as a third party because of its systemic interest in the correct interpretation of the relevant WTO provisions, as well as in the correct application of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"). At the DSB's meeting of 28 September 2006 the European Communities declared that it reserved its third-party rights in relation to the recourse to Article 21.5 of the *DSU* by Brazil.[1]

3. As a third party, the European Communities does not necessarily comment on every detail of the parties' submissions. The fact that the European Communities has not commented on a particular argument of the parties, or on the legal reasoning and findings in the Panel Report or Appellate Body Report should not be taken as an endorsement of such arguments, reasoning or findings. As is customary, the European Communities will refrain from analysing the facts of the case in detail but will present its views on a number of issues which raise systemic questions.

4. There are a number of systemic issues that arise from the parties' submissions and on which the European Communities wishes to comment. They will be dealt with under the following headings:

- Panel composition;
- Burden of proof;
- Adverse effects-related recommendations and rulings of the DSB:
  - Obligation to implement;
  - *Present* serious prejudice;
  - *Threat of* serious prejudice; and
- Mandatory/discretionary.

5. There are other issues, including the United States request for certain preliminary rulings, on which the European Communities intends to comment, and reserves its right to make further comments at the third party session of the Panel's first substantive meeting with the parties, once the parties' rebuttals are available.

II. PANEL COMPOSITION

A. INTRODUCTION

6. The European Communities would like to make a submission in relation to the statement made by Brazil at the meeting of the DSB on 26 October 2006, regarding the composition of the Panel established on 28 September 2006 pursuant to Article 21.5 of the *DSU* in this case.

7. Brazil had made a request under Article 8.7 of the *DSU* for the composition of a compliance panel. In its request, Brazil had asked the Director-General to nominate the three members of the panel in the original proceedings. Although all three members of the panel were available for service

[1] WTO Doc. WT/DSB/M/220 of 2 November 2006, paragraph 50.

in the Article 21.5 proceedings, the Director-General elected to call only one of the panellists back to service, and to nominate two new panellists.

8. In a letter to the Director-General following Brazil's request for composition under Article 8.7 of the *DSU*, the United States objected to the re-nomination of two of the original panellists, on the basis that they are nationals of third parties to the dispute. Brazil found the United States' objection "curious" and set out a number of reasons to justify its opinion in its statement on 26 October 2006.

B. RE-COMPOSITION OF PANEL NOT NECESSARY

9. Article 21.5 *DSU* states that:

> Where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures, including *wherever possible* resort to the *original panel.* … (emphasis added)

10. A plain reading of the text of Article 21.5 *DSU* conveys the intention of the drafters of the *DSU* that if the original panel is available then it shall deal with the Article 21.5 *DSU* proceedings. If the original panel is available, it follows that there is no requirement for it to be re-composed, as it already exists and is available. It also follows that where the original panel is available, there is certainly no requirement for a new panel to be composed.

11. There are, however, certain limited circumstances in which the original panel would be unavailable. It would not be possible to refer the matter to the original panel if, for example, one of the panellists had resigned or died or was otherwise unavailable. It would also not be possible to refer the matter to the original panel if one of the panellists had a conflict of interest, for instance, if a panellist had acquired an equity stake in a United States or Brazilian cotton company. In such a case the panellist would be bound to resign and thus become unavailable. However, the European Communities is of the view that a panellist being a citizen of a third party to the dispute pursuant to an agreement already given under Article 8.3 of the *DSU* cannot for that reason alone require him to resign at the implementation stage. Where a panellist has the citizenship of a third party to the dispute then the presumption and starting point is that the parties should resort to the original panel.

12. If a panellist is unavailable the parties should apply Article 9.3 of the *DSU* by analogy so that "to the greatest extent possible the same persons shall serve as panellists". So the starting position should be that if one panellist is unavailable, then the other two panellists continue to serve on the panel.

C. CITIZENS OF THIRD PARTIES

13. Article 8.3 of the *DSU* states that:

> Citizens of Members whose governments[6] are parties to the dispute or third parties as defined in paragraph 2 of Article 10 shall not serve on a panel concerned with that dispute, unless the parties to the dispute agree otherwise.
>
> [6] In the case where customs unions or common markets are parties to a dispute, this provision applies to citizens of all member countries of the customs unions or the common markets.

14. The first clause of Article 8.3 of the *DSU* thus prohibits citizens of third parties from serving on "a panel concerned with that dispute". However, the second clause of Article 8.3 of the *DSU* permits the parties to agree that this prohibition does not apply.

15. The original panel had a Polish Chairman with Chilean and Australian (Mr. Daniel Moulis) Members.

16. Australia had reserved its third party rights when the original panel was established on 18 March 2003. It necessarily follows that Brazil and the United States must have (or must be deemed to have) entered into an unconditional agreement that the prohibition contained in the first clause of Article 8.3 did not apply to Mr. Moulis. Brazil and the United States thus agreed that Mr. Moulis was not to be prohibited from serving on "a panel concerned with that dispute", even though Australia was a third party. This must be so, otherwise the original panel (and presumably the original Panel Report) would be inconsistent with Article 8.3 of the *DSU*.

17. Both parties (the United States and Brazil) having entered into such an agreement that the prohibition in the first clause of Article 8.3 (precluding Mr. Moulis from serving on "a panel concerned with that dispute") was not applicable, there is no basis in the DSU for such agreement to be withdrawn at any time solely on the basis that Mr. Moulis is a national of a third party. The United States or Brazil or indeed both of them might subsequently have had "second thoughts", and might have wished Mr. Moulis to resign or to sack him. Perhaps as a result of a preliminary ruling; or after a hearing; or following questions; or following the issuance of the factual part or the interim report. But the DSU affords the parties no such right, and with good reason. It would obviously be deeply destructive to the independence of panellists, and intolerable from a systemic point of view, if either party could unilaterally sack a panellist, citing only as a reason that the panellist is a national of a third party, when agreement under Article 8.3 of the *DSU* has already been given.

18. The text of Article 8.3 *DSU* unequivocally supports the European Communities' interpretation on this matter. It states that "…third parties … shall not serve on ***a panel concerned with that dispute***, unless the parties to *the dispute* agree otherwise." The use of the words "a panel concerned with that dispute" indicates that the drafters of this article intended that the rule in Article 8.3 (that is, both the prohibition and the agreement) are to apply more broadly than to their participation in the original proceedings ("the [original] dispute"). Article 21.5 *DSU* proceedings are certainly "concerned with" the original dispute. It therefore follows that the general prohibition on citizens of third parties serving as panellists applies in relation to their serving on panels considering Article 21.5 *DSU* proceedings; and the same must therefore be true of the agreement referred to in the second clause of Article 8.3 of the *DSU*.

19. Crucially, nothing in Article 8.3 *DSU* provides for a party to "the dispute" or "concerned with that dispute" to withdraw the consent ("agree[d] otherwise"), once given, for a citizen of a third party to serve on a panel concerned with that dispute. It is therefore not open to the United States to withdraw its consent in Article 21.5 *DSU* proceedings, in the same way as it would have been unable to withdraw its consent after the interim report was published or just before the final hearing of the original panel.

20. If a Member is free to object to the composition of a panel in such circumstances then there will be a strong perception amongst other Members that the Member has objected since it disagrees with the original panel's findings. This perception will be underlined by the fact that an objection was not made under Article 8.3 *DSU* in respect of the composition of the original panel.

D. ROLE OF ARTICLE 8.7 DSU

21. Article 8.7 of the *DSU* states that if the parties to the dispute cannot agree on the panellists the Director-General shall determine the panel's composition "in accordance with any relevant special or additional rules or procedures of the covered agreement or covered agreements which are at issue in the dispute". The European Communities submits that Article 21.5 of the *DSU* represents such a

relevant special rule. The Director-General, in exercising his discretion under Article 8.7 of the *DSU*, is therefore obliged to have regard to the provisions of Article 21.5 of the *DSU*.

22. Article 21.5 of the *DSU* states that an implementation "dispute shall be decided … wherever possible [by] resort to the original panel".

23. The European Communities agrees with Brazil that Article 21.5 *DSU* provides for resort to the original panel because the aim of Article 21.5 *DSU* proceedings is that they be dealt with as expeditiously as possible given that the dispute has already been settled by the panel (and in this case also by the Appellate Body).

24. The European Communities agrees with Brazil that "To facilitate the expeditious disposal of Article 21.5 proceedings, the provision calls for resort to the original panel in all but those narrow circumstances in which it is impossible for the original panellists to serve."[2] For the reasons set out above, in this particular case the United States should not have been able to successfully withdraw its agreement to an existing panellist continuing to serve on any panel concerned with the dispute solely on the grounds that he is a national of a third party.

25. It is the European Communities' view that in applying Article 8.7 of the *DSU*, in light of Article 21.5 of the *DSU*, the Director General was obliged to reject the United States attempt to withdraw its agreement under Article 8.3 of the *DSU* solely on the grounds that an existing panellist is a national of a third party.

E. UNATTRACTIVE PRECEDENT

26. The European Communities agrees with Brazil that the circumstances of this case set an unattractive precedent. The European Communities agrees with Brazil that this precedent could be invoked in other cases, because implementing Members could always object to the participation, in Article 21.5 *DSU* proceedings, of panellists who ruled against them in the original dispute.

F. PANEL SHOULD MAKE A FINDING OR RULING

27. The European Communities realises that it is not self-evident that this Panel should make findings or rulings regarding the propriety of its own composition. However, the European Communities believes that there is precedent for such a proposition, and that it is highly desirable in this case given the systemic importance of the issue.

28. The European Communities submits that the Panel has the authority to rule on the propriety of its own composition. Authority for this can be found in the *Australia – Automotive Leather* case. In that case the panel considered an Australian request that the panel terminate its work and, in effect, disestablish itself. In addition, the panel did not rule out the fact that, once the DSB has established a panel, the panel so established has the authority to rule on the propriety of its own establishment.[3]

29. Furthermore, the European Communities submits that, even if the parties do not address this issue directly in their submissions, the Panel has a duty to address it, as it is of fundamental importance for the correct interpretation of the *DSU* and for the smooth and equitable operation of

[2] Statement made by Brazil at the Meeting of the DSB on 26 October 2006.
[3] Panel Report, *Australia – Automotive Leather*, paragraphs 9.10 to 9.13.

the WTO dispute settlement system. In the *Mexico – HFCS (Article 21.5)* case the Appellate Body held that[4]:

> … panels have to address and dispose of certain issues of a fundamental nature, even if the parties to the dispute remain silent on those issues. In this regard, we have previously observed that "[t]he vesting of jurisdiction in a panel is a fundamental prerequisite for lawful panel proceedings."[34] For this reason, panels cannot simply ignore issues which go to the root of their jurisdiction – that is, to their authority to deal with and dispose of matters. Rather, panels must deal with such issues – if necessary, on their own motion – in order to satisfy themselves that they have authority to proceed.
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> [34] Appellate Body Report, *United States – 1916 Act*, supra, footnote 32, para.54.

30. The European Communities submits that these cases provide authority for the view that the Panel should make findings on an analogous and very important systemic issue in the interpretation of the *DSU*. Indeed, the European Communities submits that it is vitally important that the Panel delivers a finding or ruling on this systemic issue to avoid the perception that Members can always object to the participation, in Article 21.5 *DSU* proceedings, of panellists who ruled against them in the original dispute.

III. BURDEN OF PROOF

31. The European Communities submits that Brazil, as the applicant in these Article 21.5 *DSU* proceedings, bears the burden of proving its assertions that the United States has failed to implement, in a timely and complete manner, the recommendations and rulings of the DSB.

32. The general principles applicable to burden of proof, as stated by the Appellate Body in *US – Shirts and Blouses*, require that a party claiming a violation of a provision of the WTO Agreement by another Member must assert and prove its claim.[5] In the present Article 21.5 *DSU* proceedings the European Communities submits that it is Brazil, which has challenged the United States' implementation of the recommendations and rulings of the DSB, that bears the burden of proving that the United States has not implemented them in a timely and complete manner. It is therefore the responsibility of Brazil to submit evidence sufficient to establish a *prima facie* case that the United States has not implemented the recommendations and rulings of the DSB in a timely or complete manner. Once Brazil has done so, it is for the United States to submit evidence sufficient to rebut that *prima facie* case.

33. The European Communities also recalls that the Appellate Body has observed that various international tribunals, including the International Court of Justice, have generally and consistently accepted that the party that asserts a fact, whether claimant or respondent, is responsible for providing proof thereof.[6]

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[4] Appellate Body Report, *Mexico – HFCS (Article 21.5)*, paragraph 36.
[5] Appellate Body Report, *US – Shirts and Blouses*, pages 14 to 16.
[6] Appellate Body Report, *US – Shirts and Blouses*, page 14.

IV. ADVERSE EFFECTS-RELATED RECOMMENDATIONS AND RULINGS OF THE DSB

A. OBLIGATION TO IMPLEMENT

34. Brazil claims that between the expiry of the implementation period on 21 September 2005 and the elimination of Step 2 payments on 1 August 2006, there did not "exist" any United States "measures taken to comply" with the adverse effects-related recommendations and rulings of the DSB.[7]

35. In the view of the European Communities, one of the tasks incumbent on the present Article 21.5 *DSU* Panel is to examine whether by taking no positive action the United States could nevertheless be "in conformity with" its obligations under the *SCM Agreement*. As the Appellate Body in *Canada – Aircraft (Article 21.5)* held:

> Proceedings under Article 21.5 do not concern just *any* measure of a Member of the WTO; rather, Article 21.5 proceedings are limited to those "measures *taken to comply with* the recommendations and rulings" of the DSB. In our view, the phrase "measures taken to comply" refers to measures which have been, or which should be, adopted by a Member to bring about compliance with the recommendations and rulings of the DSB. In principle, a measure which has been "taken to comply with the recommendations and rulings" of the DSB, will *not* be the same measure as the measure which was the subject of the original dispute, so that, in principle, there would be two separate and distinct measures: the original measure which *gave rise* to the original recommendations and rulings of the DSB, and the "measures taken to comply" which are – or should be – adopted to *implement* those recommendations and rulings.[8]

36. However, from the text of Article 7.8 of the *SCM Agreement* it is not clear that the United States even had to actually *do* anything to comply with the findings and recommendations of the original panel.

37. Article 7.8 of the *SCM Agreement* states that:

> Where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member within the meaning of Article 5, the Member granting or maintaining such subsidy shall <u>*take appropriate steps*</u> *to remove the adverse effects*[9] or shall withdraw the subsidy.

38. Thus, the text of Article 7.8 of the *SCM Agreement* does not state expressly that a Member that has been requested by the DSB to implement its recommendations and rulings under Article 7.8 of the *SCM Agreement* actually has to *do* anything. Article 7.8 of the *SCM Agreement* gives the implementing Member two choices as to how to implement DSB recommendations and rulings. It can "take appropriate steps to remove the adverse effects [of the subsidy]". On the other hand, an implementing Member also has the choice to comply with the DSB's recommendations and rulings by "withdraw[ing] the subsidy".

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[7] Section 6 of Brazil's First Written Submission.
[8] Appellate Body Report, *Canada – Aircraft (Article 21.5)*, paragraph 36.
[9] European Communities' emphasis added.

39. It is clear that between the implementation date of 21 September 2005 and 31 July 2006 the United States did not withdraw any of the subsidies in question. However, this does not automatically mean that the United States has not complied with the DSB's recommendations and rulings as it was open for the United States to choose instead to "take appropriate steps to remove the adverse effects".

40. The European Communities submits that in "tak[ing] appropriate steps to remove the adverse effects" an implementing Member can exercise its discretion as to how best to remove those adverse effects. It could choose to do so by enacting new legislation, amending current legislation, or by an executive order or other types of administrative action. These are all examples of positive acts which could be taken by an implementing Member.

41. However, the European Communities further submits that "tak[ing] appropriate steps" may also include, in certain cases, taking no positive action at all; in other words, doing nothing. The test which taking no positive action has to meet in order to comply with the *SCM Agreement* is that it constitutes "appropriate steps to remove the adverse effects". The question as to whether taking no positive action actually is "appropriate" and actually does "remove" the adverse effects should be judged by a careful analysis of the particular facts and circumstances of each case. It may be in certain cases that other facts and circumstances have changed to such an extent that the adverse effects of the subsidies have stopped; for instance, a subsidy may have expired and adverse effects may have stopped.

42. If there are three subsidies at issue and the original panel holds that they cumulatively had an adverse effect, it is possible that the removal of one of those subsidies could remove the adverse effect.

43. In a case where the subsidy or adverse effects are discontinued the European Communities submits that the complaining party in Article 21.5 *DSU* proceedings is bound to analyse whether the implementing party has taken appropriate steps to remove the adverse effects with reference to "present" circumstances rather than the possibly rather different circumstances which may have existed when the DSB made its original rulings and recommendations. However, analysis of the "present" circumstances and context will invariably entail analysis of the latest relevant statistical and financial information and reports, so in this sense the analysis cannot be absolutely contemporaneous with the position on the ground. However, the complaining party in Article 21.5 *DSU* proceedings should ensure that its analysis is as up to date as is possible and the European Communities would expect that the Panel will employ a "reasonableness" test in its analysis thereof.

44. In the *US – Softwood Lumber VI, (Article 21.5)* panel report it was noted that,

> [t]he role of a panel in an Article 21.5 panel proceeding is to evaluate the challenged measure to determine its consistency with the defending Member's obligations under the relevant WTO Agreements.[10]

45. Thus, it said, the panel,

> is not limited by its original analysis and decision – rather, it is to consider, with a fresh eye, the new determination before it, and evaluate it in light of the claims and arguments of the parties in the Article 21.5 proceeding.[11]

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[10] Panel Report, *US – Softwood Lumber VI (Article 21.5)*, paragraph 7.12.
[11] Panel Report, *US – Softwood Lumber VI (Article 21.5)*, paragraph 7.12.

46. The European Communities submits that the panel's reasoning in *US – Softwood Lumber VI (Article 21.5)* on this point should apply in the present case. Although the United States may not have taken any positive action to comply with the panel and Appellate Body's findings and recommendations between the implementation date of 21 September 2005 and 31 July 2006, the Panel cannot, subject to the principle of *res judicata*, be limited by the earlier panel and Appellate Body reports as it must make a new determination in the present Article 21.5 *DSU* proceedings.

47. In *US – Softwood Lumber VI (Article 21.5)*, the panel also observed that,

> [w]hile we cannot preclude the possibility that a Member might implement a DSB recommendation by specifically answering points raised by a panel (or the Appellate Body) in the relevant decisions, this is by no means required by the DSU.[12]

48. On appeal the Appellate Body concluded that the panel's statements in this regard did not violate Article 11 of the *DSU*. Again, this case demonstrates that the lack of positive action taken by the United States to comply with the panel and Appellate Body's findings and recommendations between the implementation date of 21 September 2005 and 31 July 2006 is not necessarily fatal to its defence. As stated above, subject to the principle of *res judicata*, the Panel cannot be restricted by the earlier panel and Appellate Body reports as it must make a new determination in the present Article 21.5 *DSU* proceedings.

B. PRESENT SERIOUS PREJUDICE

49. In its adverse effects-related recommendations and rulings, the original panel, as affirmed by the Appellate Body, found that the price-contingent United States marketing loan program, counter-cyclical payment program and Step 2 program of the FSRI Act of 2002 caused significant price suppression in the world market for upland cotton, in violation of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement.* The panel found that:

> the United States is obliged to take action concerning its present statutory and regulatory framework as a result of our "present" serious prejudice findings.[13]

50. The DSB adopted the panel and Appellate Body reports that obliged the United States to remove the adverse effects caused by the subsidies, or to withdraw the subsidies by 21 September 2005.

51. In the present Article 21.5 *DSU* proceedings Brazil claims that the United States did not repeal or amend any of the three price-contingent subsidy programs until 1 August 2006, when it finally discontinued solely the Step 2 program. Brazil claims that the far larger marketing loan and counter-cyclical payment programs have not been removed or amended.

52. In the second of Brazil's claims concerning adverse effects-related recommendations and rulings of the DSB, Brazil claims that the non-repealed price-contingent United States marketing loan and counter-cyclical payment programs under the FSRI Act of 2002 cause *present*[14] serious prejudice in the form of significant price suppression in the world market for upland cotton, and an increase in the world market share, in violation of Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*. In other words, Brazil claims that, to the extent measures taken to comply with the adverse-effects related recommendations and rulings of the DSB exist (i.e., the repeal of Step 2 and the non-repeal of

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[12] Panel Report, *US – Softwood Lumber VI (Article 21.5),* paragraph 7.12.
[13] Panel Report, *US – Upland Cotton,* paragraph 7.1501.
[14] European Communities' emphasis added.

the marketing loan and counter-cyclical payment programs), those measures are deficient, and result in inconsistencies with the covered agreements, within the meaning of Article 21.5 of the *DSU*.

53. With the exception of those circumstances set out in Part IV.C of this submission of the European Communities, in order for Brazil to be able to make a successful claim that the price-contingent United States marketing loan and counter-cyclical payment programs have caused it serious prejudice, it must be able to evidence that the serious prejudice is actually *present*.

54. In establishing its claim, Brazil relies on data covering the marketing year 2005 – as well as additional available data since marketing year 2002, the first marketing year under the FSRI Act of 2002.[15] Brazil states in its first written submission that in order to establish "present" serious prejudice the complaining party must use data from the most recently completed marketing year.[16] However, the European Communities submits that, in establishing a claim of *present* serious prejudice, Members are obliged to rely on the most recent relevant data reasonably available to them. For instance, the first quarter of the United States' marketing year 2006 for upland cotton runs from 1 August 2006 until 31 October 2006. It is the European Communities' view that, if the data for the first quarter of marketing year 2006 was relevant and reasonably available to Brazil, it would have been obliged to establish any claim of *present* serious prejudice with reference to that data in its first written submission on 17 November 2006, a date which is almost three weeks after the end of the first quarter of marketing year 2006.

55. The United States, as the defending party in this dispute, is also obliged to respond to any complaint of *present* serious prejudice with reference to the most recent reasonably available relevant data. Even if the data for the first quarter of marketing year 2006 had not been reasonably available to Brazil, but it became reasonably available to the United States in the period between the lodging of Brazil's first written submission and the lodging of the United States' first written submission, the United States would be obliged to refer to it in responding to a complaint of *present* serious prejudice. The first written submission of a defending party in a matter brought under the *DSU* is not a rebuttal, so the defending party is obliged to set out its arguments and, in responding to any complaint of *present* serious prejudice, to refer to the most recent reasonably available and relevant data notwithstanding the data which the complaining party has referred to.

56. Support for the European Communities' approach can be seen in the panel's and Appellate Body's approach to the analogous concept of "present injury" in anti-dumping cases. For instance, in *US – Softwood Lumber VI* the panel stated that it must be clear from an authority's determination of threat of material injury that the authority has evaluated "how the future will be different from the immediate past, such that the situation of no present material injury will change in the imminent future to a situation of material injury . . . .".[17] This also applies to considerations of present injury. As the panel stated in *Mexico – Rice AD Measures*:

> An authority that fails to examine data that includes the most recent available information will not be in a position to make judgments about the immediate past. The same can be said about findings of present injury. An authority can only make

[15] The United States' marketing year for upland cotton runs from 1 August to 31 July. The 2005 marketing year covered the period from 1 August 2005 until 31 July 2006.

[16] Paragraph 212 of Brazil's First Written Submission.

[17] Panel Report, *US – Softwood Lumber VI,* paragraph 7.58.

objective determinations about the present, or the imminent future, if it is examining a period that includes the most recent available information.[18]

57. The European Communities submits that the Panel can apply the above reasoning in relation to "present injury" in anti-dumping cases to the interpretation of "present serious prejudice" in subsidies cases such as the present case. The two concepts are very similar and have similar objects and effects within their respective agreements which are annexed to the WTO Agreement. Indeed, while Article 3.1 of the *Anti-Dumping Agreement* and Article 15.1 of the *SCM Agreement* require that a determination of injury be based on "positive evidence", Article 6.8 of the *SCM Agreement* states that the existence of serious prejudice should be determined "on the basis of the information submitted to or obtained by the panel". The Appellate Body has confirmed that the reference to "positive evidence" within the meaning of Article 3.1 of the *Anti-Dumping Agreement* necessitates a "sufficiently relevant nexus between the data relating to the period of investigation and current injury".[19] Similarly, the existence of "present serious prejudice" can only be properly determined if such a sufficiently relevant nexus exits between data submitted to or obtained by the Panel and present serious prejudice.

58. The European Communities would submit that the more recent the data, the more convincing will be the demonstration of *present* serious prejudice. For instance, if the most recently completed marketing year for which figures are available is from ten years ago then the European Communities would submit that this would clearly be unreasonably old data to be used in calculating whether a measure constituted "present" serious prejudice. In the majority of cases involving a "marketing year" the European Communities would expect that the "most recently completed marketing year" would be interpreted by a panel as meaning the data for the marketing year directly preceding the current marketing year, or the data for the quarterly or six monthly periods in the current marketing year. Only in very special cases should the Panel consider making an exception to this general principle.

C. THREAT OF SERIOUS PREJUDICE

59. In section 8 of Brazil's first written submission, Brazil seems to evidence the *threat* of serious prejudice on the basis of "projections" of the United States' subsidy outlays going forward.

60. The European Communities recalls the findings by the original panel with respect to Brazil's claims of the *threat* of serious prejudice in those proceedings. In contrasting "*threat* of serious prejudice" with "*present* serious prejudice," the original panel found as follows:

> We believe that "threat" of serious prejudice refers to something distinct from serious prejudice. However, in terms of the rising continuum of seriously prejudicing another Member's interests, that ascends from a "threat" of serious prejudice up to "serious prejudice," we see "serious prejudice" as necessarily *including* the concept of a "threat" and *exceeding* the presence of a "threat" for purposes of answering the relevant inquiry. This is confirmed by the text of footnote 13 of the *SCM Agreement*, which indicates that serious prejudice "includes" threat of serious prejudice.[20]

61. In this respect, the European Communities concurs with Brazil's statement in its first written submission in this case that present serious prejudice would normally be *preceded in time* by a

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[18] Panel Report, *US - Rice AD Measures*, paragraph 4.410. See also: Appellate Body Report, *US - Rice AD Measures*, paragraph 167.

[19] Appellate Body Report, *US - Rice AD Measures*, paragraph 167.

[20] Panel Report, *US – Upland Cotton*, paragraph 7.1495.

prejudice that threatens to become serious, and serious prejudice would be the realisation of a threat of serious prejudice.

62. The text of the cited legal provisions leads the European Communities to conclude that either serious prejudice, or threat of serious prejudice, or both in combination, may trigger the remedies available in Article 7 of the *SCM Agreement*. The existence of either one, or the other, is both a necessary and sufficient condition, in and of itself, to achieve this.[21]

63. The European Communities agrees with the original panel's conclusion that a finding of present serious prejudice includes the concept of threat of serious prejudice. The European Communities also agrees with the original panel's conclusion that a finding of present serious prejudice is a sufficient condition to trigger the remedy available in Article 7.8 of the *SCM Agreement*.

V. ALLEGED SO-CALLED "MANDATORY-DISCRETIONARY" DISTINCTION

64. The United States submits that, since Brazil is making an "as such" claim against the US marketing loan and counter-cyclical payment "programs", in order to succeed, Brazil must "show" that the measure "mandates" a breach of Articles 5(c) and 6.3(c) or 6.3(d) of the *SCM Agreement*. The United States does not refer to any provision of WTO law to support its submission. Rather, the United States asserts that such a requirement "has been consistently applied in GATT and WTO dispute settlement proceedings". The United States submits that the panel in the original dispute appeared to confuse the "mandatory-discretionary" distinction with the different question of whether something can be challenged as a measure if it has no binding legal effect. The United States further submits "more specifically" that Brazil would have to demonstrate that the measure mandates actions "that will necessarily cause the kind of effects alleged by Brazil under Article 6.3(c) and 6.3(d) of the *SCM Agreement*." According to the United States, the provision in question "simply sets out the conditions" under which payment will be made, and for that reason does not "mandate" anything; and thus cannot be WTO inconsistent.[22]

65. The European Communities disagrees with the United States submissions. The European Communities considers that no such requirement can be derived from the text of the *SCM Agreement* or any other WTO agreement, nor from the case law. The European Communities observes that the United States does not actually explain what, according to the United States, the content of the distinction is supposed to be. Evidently, it is not and cannot be co-extensive with the question of causation. Nor can it be that a measure is automatically WTO consistent merely because it contains conditions. Contrary to what the United States submits, this matter was litigated at length before the Appellate Body in *US-Zeroing*, and the arguments of the United States were not accepted.

66. Referring to and summarising its submission in that case, the European Communities recalls that the legal basis for, origins, evolution and content of the so-called mandatory/discretionary doctrine are obscure. The United States cites no legal basis for the alleged rule in the WTO Agreements. A careful review of past GATT and WTO panel reports reveals that under the heading "mandatory/discretionary" one will not in fact find a homogenous, systematic and consistent articulation of the same point or principle. Rather, one finds slightly different ideas or concepts,

[21] Panel Report, *US – Upland Cotton*, paragraphs 7.1495 to 7.1497.
[22] United States first written submission, paragraphs 196 to 202.

applied to disparate factual situations, and often leading to rather different results.[23] The mandatory/discretionary rule is not anywhere articulated in the WTO agreements, and certainly not in the general, abstract and mechanistic terms in which it is invoked by the United States. Rather, its alleged existence is entirely based on the alleged "consistent practice" of past GATT and WTO panels. But there is no such "consistent practice".

67. One-by-one, some of the things that it has from time-to-time been suggested the so-called mandatory/discretionary rule might stand for have, particularly on review by the Appellate Body, fallen by the way-side. There is, for example, no need that the measure be adopted by the "legislature" as opposed to the "executive". Any measure imputable to a Member is susceptible to review.[24] There is, for example, no need that the measure is "binding" in municipal law. Even "non-binding" measures are susceptible to review.[25] It is irrelevant, for example, if the measure can be changed, or how it might be changed.[26] A measure may be inconsistent even if it has not yet been applied (although evidence of its "as applied" use may evidence a finding of inconsistency).[27] Also irrelevant is the assertion that the municipal law measure is allegedly susceptible to various interpretations by the municipal courts.[28]

68. The United States has in the past asserted that the "mandatory/discretionary" rule means that the measure must *in all cases* require WTO-inconsistent action before it can be impugned. The European Communities does not agree that such a rule exists or is to be mechanistically applied. With the possible exception in practice of numbers, it is <u>never possible</u> to say that two general and normative rules not expressed in identical terms will *always* produce the same result when applied to any set of facts. It is always possible to imagine a set of facts to which the application of the two rules will produce different results. This simply results from the fact that there is a penumbra associated with all language, especially when used in relatively abstract terms. The *mechanistic* application of an "in all cases" test thus stands for the proposition that general municipal measures should never or almost never be found "as such" inconsistent; a proposition that flatly contradicts the provisions of the *SCM Agreement* and the *WTO Agreement*. In the light of Article XVI:4 of the WTO Agreement and Article 32.5 of the *SCM Agreement*, Members must ensure conformity with WTO law, either through direct effect, or through implementing measures that are themselves in conformity with WTO law.

69. The European Communities believes that, just as the "mandatory/discretionary" rule is not, in truth, borne of any abstract basic principle expressed in the WTO agreement or elsewhere, but has rather been puffed-up by dubious assertion based on specific past cases; so we may expect, quite appropriately, to witness its demise, on a case-by-case basis. The Appellate Body could confirm,

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[23] See, for example, *Mandatory and Discretionary Legislation: the Continued Relevance of the Distinction under the WTO*, Sharif Bhuiyan, Journal of International Economic Law 5(3), 571-604; and *The Mandatory/Discretionary Doctrine in WTO Law, The US-Section 301 Case and its Aftermath*, Yoshiko Naiki, Journal of International Economic Law 7(1), 23-72.

[24] Such a requirement was sometimes alleged based on the wording of a GATT Working Party Report commenting on the GATT Protocol of Provisional Application, suggesting that a "mandatory" measure "imposes on the ***executive*** authority requirements which cannot be modified by ***executive*** action". Such an assertion does not hold good under WTO law (Appellate Body Report, *US-Corrosion-Resistant Steel*, paragraph 81).

[25] Appellate Body Report, *US-Corrosion-Resistant Steel*, paragraph 38 (US "non-binding" argument) and paragraph 85; Appellate Body Report, *Guatemala – Cement I*, paragraph 69, footnote 47. The US now agrees with the EC and the Appellate Body on this point (US first written submission, footnote 286).

[26] Appellate Body Report, *US-Corrosion-Resistant Steel*, paragraph 39 (US "modification" argument) and paragraphs 81 to 101.

[27] Appellate Body Report, *US-Corrosion-Resistant Steel*, paragraph 82.

[28] Appellate Body Report, *US-1916 Act*, paragraph 90.

once and for all, that there is, in truth, no such principle. In the opinion of the European Communities, that is what it has effectively done by finding that such a "rule" is not to be mechanistically applied. Alternatively, the Appellate Body may, in one successive case after another, explain why the rule does not avert an "as such" finding of inconsistency in the particular case. Whether it's a quick execution or a slow and painful death, the end result is the same. This view is confirmed by the Appellate Body Report in *US-Zeroing*.[29]

[29] Appellate Body Report, *US-Zeroing*, paragraphs 62 and 208 (summarising US argument); paragraphs 67, 68 and 210 (summarising EC argument) and paragraphs 211 to 214 (Appellate Body findings).

ANNEX A-9

THIRD PARTY SUBMISSION OF JAPAN

(5 January 2007)

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I. INTRODUCTION

1. Japan welcomes the opportunity to present its views to the Compliance Panel in this dispute, which was brought by Brazil to challenge the implementation by the United States of the recommendations and rulings of the Dispute Settlement Body (DSB) in *United States – Subsidies on Upland Cotton* (*Upland Cotton*).

2. As a third party, Japan's comments stem from its systemic interest in ensuring objective and consistent interpretation of the WTO agreements, in particular the Agreement on Subsidies and Countervailing Measures (ASCM) and the Dispute Settlement Understanding (DSU). Japan would like to address the following issues discussed in the First Written Submissions of Brazil and the United States:

- The standards discussed by Brazil for establishing "threat of serious prejudice" under Part III of the ASCM;
- The U.S. argument that the Panel lacks the authority to issue a ruling where a party has taken no action to bring a measure into compliance; and
- The importance of ensuring that, when a Member resorts to an outside source or index, it fully explains its rationale for doing so.

II. ARGUMENT

A. THE THREAT OF SERIOUS PREJUDICE STANDARDS DISCUSSED BY BRAZIL ARE FLAWED

3. Japan is of the view that the most important issue of general interest raised in this dispute is the appropriate standard for establishing threat of serious prejudice under Part III of the ASCM.[1] As at least one panel has recognized, neither Article 5(c) nor footnote 13 of the ASCM "defines or elaborates" on the concept of "serious prejudice" to the interests of another Member, much less the concept of "threat".[2] Reflecting the lack of textual guidance, Brazil discusses two markedly different standards for adoption by the Panel. First, Brazil presents for adoption a standard of "'significant likelihood' of serious prejudice in the future".[3] Second, based on the United States position in the original proceeding, Brazil ascribes to the United States a standard based on Article 15.7 of the ASCM.[4] As explained below, in Japan's view, each proposal has attributes, but ultimately both are flawed and should be rejected.

4. This issue is exceedingly important and has far-reaching implications. Japan asks the Panel to scrutinize the two proposals, taking into consideration the comments set forth below.

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[1] *See* Agreement on Subsidies and Countervailing Measures, Art. 5(c) and n.13.

[2] *Korea – Measures Affecting Trade in Commercial Vessels*, WT/DS273/R (7 March 2005), para. 7.529.

[3] *United States – Subsidies on Upland Cotton*; *Recourse by Brazil to Article 21.5 of the DSU*, WT/DS267, Brazil's First Submission, para. 259.

[4] *Id*. at paras. 254 – 258. *See* ASCM, Article 15.7.

1. The Proposal Brazil Ascribes to the United States is Flawed – The Threat Standard of Part V of the Agreement on Subsidies and Countervailing Measures Should Not Be Imported to Part III

5. The standard Brazil ascribes to the United States is drawn from Article 15.7 of the ASCM. The standard has two-parts as follows:

1. The "change in circumstances which would create a situation in which the subsidy would cause [serious prejudice] must be clearly foreseen and imminent"; and

2. The threat determination "shall be based on facts and not merely on allegation, conjecture or remote possibility".[5]

In essence, this proposal would import the threat of material injury standard from Part V to Part III of the ASCM for the purposes of determining "threat of serious prejudice".

6. As discussed in Section II.B.2. below, Japan agrees that an evidentiary requirement is an important part of a threat standard. However, as explained below, Japan would reject this legal standard.

7. Brazil, in its First Submission, demonstrates that textual reasons[6] and practical reasons[7] militate against adopting the "clearly foreseen and imminent" legal standard. For the sake of brevity, Japan will not repeat them.

8. There is another important reason to reject this proposal. Parts III and V of the ASCM serve markedly different purposes. The Part V legal standard for "threat" reflects this difference and, therefore, is an inappropriate standard for "threat of serious prejudice" under Part III. Part V addresses countervailing measures. It cabins the discretion granted to national authorities to conduct investigations and impose countervailing duties (CVDs). Article 15 of Part V sets out requirements for injury determinations by national authorities. Article 15.7, inter alia, establishes a rigorous two-part standard that must be met before a CVD can be applied on the basis of an alleged "threat" of material injury. One part of the standard is an evidentiary requirement ensuring that a finding of "threat" is based on facts.[8] The other part is a strict legal standard stating the conditions that must be met before an affirmative finding of "threat" can be made.[9]

9. As compared to the concept of actual "injury", the concept of "threat of material injury" by nature is less defined. Indeed, in the anti-dumping context, the Appellate Body has referred to "threat" findings as involving "intrinsic uncertainty".[10] In Part V of the ASCM, Articles 15.7 and 15.8 address this difference. Along with the exhortation of Article 15.8 that national authorities exercise "special care" in threat cases, the two parts of the Article 15.7 standard work together to limit the discretion of national authorities and guarantee against misuse.[11]

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[5] *Id.*

[6] *Id.*, para. 255.

[7] *Id*., para. 256.

[8] *See* ASCM, Article 15.7, first sentence.

[9] *Id.*, second sentence.

[10] *Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States; Recourse to Article 21.5 of the DSU by the United States*, WT/DS132/AB/RW (22 October 2001), para. 85.

[11] *See, e.g., United States – Investigation of the International Trade Commission in Softwood Lumber from Canada; Recourse to Article 21.5 of the DSU by Canada*, WT/DS277/AB/RW (13 April 2006), para. 96 (Article 15.7 of the ASCM "enjoin[s] a panel to *scrutinize carefully* the inferences and explanations of the

10. The original Panel in this proceeding properly recognized that ASCM Part V, for a variety of reasons, may not be proper context for interpreting and applying Part III.[12] The Panel recognized the significant differences in the purposes and instruments of Part III, which addresses WTO claims of "serious prejudice", and Part V, which addresses national authorities' conduct of CVD investigations and imposition of CVDs, even though both Part III and Part V address subsidies.

11. In this specific case, Part III issues are completely devoid of concerns relating to limiting the discretion of national authorities to prevent misuse thereof in the conduct of domestic CVD investigations set forth above that apply to Part V. In a "threat of serious prejudice" claim under Part III, the provisions and standards are applied by panels and the AB. No national authority is involved.

12. The Panel should reject the standard Brazil ascribes to the United States for this reason, as well as those set out by Brazil in paragraphs 255-256 of its First Submission relating to textual analysis of ASCM Article 5(c), accompanying note 13 and Article 15.7 and to the possible effect of precluding remedies for certain types of subsidy programs.

2. Brazil's Proposed Standard Does Not Explicitly Include an Evidentiary Requirement

13. Brazil proposes a separate, less stringent standard for establishing "threat of serious prejudice". Brazil proposes that the Panel find that a "threat of serious prejudice" exists where there is a "'significant likelihood' of serious prejudice in the future."13 As an initial matter, Japan notes that this proposal is incomplete as it does not include an explicit evidentiary requirement.[14] An explicit evidentiary requirement such as that set forth in the first sentence of ASCM Article 15.7[15] is a crucial component of any "threat" standard. It is necessary to tie to real world facts what otherwise is an amorphous concept.

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investigating authority in order to ensure that any projections or assumptions made by it, as to likely future occurrences, are adequately explained and supported by positive evidence on the record" (emphasis added; referring also to Article 3.7 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994 (AD Agreement)) citing *United States – Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia*, WT/DS177, 178/AB/R (1 May 2001), para. 136; *Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States; Recourse to Article 21.5 of the DSU by the United States*, WT/DS132/AB/RW (22 October 2001), para. 85.

Panels have rigorously applied the standard governing "threat" in the safeguard context under Articles 4.1(b) and 4.2(a) of the Agreement on Safeguards and in the anti-dumping context under Article 3.7 of the AD Agreement. *See*, *e.g.*, *Argentina – Definitive Safeguard Measure on Imports of Preserved Peaches*, WT/DS238/R (14 February 2003), paras. 7.83 – 7.133 (rejecting affirmative threat finding of national authority); *Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products*, WT/DS207/R (3 May 2002), paras. 7.163 – 7.174 (same); *Argentina – Safeguard Measures on Imports of Footwear*, WT/DS121/R (25 June 1999), paras. 8.281 – 8.286 (same); *Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States; Recourse to Article 21.5 of the DSU by the United States*, WT/DS132/AB/RW (22 October 2001), paras. 76 – 101 (upholding Panel's rejection of national authority's affirmative threat finding).

[12] *See, e.g., United States – Subsidies on Upland Cotton*, WT/DS267/R (8 September 2004), para. 7.1167.

[13] Brazil's First Submission, para. 259.

[14] Japan notes, however, that, after setting out the proposed standard, Brazil lists a number of factors for consideration, which indicates an appreciation of the evidentiary concerns raised by the amorphous nature of threat claims. *See id*., para. 260.

[15] *See also* Agreement on Safeguards, Article 4.1(b) ("A determination of the existence of a threat of serious injury shall be based on facts and not merely on allegation, conjecture or remote possibility"); AD Agreement, Article 3.7 ("A determination of a threat of material injury shall be based on facts and not merely on allegation, conjecture or remote possibility").

14. Japan recognizes that this position could be criticized as inappropriately importing a provision from Part V, contrary to (or inconsistent with) Japan's argument in Section II.A.1. above. However, in this instance, the importation makes sense. Any type of threat determination – whether it be of serious prejudice, material injury or serious injury – must be grounded in fact.

15. Turning to Brazil's proposed legal standard – "significant likelihood" – Japan is of the view that the standard is more balanced than the legal standard of Article 15.7 of the ASCM. However, Brazil's proposed standard offers little concrete guidance – what, exactly, constitutes a significant likelihood? Japan notes that panels previously have had occasion to discuss "likely" and "likelihood". In a proceeding involving the AD Agreement, the panel examined the meaning of "likely" as it is used in Article 11.2 in the phrase "whether the injury would be likely to continue or recur".[16] In a later proceeding, a panel examining a threat determination under Article 4.1(b) of the Agreement on Safeguards examined the phrase "clearly imminent", concluding that it signaled that an affirmative threat finding required the existence of a "high degree of likelihood that the anticipated serious injury will materialize in the very near future."[17] The inclusion of the word "significant" suggests a stricter standard than that examined by the panel in *U.S. – DRAMS* and comes closer to a "high degree of likelihood" as discussed in *Preserved Peaches*, but the question remains as to what exactly would constitute a "significant likelihood". In any case, these earlier panel reports might be of assistance in evaluating Brazil's proposal.

3. Final Comments on Threat of Serious Prejudice

16. When the Panel addresses the issue of the appropriate standard for "threat of serious prejudice", Japan understands it will proceed in accordance with Article 3.2 of the DSU and Section 3 of the Vienna Convention on the Law of Treaties.

17. In addition, Japan asks the Panel to consider that the "threat" standard must be applicable to circumstances that are very different from those in this case. As Brazil notes, the standard must not, by its very structure, ignore an entire class of threat cases, especially cases in which serious prejudice had been established in an earlier proceeding.[18] At the same time, though, the standard must be strict enough to discourage specious threat claims.

B. THE U.S. ARGUMENT THAT THE PANEL LACKS THE AUTHORITY TO ISSUE A RULING WHERE A PARTY HAS TAKEN NO ACTION TO BRING A MEASURE INTO COMPLIANCE IS FLAWED AND SHOULD BE REJECTED

18. The United States argues that the Panel lacks the authority to address Brazil's arguments regarding the U.S. Marketing Loan Program and Countercyclical Program.[19] Under scrutiny, the U.S. argument reduces to a position that is indefensible – the U.S. would subject to Article 21.5 review a Member that in good faith attempts to alter a non-compliant measure to bring it into compliance, but would insulate from Article 21.5 review a Member that takes no action to bring a non-compliant measure into conformity with WTO provisions.

[16] *See United States – Anti-Dumping Duty on Dynamic Random Access Memory Semiconductors (DRAMS) of One Megabit or Above from Korea*, WT/DS99/R (29 January 1999), paras. 6.44-6.51.
[17] *Argentina – Definitive Safeguard Measure on Imports of Preserved Peaches,* WT/DS238/R (14 February 2003), para. 7.120.
[18] *Cf*. Brazil's First Submission, paras. 256-258.
[19] *See* U.S. First Submission, paras. 45 – 48; *see also id*., paras. 49 – 56.

19. The United States cites the Appellate Body report in EC – Bed Linen 21.5 to support its position[20], but the citation is unavailing. The U.S. characterization of the Appellate Body report is questionable. The most pertinent part of the report is the following statement:

> 87. We conclude, therefore, that, in these Article 21.5 proceedings, India has raised the *same* claim under Article 3.5 relating to "other factors" as it did in the original proceedings. In doing so, India seeks to challenge an aspect of the original measure which has not changed, *and which the European Communities did not have to change*, in order to comply with the DSB recommendations and rulings to make that measure consistent with the European Communities' WTO obligations.[21]

Thus, the situation in *EC – Bed Linens 21.5* is not analogous to the instant proceeding.

20. The U.S. argument, if accepted, could create an endless loop of litigation where a Member refused to alter a measure found to be non-compliant. By cutting off access to review under Article 21.5, the U.S. argument would require the Member that won the original challenge to bring a separate dispute regarding the unchanged measure. In Japan's view, this result is to be avoided.

21. Japan asks the Panel to reject this U.S. argument.

C. CONCERNS RAISED BY THE PARTIES' USE OF OUTSIDE SOURCES

22. In a case as complex as *Upland Cotton*, the parties of necessity resort to non-WTO related sources to advance their positions. To ensure that each outside source is properly used, panels and the Appellate Body should scrutinize each source and its relationship to the proposition it is alleged to support.

23. This proceeding presents many examples of this practice. Japan wishes to focus on two in particular – Brazil's reliance on the OECD Arrangement on Officially Supported Export Credits (OECD Arrangement)[22] and the U.S. use of a report by the International Cotton Advisory Committee (ICAC).[23]

1. Brazil's Use of the OECD Arrangement on Officially Supported Export Credits

24. Brazil relies on the OECD Arrangement for the limited purpose of establishing that fees for Export Credit Guarantees (ECGs) under the U.S. General Sales Manager (GSM) 102 program are less than the minimum premium rates (MPRs) in the Arrangement (and, to simplify Brazil's argument, are thus below market).[24]

25. In Japan's view, the OECD Arrangement appears to be an inappropriate reference in this proceeding. First, the OECD Arrangement does not cover agricultural products. Second, as Brazil recognizes elsewhere (in explaining its use of another outside index), the risks of financing arrangements for bulk agricultural commodity products, such as cotton, are not only substantial, but

[20] *Id*., para. 46, citing *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India*; *Recourse to Article 21.5 of the DSU by India*, WT/DS141/AB/RW (24 April 2003), para. 87.

[21] *EC – Bed Linens – 21.5 AB*, para. 87 (first emphasis in original; second emphasis added).

[22] *See* Brazil's First Submission, paras. 438 – 443, citing Exhibit Bra – 546 (OECD document TD/PG (2005) 38/FINAL, 5 December 2005).

[23] *See* U.S. First Submission, para. 60, quoting "Cotton: Review of the World Situation", ICAC, p. 11 (May – June 2006) (BRA – 485).

[24] *See* Brazil's First Submission, paras. 438 – 443.

also unique. Brazil notes that the tenor for Letter of Credit Insurance (LCI) granted by the Export-Import Bank of the United States (Ex-Im Bank) is capped at 180 days for bulk agricultural products.[25] Furthermore, the scope of application of the OECD Arrangement is export credits with repayment terms of two years or more. Thus, Brazil's use of the OECD Arrangement in this case is inappropriate.

26. Japan urges the Panel to closely examine Brazil's rationale for its use of the OECD Arrangement MPRs.

2. The U.S. Use of the International Cotton Advisory Committee Report

27. Japan also takes issue with the use by the United States of an ICAC report. The United States quotes the ICAC report for the proposition that, following the 1 July 2005 modifications, the U.S. government's export credit guarantee programs "'*comply with the WTO ruling*.'"[26]

28. The ICAC is not empowered to determine whether a WTO Member's measures comply with a WTO provision or whether changes to a non-compliant measure have brought the measure into compliance. Therefore, Japan is of the view that citations such as this are not relevant to the instant dispute.

29. Japan urges the Panel to closely examine the U.S. use of the ICAC Report.

III. CONCLUSION

30. Japan respectfully requests the Compliance Panel to examine carefully the facts and arguments presented by Brazil and the United States in light of the comments above, in order to ensure objective and consistent interpretation of the WTO agreements, particularly the ASCM and the DSU. We welcome any questions that the Panel may have regarding this submission.

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[25] *See* Brazil's First Submission, paras. 387 and 389.

[26] *See* U.S. First Submission, para. 60, quoting "Cotton: Review of the World Situation", ICAC, p. 11 (May – June 2006) (BRA – 485) (emphasis added by United States).

ANNEX A-10

THIRD PARTY SUBMISSION OF NEW ZEALAND

(5 January 2007)

CONTENTS

Page

I. INTRODUCTION

1.01 The rulings and recommendations of the panel and of the Appellate Body in *United States – Subsidies on Upland Cotton* adopted by the Dispute Settlement Body ("DSB") on 21 March 2005 constituted an important step in the interpretation and application of the provisions of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement") in respect of both prohibited and actionable subsidies. In particular it clarified the meaning and scope of the concept of serious prejudice in Article 6 of the SCM Agreement. New Zealand was a third party in that case because of its systemic interest in the integrity of these provisions. As a leading agricultural exporter New Zealand has a particular interest in the application of the subsidies disciplines to agricultural products. Thus, New Zealand welcomed the adoption of the panel and Appellate Body reports.

1.02 Brazil now brings the matter of United States subsidies in respect of upland cotton back under Article 21.5 of the Dispute Settlement Understanding (DSU). Brazil argues that the United States action and inaction in respect of the recommendations and rulings of the DSB puts it in violation of its obligations under Articles 5 and 7.8 of the SCM Agreement. Failure by the United States to remove the adverse effects or withdraw the subsidising measures as required by Article 7.8 of the SCM Agreement, calls into question the very viability of the disciplines in that Agreement. As a result, New Zealand is exercising its right as a third party in this Article 21.5 compliance proceeding.

1.03 In New Zealand's view, the decision of the panel in this case will have far-reaching implications. Not only is the fact of non-compliance a threat to the subsidy disciplines of the SCM Agreement, but the arguments put forward by the United States in its response to the claim of Brazil have serious systemic implications for the future application of the SCM Agreement. New Zealand will elaborate on this aspect throughout this submission.

II. THE FINDINGS IN QUESTION AND THE ALLEGED MEASURES OF IMPLEMENTATION

2.01 In this submission New Zealand will focus on the implementation of the recommendations and rulings of the DSB in respect of the subsidies that were found by the panel in the original proceedings to be actionable. The relevant part of the panel's findings is paragraph 8.1(g)(i) which provides:

> the effect of the mandatory price-contingent United States subsidy measures – marketing loan programme payments, user marketing (Step 2) payments, MLA payments and CCP payments - is significant price suppression in the same world market within the meaning of Article 6.3(c) of the *SCM Agreement* constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*;

2.02 In paragraph 8.3 the panel went on to say in respect of its finding in paragraph 8.1(g)(i), that in light of Article 7.8 of the SCM Agreement the United States was under an obligation to "take appropriate steps to remove the adverse effects … or withdraw the subsidy". The Appellate Body expressly upheld the finding of the panel in paragraph 8.1(g)(i).

2.03 As Brazil has pointed out, the only action taken by the United States in implementing the recommendations and rulings of the DSB on 21 March 2005 has been the abolition of user marketing (Step 2) payments. The programmes under the Farm Security and Rural Investment ("FSRI") Act of 2002 providing for marketing loan payments and counter-cyclical payments remain. Since these were the major contributors to the price suppression and hence the serious prejudice found by the panel then, as Brazil argues, the United States has failed to remove the adverse effects as required by Article 7.8 of the SCM Agreement and thus remains in violation of Article 5 of the SCM Agreement.

2.04 The United States response falls into two broad areas. First, the United States argues that certain claims made by Brazil are outside the scope of DSU Article 21.5 proceedings and requests that the panel make preliminary rulings to that effect. Second the United States claims that Brazil has failed to show that in the absence of the Step 2 payments, the marketing loan and counter-cyclical programmes cause serious prejudice either through price suppression or through an increase in world market share. In New Zealand's view both of these arguments are flawed. In this submission, New Zealand will provide some comments on the United States claims. In respect of the request for preliminary rulings, New Zealand will focus on the claim that the marketing loan and counter-cyclical programs are outside the scope of these Article 21.5 proceedings.

III. DSU ARTICLE 21.5 AND SCM AGREEMENT ARTICLE 7.8

3.01 Before addressing the United States preliminary rulings claim, New Zealand wishes to make some comments on the uniqueness of this case and the importance of its implications. This Article 21.5 proceeding involves for the first time the question of compliance in respect of the obligation under Article 7.8 of the SCM Agreement either to withdraw the subsidy or to "take appropriate steps to remove the adverse effects". Hence this panel is faced with the interpretation of both DSU Article 21.5 and Article 7.8 of the SCM Agreement and with determining their relationship to each other.

3.02 DSU Article 21.5 mandates a panel to consider "the existence or consistency of measures taken to comply with the recommendations and rulings" of the DSB. As the Appellate Body has pointed out, this provision entitles a panel to determine whether any measures exist to implement the recommendations and rulings of the DSB.[1] However, when compliance with Article 7.8 of the SCM Agreement is raised in an Article 21.5 proceeding, it is not just a question of the existence of measures or of their consistency with the recommendations and rulings of the DSB that has to be considered. If the subsidising measures in question have not been withdrawn then there is the further question of whether "appropriate steps" have been taken to remove the adverse effects of those measures.

3.03 In New Zealand's view, an enquiry to determine whether Article 7.8 of the SCM Agreement has been complied with can involve a panel in looking at three things. First, a panel must determine whether the subsidising measures have been withdrawn. Second, if those measures have not been withdrawn, then the panel must consider whether any steps have been taken to remove the adverse effects. Third, if the panel finds that steps have been taken to remove the adverse effects, then it must determine whether those steps are "appropriate".

3.04 In New Zealand's view, the steps would only be "appropriate" if they are capable of removing the adverse effects. The *Oxford English Dictionary* defines "appropriate" as meaning "specially fitted, suitable, proper".[2] A measure that is not capable of achieving its objective of removing the adverse effects would be neither suitable nor appropriate. As a consequence, steps taken by an implementing Member that are not capable of removing the adverse effects would not be "appropriate steps" within the meaning of Article 7.8 of the SCM Agreement.

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[1] Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Second Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW2, 14 March 2006, para. 93.

[2] *The Oxford English Dictionary* (2nd Edition) – Volume I, Clarendon Press, Oxford: 1989, p. 586.

IV. THE PRELIMINARY RULINGS CLAIM

4.01 The United States claims that marketing loans and counter-cyclical programmes under the FSRI are "outside the scope" of the Article 21.5 proceeding. The United States presents two arguments in this respect. First, it argues that the DSB ruling covered only certain "payments" under those programmes, not the programmes themselves. Second, the United States argues that these programmes do not constitute "measures taken to comply" with the recommendations and rulings of the DSB and hence they fall outside the scope of DSU Article 21.5. In New Zealand's view both arguments are unsupportable. Moreover, if these arguments were to be upheld, the actionable subsidy regime under the SCM Agreement would be completely undermined.

4.02 New Zealand notes that the United States also requests a preliminary ruling that Brazil's claim that no action was taken by the United States in implementation of the recommendations and rulings of the DSB between 21 September 2005 and 31 July 2006 is also outside the scope of these proceedings. On this matter, however, Brazil is undoubtedly correct. The United States cannot claim that since it took no implementing action until 1 August 2006, that period is outside the scope of these proceedings. DSU Article 21.5 applies to the "existence" of measures not just to the consistency of measures actually taken to comply with the recommendations and rulings of the DSB.

A. THE PAYMENTS/PROGRAMMES DISTINCTION

4.03 The United States claim that the panel's finding in paragraph 8.1(g)(i) is limited to specific payments and did not cover the programmes that authorise those payments involves a rewriting of the panel's findings. The United States seeks to revise the finding of the panel in light of certain arguments made by Brazil in the panel proceedings, but there is no justification for rewriting the conclusions of the panel in this way.

4.04 An examination of the panel's finding indicates that the United States contention simply has no basis. In paragraph 8.1(g)(i) the panel made a finding about "the effect of the mandatory price-contingent United States subsidy measures". The finding was that these measures constituted "significant price suppression". The descriptive reference to "marketing loan programme payments, user marketing (Step 2) payments, MLA payments and CCP payments" does not alter the nature of the finding. Payments are not mandatory subsidy measures; they are simply the means by which the subsidy measures are implemented.

4.05 Moreover, it is quite clear that the panel's analysis of the subsidy measures that caused price suppression was of the programmes under the FSRI under which payments are made. The panel determined that the marketing loan payments are mandatory by reference to the "text of the measure".[3] The "measure" here is the marketing loan programme, not the payment itself. The panel states, "the structure, design and operation of the marketing loan programme has enhanced production and trade-distorting effects"[4]. Again, it is the programme under which the payments were made that was being considered by the panel, not just specific payments.

4.06 The United States claims that the statement of the panel in paragraph 7.1501 that "the United States is obliged to take action concerning its present statutory and regulatory framework as a result of our ‘present' serious prejudice finding" is not a recommendation of the panel, and thus presumably is not binding on the United States. What this argument ignores, however, is that although not a recommendation as such, the statement is relevant to understanding the findings of the

[3] Panel Report, *United States – Subsidies on Upland Cotton* WT/DS267/R, 8 September 2004, paragraph 7.1291.

[4] *Ibid*, paragraph 7.1295.

panel. It gives meaning to the finding in paragraph 8.1(g)(i) relating to the "United States subsidy measures" that constituted significant price suppression.

4.07 In short, read properly in the context of the panel's decision as a whole, the finding in paragraph 8.1(g)(i) is not limited to the specific payments in MY 1999-2002. It applies to the measures under which those payments are authorised and hence to the marketing loan and counter-cyclical programmes themselves.

4.08 Moreover, the United States distinction between payments and programmes leads to an absurd result. It means that serious prejudice would have to be proved annually in the light of payments that have been made by which time the adverse effects have already occurred and it would be too late to withdraw the measure that caused them. To argue that the panel was referring only to payments in MY 2002 makes nonsense out the panel's own reference to Article 7.8 of the SCM Agreement and to the requirement to withdraw the subsidy. How can a subsidy be withdrawn if in fact the subsidy is over and the subsidizing effect is past? The United States arguments would simply undermine the disciplines on actionable subsidies in the SCM Agreement.

B. THE "MEASURES TAKEN TO COMPLY" ARGUMENT

4.09 The United States also argues that the marketing loan and counter-cyclical payments programmes are outside the scope of these Article 21.5 proceedings because they are not "measures taken to comply with the recommendations and rulings" of the DSB. According to the United States, "Article 21.5 applies only with respect to a disagreement as to the existence or consistency of a measure taken to comply", hence it cannot apply to programmes that existed at the time the matter came before the original panel and are unchanged. Under the United States logic, any such challenge to these measures has to be the subject of a new complaint.

4.10 In New Zealand's view, the United States argument ignores the fact that Article 21.5 is not the only relevant provision in these proceedings. In respect of the panel's finding under paragraph 8.1(g)(i), the obligation on the United States is found in Article 7.8 of the SCM Agreement. This provision grants the United States the choice either to withdraw the measures in question or to remove the adverse effects. Having chosen not to withdraw the marketing loan and counter-cyclical payments programmes, the United States cannot now avoid its obligation under Article 7.8 of the SCM Agreement to remove the adverse effects of those subsidy programmes by claiming that they are not measures taken to comply within the meaning of DSU Article 21.5. The United States cannot use the provisions of Article 21.5 to nullify its obligation under Article 7.8 of the SCM Agreement.

4.11 As pointed out in paragraphs 3.03 and 3.04 above, in applying Article 7.8 of the SCM Agreement to the present case the panel has to determine whether the measures causing serious prejudice have been withdrawn. In the case of the marketing loan and the counter-cyclical payments programmes they have not been withdrawn. The panel must then determine whether steps have been taken to remove the adverse effects found to exist by the original panel. It must then determine whether any steps that have been taken are "appropriate", that is whether they are measures that are capable of removing the adverse effects. DSU Article 21.5 cannot be invoked, as the United States seeks to do in this case, as a barrier to the panel conducting such an analysis.

V. THE SUBSTANTIVE CLAIMS

5.01 Brazil argues that even in the absence of the Step 2 payments programme, marketing loan payments and counter-cyclical payments alone cause significant price suppression. Indeed, Brazil argues that the removal of the Step 2 programme could increase counter-cyclical payments, thus adding to the significant price depression. Brazil also argues that marketing loan and counter-cyclical payments threaten to cause serious injury in MY 2006 and beyond. New Zealand supports these claims.

5.02 The United States response falls into three broad categories. First the United States argues that Brazil has not substantiated its claim that the effect of the Step 2 payments on price suppression was "relatively modest". Second the United States claims that Brazil is in effect arguing that the marketing loan and counter-cyclical payments *per se* violate the WTO Agreements, and that this could only occur if the programmes "mandate a breach" of those agreements, which the United States claims that they do not. Thirdly, the United States argues that Brazil has failed to make a *prima facie* case of the WTO inconsistency of the marketing loan and counter-cyclical payments programmes.

5.03 New Zealand will comment on each of these arguments, but before doing so will make a preliminary observation about the implications of the United States arguments in the context of an Article 21.5 case where the central question is whether there has been compliance with Article 7.8 of the SCM Agreement.

5.04 The essence of the arguments of the United States is that Brazil has the burden of showing that in the light of the removal of the Step 2 payments programme the marketing loan and counter-cyclical payments programmes cause or threaten serious prejudice, and it has failed to meet that burden. There is no doubt that as complainant in this Article 21.5 proceeding Brazil bears the burden of proof.[5] The question is what does such a burden entail?

5.05 In the present case, the DSB recommendations and rulings of 21 March 2005 covered three programmes; the Step 2 payments programme, the marketing loan payments programme and the counter-cyclical payments programme. But having chosen to remove only one of those programmes, the United States now claims that Brazil has the burden of showing that the remaining two programmes cause serious prejudice. Thus, in substance the United States is claiming that Brazil must prove again what it had already proved and what has been already been found by the original panel to cause serious prejudice. This cannot be the intent of either DSU Article 21.5 or Article 7.8 of the SCM Agreement. A Member should not have the burden of proving something that has already been decided by the original panel.

5.06 In New Zealand's view, Article 7.8 of the SCM Agreement operates to distribute the burden of proof somewhat differently. Since an implementing Member has the option of either withdrawing the subsidising measure or removing the adverse effects, a Member that fails to withdraw the measure in question then should have the burden of showing that it has removed the adverse effects. Thus, in the present case proof by Brazil that the measures found by the original panel to cause adverse effects have not been withdrawn should establish a *prima facie* case that implementation has not occurred and the burden should then shift to the United States to prove that the adverse effects caused by those subsidising measures have been removed.

A. THE UNITED STATES CLAIM THAT THE IMPACT OF THE REMOVAL OF STEP 2 PAYMENTS IS NOT "RELATIVELY MODEST"

5.07 Much of the United States argument that Brazil is incorrect in treating the impact of the removal of Step 2 payments as "relatively modest" is focused on what it perceived Brazil to be arguing before the original panel. But this is simply not relevant. Rather, it is what the panel decided and the actual impact of the removal of the Step 2 payment programme that is relevant. The original panel concluded that the marketing loan and counter-cyclical payments programmes contributed to

[5] Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R, 25 April 1997, p. 14.

price suppression and serious prejudice. In its First Written Submission Brazil has demonstrated that notwithstanding the withdrawal of the Step 2 payments programme, payments under the marketing loan and counter-cyclical payments programmes caused price suppression in the world market in MY 2005 and an increase in United States world market share in upland cotton in MY 2005. Thus, there is serious prejudice within the meaning of SCM Article 5(c).

5.08 The United States claim about the significance of the removal of the Step 2 payments programme is undermined by a comparison of the amounts paid under the various programmes. Step 2 payments are small compared to marketing loan and counter-cyclical payments. In the most recent year, 2005, for example, the Step 2 payments amounted to US$350 million. In the same year, the marketing loan and counter-cyclical programme payments amounted to US$2,170 million.[6] Similar ratios existed in most other years. There is no doubt that the removal of the Step 2 payment programme had some impact, but the United States cannot ignore the much larger volume of subsidisation under the two programmes that have not been withdrawn or modified.

5.09 The United States also seeks to counter Brazil's argument that eliminating Step 2 payments could result in a higher counter-cyclical payment rate by arguing that in the current year there could not be any increase in counter-cyclical payments. But, this is because counter-cyclical payments are already at their maximum rate.[7] In other words, the United States is not arguing that the counter-cyclical programme would not compensate for the elimination of the Step 2 payments; rather, it is arguing that payments are already so high that under current conditions no further payments can be made. None of this supports the United States contention that the programme does not have a price suppressing effect.

5.10 The United States also contends that Brazil fails to recognize that the elimination of Step 2 payments will result in a lowering of marketing loan payments. While this may be true because marketing loan payments are configured on world prices, which would increase with the elimination of Step 2 payments, what the argument ignores is the fact that these programmes are distorting whether or not payments are made under them. It is the programmes themselves not the payments that create expectations. Producers know that the loan rate is there to support them, that there is a target price[8] that they will receive either from the market or from the government. Neither the elimination of Step 2 payments nor any lowering of marketing loan payments in fact diminishes the distorting effect of the marketing loan and counter-cyclical programmes.

5.11 Finally, even the United States own figures show that the impact of the elimination of the Step 2 payment programme is modest. On one occasion it cites an increase of 0.4c/lb in the adjusted world price or $2.25 per ha[9] and on another occasion it cites an increase in the world price of 1.4c/1b or $2.30 per ha.[10] By comparison with the futures price in 2005-2006 (52.9-59.35 cents per pound)[11], loan rate (52 cents per pound)[12] or target price in the same period (72.4 cents per pound)[13], this effect on world prices of the elimination of the Step 2 payment programme is indeed "relatively modest".

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[6] *United States – Subsidies on Upland Cotton – Recourse by Brazil to Article 21.5 of the DSU* (DS267), First Written Submission of Brazil, 17 November 2006, ("Brazil First Written Submission"), para. 111, and Table 6.

[7] *United States – Subsidies on Upland Cotton – Recourse by Brazil to Article 21.5 of the DSU* (DS267), First Submission and Request for Preliminary Rulings of the United States, 15 December 2006, ("United States First Written Submission"), para. 162.

[8] United States First Written Submission, para. 161.

[9] United States First Written Submission, para. 174.

[10] United States First Written Submission, para. 169.

[11] United States First Written Submission, para. 231.

[12] *Ibid*.

[13] United States First Written Submission, para. 161.

5.12 The United States arguments leave intact the fundamental point made by Brazil, that even in the absence of the Step 2 payment programme, the marketing loan and counter-cyclical programmes still result in significant price suppression within the meaning of Article 6.3(c) of the SCM Agreement and thus cause serious prejudice contrary to Article 5(c) of the SCM Agreement.

B. THE UNITED STATES CLAIM THAT MARKETING LOAN AND COUNTER-CYCLICAL PAYMENTS PROGRAMMES DO NOT MANDATE A BREACH OF THE WTO AGREEMENTS

5.13 The United States claims that Brazil cannot challenge the marketing loan and counter-cyclical payments programmes unless it can show that these programmes mandate a breach of the WTO agreements. In the United States view, to do so Brazil would have to show that these programmes mandated actions that must lead to the effect of causing serious prejudice to Brazil, and Brazil has not done so.

5.14 Once again, the United States is ignoring the fact that the original panel had already determined that payments under the programmes in question caused serious prejudice to Brazil. Equally, the United States is ignoring the fact that the question in this case is not whether the programmes in question require that adverse effects are caused to Brazil, but whether the United States has taken appropriate steps to remove the adverse effects found by the original panel to exist as a result of the operation of these programmes. In this context, the mandatory/discretionary distinction called in aid by the United States is simply irrelevant.

C. THE UNITED STATES CLAIM THAT BRAZIL HAS FAILED TO MAKE A *PRIMA FACIE* CASE OF WTO INCONSISTENCY OF THE MARKETING LOAN AND COUNTER-CYCLICAL PAYMENTS PROGRAMMES

5.15 As pointed out earlier, the United States arguments on the WTO-consistency of the marketing loan and counter-cyclical payments programmes are tantamount to placing on Brazil a burden to prove once again what it had already proved before the original panel. In New Zealand's view such an approach to the application of Article 7.8 of the SCM Agreement risks depriving the actionable subsidies provisions of the SCM Agreement of their proper effect. Furthermore, New Zealand sees many of the arguments of the United States as attempts to reargue what it argued before the original panel, and lost. Again, such an approach is consistent with the objectives of neither DSU Article 21.5 nor Article 7.8 of the SCM Agreement.

1. Counter-cyclical Payments

5.16 The United States attempts to counter Brazil's arguments about the trade-distorting effects of counter-cyclical payments by blurring the line between counter-cyclical payments and decoupled payments. Thus, it cites studies relating to decoupled payments and says that they provide "valuable insights".[14] The United States also refers to studies concerning general wealth risks[15], as if they were equally applicable to the revenue risk that counter-cyclical payments are concerned with, again treating counter-cyclical payments as co-extensive with decoupled payments. But counter-cyclical payments are not real decoupled payments.

5.17 Real decoupled payments are green box measures and as defined in Annex 2 of the Agreement on Agriculture cannot be linked to the type or volume of production (paragraph 6(b)), or be related to or based on prices (paragraph 6(c)). Counter-cyclical payments, by contrast, are clearly and explicitly linked to prices. The fact that in many years such payments are likely to be paid out at

[14] United States First Written Submission, para. 213.
[15] United States First Written Submission, para. 209.

the maximum rate[16] does not change the fact that they are linked to prices. The question is what would farmers do differently if there were no counter-cyclical payments and farmers were, essentially, "guaranteed" 13.73c/lb less for their cotton? Counter-cyclical payments are clearly not green box measures and hence are presumptively trade distorting.

5.18 The same fallacy of linking counter-cyclical payments to decoupled payments is found in the United States arguments about the increase in wealth from counter-cyclical payments accruing to non-operator landlords and hence capitalised into higher land values.[17] While this is certainly true of real decoupled payments, it is simply not plausible in the case of counter-cyclical payments. What producer is going agree to the "modified rental arrangements" that the United States refers to[18], when counter-cyclical payments could be at 13.73 c/lb one year and at zero the next?

2. Marketing Loan Payments

5.19 The United States claims that Brazil has failed to demonstrate that marketing loan payments are having significant price-distorting effects. Yet the proposition that marketing loan payments are distorting is almost self-evident. Marketing loan payments are amber box measures, the category in which are included the non-prohibited measures with the most distorting effect on production and trade.

5.20 Moreover, the United States arguments about marketing loan payments ignore once again that it is the expectations of producers that are important and that those expectations are generated because of the existence of the applied administrative prices under the marketing loan programme, not because of the financial transfers in any year. Thus, the United States argument that since cotton futures prices in MY 2006 were higher than the loan rate then the loan rate would have no effect on producers planting decisions[19] misses the point. First, the loan rate will not always be below the futures prices; in some years there have been large amounts paid out under the marketing loan programme.[20] Second, the programme offers a guarantee by the government that producers will receive a particular price whether they are involved in the futures market or not.

5.21 Furthermore, the United States claims that at the time of planting producers "*did not expect*" that they would receive these payments on harvest[21] is a clever play on the word "expect". No doubt producers hoped that they would receive a higher price. But what they certainly expected was that they would receive at least the guaranteed price of 52c/lb, regardless of what happened in the market place, because that is what the law mandated. As the Appellate Body pointed out in the original proceeding[22]:

> … although farmers had expected higher prices in making their planting decisions, they were also aware that if actual prices were ultimately lower, they would be "insulated"[23] by government support, including not only marketing loan program payments but also counter-cyclical payments, …

[16] United States First Written Submission, para. 211.
[17] United States First Written Submission, paras. 216-219.
[18] United States First Written Submission, para. 216.
[19] United States First Written Submission, para. 230.
[20] United States First Written Submission, para. 248.
[21] United States First Written Submission, para. 231. (Emphasis in original.)
[22] Appellate Body Report, *United States – Subsidies on Upland Cotton*, 3 March 2005, WT/DS267/AB/R, ("*U.S. – Upland Cotton (AB)*"), para. 445.
[23] Panel Report, *United States – Subsidies on Upland Cotton*, 8 September 2004, WT/DS267/R, ("*U.S. – Upland Cotton (Panel)*"), para. 7.1294.

5.22 Thus, it was the guarantee of insulation that was affecting planting decisions – whether the price was received from the market or the government was immaterial. In fact, it is most unlikely that the farmers give the same weight to futures prices as to the guaranteed loan rate. To do so would require them to sell all their crops forward at the future rate and take the risk that their actual production would allow them to meet their forward commitments – in effect to take the production risk from which marketing loan programme payments based on actual production was protecting them.

3. Marketing Loan and Counter-Cyclical Payment Programmes and Market Signals

5.23 Much of the United States argument is directed to trying to demonstrate a link between producer decisions and market signals. However, the United States does not and cannot demonstrate that planting decisions of producers were shaped by market factors. The United States failed to do so before the original panel and the Appellate Body, and its attempt to reargue the matter in these Article 21.5 proceedings is equally ineffective.

5.24 The United States argues that the fact that the United States share of production has been stable over the life of the marketing loan and counter-cyclical programmes indicates that the programmes are not insulating producers from market signals.[24] But, the question is not whether United States share of production has been stable it is whether in the absence of the marketing loan and counter-cyclical payments programmes the United States market share would be at current levels. And the answer to that question would have to be no. The United States says that Brazil's claim that "*But for* the effect of price-contingent U.S. marketing loan and counter-cyclical payments, it would be expected that non-subsidized producers, such as those in Brazil and West and Central African countries, would have significantly increased their share of production and exports in the world market"[25] simply assumes its own conclusion.[26] But this is just assertion not argument, and thus the United States has no response to Brazil's position.

5.25 The United States argues that there is an inconsistency between Brazil's assertion that there is no link between prices and United States acreage, production and exports, and its claim that the United States is the single most important market influencing world market prices.[27] If the United States is the single most important market influencing world prices, the United States says, then surely there must be a link between world prices and United States planted acreage, production and exports. But the inconsistency is of the United States own making. The link is not between world prices and United States production. It is between domestic, guaranteed prices and United States production. And, that of course, is the source of the problem.

5.26 The United States claim that at the time of planting a farmer "cannot *know* what final prices and final costs will be,"[28] says less than meets the eye. What the farmer does know is that for all cotton harvested the price will be at least the loan rate. In addition, if market price is not significantly above the loan rate and the planting is on base acres there will be a counter-cyclical payment top-up (albeit based not on actual production, but on average yields in earlier years). So, if the farmer continues to produce cotton the expected return is going to be around the target price for most production on base acres. By contrast, cotton producers in Africa or Brazil know that they will get only the world price – whatever that is.

[24] United States First Written Submission, para. 243.
[25] Brazil First Written Submission, para. 90.
[26] United States First Written Submission, para. 251.
[27] United States First Written Submission, para. 254.
[28] United States First Written Submission, para. 255. (Emphasis in original.)

5.27 The United States contests Brazil's claim that the marketing loan and counter-cyclical payments programmes play an essential role in ensuring that producers cover their long-term costs of production and that in the absence of these programmes producers would switch to alternative crops.[29] It is, in the United States view, variable costs not long-term costs that influence the decision on whether to continue or exit cotton farming. However, the United States claim that Brazil has provided no evidence that absent the payments farmers would exit cotton production[30] ignores the evidence that Brazil provides in fact.

5.28 In paragraph 11 of its First Written Submission, Brazil provides a table indicating total United States subsidies for upland cotton from MY 1999 to the present which demonstrates that in some years over half of the revenue received by United States cotton farmers comes from subsidies. The idea that if these subsidies were not there, producers who have been deprived of half of their income would carry on planting cotton – business as usual – is little short of absurd. Brazil also points out that without marketing loan and counter-cyclical payments between MY 2000-2005 United States cotton producers would have lost US$663 per acre.[31] No rational economic operator would continue to plant cotton under such conditions.

5.29 Furthermore, the United States claims that a substantial number of producers would not be affected by a reduction or elimination of payments because they plant on farms with no base acres or plant in excess of a farm's base acres[32], presents only part of the picture. While base acre yields are the basis for determining eligibility for counter-cyclical payments, they are irrelevant for determining marketing loan payments. So the producers who the United States claims would not be affected by the reduction or elimination of payments would in fact miss out on marketing loan payments if they were reduced or eliminated.

4. The Reliability of the Econometric Modelling

5.30 The United States claims that the econometric modelling provided by Brazil is flawed, but the United States arguments are either an attempt to reargue what was litigated before the original panel and the Appellate Body and lost, or are inconsequential. New Zealand will offer a few observations on the United States claims in this regard.

5.31 The United States makes much of the fact that in his new model Dr. Sumner has increased his United States cotton supply elasticity to 0.8.[33] However, as an alternative model to capture long run effects the United States proposes the ATPSM model which also has a United States cotton supply elasticity of 0.8![34] Moreover, the United States conveniently ignores footnote 301 in Brazil's submission[35] where it is stated "Brazil notes that Professor Sumner also ran 12 simulations using an even more conservative supply elasticity of 0.5. The results of this exercise demonstrate the robustness of the supply and price effects…."

5.32 The United States criticises Dr. Sumner for making a small change to the rest of the world (ROW) demand elasticity, -0.2 as opposed to -0.25. But this 0.05 change is a small change in relation

[29] United States First Written Submission, para. 292.
[30] United States First Written Submission, para. 297.
[31] Brazil First Written Submission, para. 158.
[32] United States First Written Submission, para 298.
[33] Brazil First Written Submission, Annex I, paras. 10-21.
[34] United States First Written Submission, Annex I, Table A7.
[35] Brazil First Written Submission, para. 171.

to the alternatives that the United States then offers, i.e. a range of 0.45 between different scenarios.[36] How can the United States claim that its own estimates have a more solid statistical basis than those used by Dr. Sumner? In fact, Dr. Sumner's demand elasticities are little different from those he used in the earlier proceeding, which were implicitly found to be credible by the original panel and Appellate Body.

5.33 Although the United States notes that the coupling factor used by Dr. Sumner is the same as the one he used in his original model[37], it then goes on to criticize the size of that factor. Once again, the United States is attempting to relitigate what had already been found to be credible by both the panel and Appellate Body in the original proceeding. In any event, while the price effects are not enormous under the United States parameters, the effect on exports - especially in the long-term – certainly is.

5. Increase in the World Market Share

5.34 The United States contests Brazil's claim that the effect of the marketing loan and counter-cyclical payments programmes is to increase the United States world market share in upland cotton and hence constitutes serious prejudice within the meaning of Article 6.3(d) of the SCM Agreement. But in seeking to show that there has been no increase in United States market share, the United States is once again addressing the wrong question.

5.35 The essence of Brazil's argument is that the United States market share is higher than it would otherwise be and that this is because of the marketing loan and counter-cyclical payments programmes. Thus, the United States arguments that its market share has not increased over the period in question are simply not relevant. Moreover, the United States own analysis proves Brazil's point. In its critique of Dr. Sumner's analysis, the United States indicates that the long-term effect of the elimination of marketing loan and counter-cyclical payments would be a reduction in United States cotton exports of up to 25 per cent in 2002-2005 and 17 per cent in 2006-2008.[38] That is a very clear measure of what United States world market share would be in the absence of the marketing loan and counter-cyclical payments programmes.

5.36 In short, the United States itself makes the *prima facie* case under Article 6.3(d) of the SCM Agreement that it claims that Brazil has been unable to make.

VI. CONCLUSION

6.01 In conclusion, in New Zealand's view, Brazil has demonstrated that the United States has failed either to withdraw the marketing loan and counter-cyclical payments programmes or to remove the adverse effects of those programmes as required by Article 7.8 of the SCM Agreement. Accordingly, the United States has failed to comply with the recommendations and rulings of the DSB of 21 March 2005.

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[36] The ROW demand elasticities used by the United States range from -0.39 to -0.84. United States First Written Submission, Annex I, Table A7.

[37] United States First Written Submission, Annex I, para. 31.

[38] United States First Written Submission, Annex I, Table A8.

ANNEX B

REBUTTAL SUBMISSIONS OF THE PARTIES

ANNEX B-1

EXECUTIVE SUMMARY OF THE REBUTTAL SUBMISSION OF BRAZIL

(Executive summary submitted on 18 January 2007)

1. Brazil's First Written Submission set out its claims regarding the existence and consistency of United States ("U.S.") measures taken to comply with the adverse effects- and export subsidy-related recommendations and rulings of the Dispute Settlement Body ("DSB") in this dispute. In its Rebuttal Submission, Brazil demonstrates that none of the arguments raised by the United States in its First Written Submission has merit or rebuts Brazil's claims.

ADVERSE EFFECTS-RELATED ARGUMENTS

2. With respect to the adverse effects-related arguments, Brazil addresses, first, four issues raised by the United States that cut across all of Brazil's adverse effects-related claims. Brazil then rebuts the substantive arguments raised by the United States.

3. *First*, the United States asserts that the appropriate year for the compliance Panel to consider is marketing year ("MY") 2006. Brazil disagrees. The compliance Panel should conduct its analysis of Brazil's claims based on MY 2005, the most recent marketing year for which complete data is available. The United States assertion that MY 2006 is a more appropriate year contradicts the United States' own view in the original proceeding that the most recent period for which complete data are available is the appropriate period.

4. *Second*, the United States challenges, either directly or indirectly, a number of findings of the original panel regarding both the nature and the effects of the U.S. marketing loan and counter-cyclical subsidies and the nature and extent of the influence of U.S. production and exports on the world market price of upland cotton. In assessing Brazil's serious prejudice claims, the compliance Panel should rely on the findings of the original panel and Appellate Body. Article 21.5 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU") is not intended or designed to allow a Member to re-litigate findings by the original panel, as upheld by the Appellate Body.

5. *Third*, the United States argues that Brazil is raising an "as such" claim against the U.S. marketing loan and counter-cyclical payment programs, and that Brazil has failed to demonstrate that these programs mandate a breach of Articles 5 and 6.3 of the *Agreement on Subsidies and Countervailing Measures* ("*SCM Agreement*"). However, Brazil's claims do not distinguish between the adverse effects caused by the statutory and regulatory framework of the programs under the Farm Security and Rural Investment Act ("FSRI Act") of 2002, and the adverse effects caused by the mandatory and price-contingent payments flowing therefrom. Instead, Brazil's claims concern the adverse effects caused by U.S. "subsidies," in terms of their "effects" on U.S. production, exports and the world market price of upland cotton. This approach is consistent with the provisions of Part III of the *SCM Agreement* and the original panel's findings.

6. *Fourth*, the United States asserts that it did not have sufficient time to respond to Brazil's threat of serious prejudice claims and that it will respond in its forthcoming submission. This unilateral decision by the United States violates the *Working Procedures of the Panel* and prejudices Brazil's ability to rebut such U.S. arguments. Brazil requests that the compliance Panel reject any

factual evidence and accompanying arguments submitted in the U.S. rebuttal submission regarding Brazil's claims that if faces a threat of serious prejudice.

7. Turning to the substantive issues regarding Brazil's adverse effects-related claims before the compliance Panel, the United States first asserts that the removal of the Step 2 subsidy is sufficient to remove the adverse effects caused by the price-contingent subsidies under the FSRI Act of 2002. This U.S. argument implies that the Step 2 subsidy – but *not* the marketing loan or counter-cyclical subsidies – was *the sole* cause of the serious prejudice found by the original panel and Appellate Body to exist during the period MY 1999-2002, as well as the *sole cause* of any serious prejudice that resulted from these three subsidies under the FSRI Act of 2002 during the period MY 2003-2005. It also implies that the United States considers the far larger and more trade-distorting marketing loan and counter-cyclical subsidies, which accounted for 42 percent of the market value of upland cotton production in Marketing Year ("MY") 2005, to have no production, export or world price effects. Much of Brazil's rebuttal submission demonstrates that this argument is false. Marketing loan and counter-cyclical payments insulate U.S. producers from market forces, maintain high levels of upland cotton planted acreage, production and exports and significantly suppress world market prices.

8. The United States argues at length that the repeal of the Step 2 subsidy will not increase counter-cyclical payments in MY 2006 and will reduce marketing loan payments. The United States also asserts that, since counter-cyclical subsidies are currently at their maximum level, they will not increase in the forthcoming year. However, studies by both the Food and Agriculture Policy Research Institute ("FAPRI") and a U.S. government agency reveal that the repeal of the Step 2 subsidy will not cause any meaningful reduction in U.S. marketing loan subsidies. Moreover, the United States argument that counter-cyclical subsidies will be at there maximum, if anything, demonstrates that the removal of the Step 2 subsidy will be insufficient to remove adverse effects. An examination of U.S. upland cotton producers' revenue demonstrates the critical importance of marketing loan and counter-cyclical payments relative to Step 2 payments. While the elimination of Step 2 payments is expected to reduce upland cotton producer's revenue by $9 per acre per year, marketing loan payments and counter-cyclical payments provided U.S. upland cotton producers with revenue of $84 per acre and $75 per base acre, respectively, in MY 2005.

9. The United States argues that the decline in U.S. exports in the beginning of MY 2006 demonstrates that the removal of the Step 2 subsidy had a large impact. The decline in U.S. exports in the first few months of MY 2006 can largely be explained by market conditions. Any additional decline from the elimination of Step 2 payments is the result of a temporary surge of exports preceding the elimination of Step 2 subsidies and a subsequent lull following Step 2's elimination. Domestic mill users and exporters naturally sought to take advantage of a lucrative export subsidy while it lasted. However, USDA predicts U.S. exports to increase significantly in the remainder of MY 2006. Indeed, USDA predicts U.S. upland cotton exports will be the second largest on record in MY 2006, slightly less than the record established in MY 2005.

10. Finally, contrary to the United States' assertion, Brazil's arguments about the effect of Step 2 payments before this compliance Panel are consistent with Brazil's position before the original panel and Appellate Body. The Step 2 subsidy had two principal effects. One was to increase upland cotton producers' revenue. However, this effect was indirect and much less important in stabilizing upland cotton producers' revenue than the far larger marketing loan and counter-cyclical subsidies. A second effect of the Step 2 subsidy was to make U.S. upland cotton competitive in the world market at all times, thereby suppressing world market prices. While the elimination of the Step 2 subsidy eliminated this second effect, upland cotton producers' revenue is still insulated from market prices by marketing loan and counter-cyclical subsidies. Thus, Brazil's assertion that the elimination of the Step 2 subsidy will have a relatively modest impact on the volume of U.S. upland cotton production and exports is consistent with a finding that the elimination may also increase world market prices.

11. In its First Written Submission, the United States addresses some of Brazil's arguments establishing a causal link between marketing loan and counter-cyclical subsidies and significant price suppression in the world market for upland cotton.

12. *First*, ignoring the findings of the original panel, the United States argues that marketing loan and counter-cyclical payments have no significant production, export or price effects. The derelict U.S. argument that upland cotton producers do not expect to receive marketing loan payments was rejected by both the original panel and Appellate Body. Brazil demonstrates that *U.S. producers have expected to receive marketing loan payments every year since MY 1999*. The United States makes similarly shoddy arguments with respect to the effect of counter-cyclical payments. Economic literature confirms that counter-cyclical payments are trade-distorting and not generally capitalized into land values. Finally, the (incomplete) data on base and planted acreage presented by the United States confirms that U.S. farmers continue to overwhelmingly plant upland cotton on upland cotton base acreage. Over 95 percent of farms that grow upland cotton receive upland cotton counter-cyclical payments.

13. *Second*, the United States argues that Brazil solely characterizes the size of marketing loan and counter-cyclical payments as "large," "very large," "huge" and "massive," but does not address their structure, design or operation. This assertion is baseless. Brazil established the structure, design and operation of marketing loan and counter-cyclical payments in Section 7.8 of its First Written Submission. In rebutting the U.S. arguments, Brazil elaborates on this further. Furthermore, the magnitude of U.S. subsidies was an important factor in the original panel's price suppression analysis and continues to be an important factor before this compliance Panel.

14. *Third*, relying on the stable U.S. share of world production and exports, the United States argues that U.S. upland cotton producers are not insulated from market prices. The United States' arguments ignore, and effectively ask this compliance Panel to overturn, one of the central findings of the original panel and the Appellate Body – that the structure, design, and operation of the marketing loan and counter-cyclical subsidies "insulates" U.S. upland cotton producers from market forces by stabilizing their revenue at very high levels and allow them to sustain artificially high levels of planted acreage, production and exports.

15. *Fourth*, the United States argues that there is no connection between large marketing loan and counter-cyclical payments and increased U.S. production of upland cotton. Instead, the United States asserts that the increase can be attributed to high yields. Brazil disagrees. But for the challenged subsidies, no increased yields would have been harvested (because no upland cotton would have been planted) on a significant portion of U.S. upland cotton acreage. This would have resulted in a significant drop in overall U.S. planted acreage, production and exports.

16. *Fifth*, the United States argues that Brazil has failed to demonstrate a temporal coincidence between marketing loan and counter-cyclical subsidies and suppressed world market prices. While many of the same factors relied on by the original panel to make this determination exist today (*i.e.*, increasing absolute levels of U.S. production and exports), other factors, such as the U.S. share of world production and exports and prices have been relatively stable under the FSRI Act of 2002. However, this stability does not indicate that marketing loan and counter-cyclical subsidies have little or no effects. Rather, the constant stream of payments from these two mandatory, price-contingent subsidies has *maintained* existing significant price suppression. It is remarkable that the United States would assert that this relatively stable state of affairs – which continues only because of the United States' failure to implement the recommendations and rulings of the DSB – somehow reflects the *absence* of a causal link between these subsidies and significant price suppression. Indeed, Brazil's very claim in these proceedings is that the U.S. marketing loan and counter-cyclical subsidies have not changed, and continue to cause serious prejudice to the interests of Brazil.

17. *Sixth*, the evidence before the compliance Panel shows that the average upland cotton producer continues to be unable to cover its long-term total production costs with market revenue. While the United States acknowledges that producers must cover their total costs in the long term, the United States asserts that upland cotton farmers cross-subsidize upland cotton production with returns from other crops and off-farm revenue. Just as this argument was rejected by the original panel, so it should be rejected by the compliance Panel. Furthermore, an examination of the United States Department of Agriculture ("USDA") cost of production data demonstrates that a significant portion of U.S. upland cotton producers are unable to, and do not expect to, cover even their variable costs of production, when adjusting for the improper U.S. definition of variable costs. This suggests that, even in the short term, a significant portion of U.S. upland cotton production is not economically viable without marketing loan and counter-cyclical payments. Finally, the International Cotton Advisory Committee ("ICAC") comparison of production costs in different countries does offer further confirmation that U.S. upland cotton farmers are high cost producers.

18. *Seventh*, the United States criticizes the results of the study by Professor Daniel Sumner, presented in Brazil's First Written Submission, as overstated and inconsistent with economic literature. However, a single study from the U.S. Journal of Cotton Science cited by the United States provides no basis for this compliance Panel to ignore the substantial academic literature in agricultural economics that finds large world market price effects arising from U.S. cotton subsidies. Indeed, the general consensus of the economic literature is that U.S. cotton subsidies increase production and exports and drive down the world price of cotton. While studies find effects of different magnitudes based on different assumptions, many economists agree that world prices would be some 10 to 25 percent higher in the absence of cotton subsidies. As the largest subsidizing country in the world, the United States accounts for the majority of these effects. These results are consistent with and confirmed by Professor Sumner's 2003 and 2006 analyses.

19. *Eighth*, whether Chinese supply, as the United States argued in the original proceeding, or Chinese demand, as the United States currently argues, is responsible for certain price movements in the world market for upland cotton is irrelevant to Brazil's claim. What is important is whether large reductions in U.S. production and exports following a removal of marketing loan and counter-cyclical subsidies would result in significantly higher prices in the world market for upland cotton. The original panel found that the United States had a substantial proportionate influence on prices in the world market for upland cotton. Nothing has changed in this respect. Large amounts of U.S. upland cotton continue to be produced and exported to world markets. China's emergence as a large importer of upland cotton does not in any way alter this dynamics.

20. *Finally*, the U.S. arguments do not refute the strong *prima facie* case that marketing loan and counter-cyclical payments resulted in an increased U.S. world market share of production, as established in Brazil's First Written Submission. The United States does not dispute that there has been an increase in the U.S. world market share of production in MY 2005, as compared to the three year average in MY 2002-2004. Further, the evidence shows that *but for* the marketing loan and counter-cyclical payments in MY 2005, the U.S. market share would not have increased, but, rather, would have fallen sharply. Finally, none of the alternative periods offered by the United States to assess a consistent trend of increased market share covers periods relevant to an assessment of how the two subsidies at issue in this dispute – marketing loan and counter-cyclical subsidies (or their predecessors) – distort U.S. production, exports, and the U.S. world market share of production.

EXPORT SUBSIDY-RELATED ARGUMENTS

21. In its First Written Submission, Brazil demonstrated that the United States' "measures taken to comply" with the DSB's export credit guarantee ("ECG")-related recommendations do not exist in some respects, and to the extent they do exist, are not consistent with Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*. As a result, the

United States has failed to implement the DSB's recommendation that it withdraw the prohibited ECG-related subsidies without delay, under the *SCM Agreement*, and otherwise bring itself into conformity with its obligations, under the *Agreement on Agriculture*.

22. In its First Written Submission, the United States challenges Brazil's claim that, following adoption of the United States' implementation measures, ECGs extended under the General Sales Manager 102 ("GSM 102") program still constitute export subsidies. In so doing, the United States wildly overstates the impact of its limited ECG-related "measures taken to comply" with the recommendations and rulings of the DSB in this dispute. None of the facts highlighted by the United States demonstrates that the GSM 102 program, as amended by the United States' measures taken to comply: (i) results in the provision of GSM 102 ECGs on terms that are consistent with market; (ii) results in premium rates which are adequate to cover the program's long-term operating costs and losses; or, (iii) avoids circumvention of the United States' export subsidy commitments.

23. The United States raises five principal arguments in its First Written Submission. Brazil addresses each of these arguments below.

24. *First*, the United States asserts that Brazil may not, in these Article 21.5 proceedings, challenge the United States' application of GSM 102 in a manner that results in circumvention of U.S. export subsidy commitments for pig meat and poultry meat. The United States asks for a preliminary ruling from the compliance Panel in this regard. Brazil did not address the United States' request in this Rebuttal Submission, but instead replied to the U.S. arguments in a further submission on 16 January 2007.

25. *Second*, the United States asks the compliance Panel to reject Brazil's claim that no measures taken to comply exist with respect to ECGs issued under the GSM 102, General Sales Manager 103 ("GSM 103") or Supplier Credit Guarantee ("SCGP") programs prior to 1 July 2005, but still outstanding subsequent to that date, for two reasons: (a) a finding by the compliance Panel would be moot with respect to SCGP ECGs issued prior to 1 July 2005, since the maximum tenor for a SCGP ECG is 180 days and no such ECGs are therefore still outstanding; and, (b) the recommendations and rulings of the DSB required the United States to "withdraw the subsidy," which the United States asserts it has effectively accomplished by changing the fee structure for GSM 102 and halting the issue of GSM 103 and SCGP ECGs.

26. Given the impact of "reschedulings" of debt guaranteed by the program, SCGP ECGs issued prior to 1 July 2005 may well still be outstanding today. Also, ECGs outstanding subsequent to 1 July 2005 were issued under the fee schedule on which the original panel and the Appellate Body based a finding of export subsidization under item (j) of the Illustrative List of Export Subsidies in Annex I to the *SCM Agreement* ("item (j)"), and therefore form an essential part of the recommendation to "withdraw the subsidy." Payments or performance under those outstanding ECGs is inconsistent with the DSB's recommendation to "withdraw the subsidy."

27. *Third*, the United States asserts that item (j) constitutes the exclusive test to determine whether an ECG program constitutes an export subsidy. The United States is essentially proposing an *a contrario* reading of item (j), under which proof that the GSM 102 program meets its long-term operating costs and losses would render the program immune from challenge as an export subsidy under the elements of Articles 1.1 and 3.1(a) of the *SCM Agreement*.

28. The interpretation offered by the United States is not supported by footnote 5 to the *SCM Agreement*; proving that GSM 102 charges fees sufficient to meet its long-term operating costs and losses would not absolve the United States of the obligation to abstain from providing *de jure* export-contingent GSM 102 ECGs at fees that confer "benefits" on U.S. exporters (to the extent doing so circumvents U.S. export subsidy commitments under the *Agreement on Agriculture*). Moreover,

available data does not demonstrate, as the United States asserts, that the ECG programs are profitable. The GSM 102 program is not structured, designed or operated to meet the long-term operating costs and losses of the programs.

29. *Fourth*, the United States appears to assert that, even if the definition of export subsidy in Articles 1.1 and 3.1(a) of the *SCM Agreement* applies to ECGs, the only applicable standard to determine whether a "benefit" is conferred, within the meaning of Article 1.1(b), is the standard embodied in Article 14(c) of the *Agreement*. Article 14(c) calls for an assessment of the impact of a government guarantee on the cost of an underlying loan, relative to the cost of the loan without the guarantee.

30. The United States argues that Brazil's approach, which consists of comparing GSM 102 fees with fees for comparable (albeit also non-market) products offered by the United States Export-Import Bank ("ExIm Bank"), does not constitute a "marketplace" comparison, since in this context, the "marketplace" contemplated under the *SCM Agreement* is not the cost of obtaining a guarantee for a one-off transaction on the export of agricultural commodities, but rather the total cost of funds at which borrowers and lenders are willing to enter commercial loans. The United States then asserts, on the basis of three examples, that commercial lenders provide loans to CCC-approved foreign obligors on better terms than available under the GSM 102 program.

31. In arguing that Article 14(c) is the exclusive standard by which to assess whether a "benefit" is conferred by a guarantee, the United States fails to recognize that there are a number of potential benefits and beneficiaries in a transaction supported by a GSM 102 ECG: the U.S. exporter; the U.S. bank; the foreign bank (referred to by Brazil as the "foreign obligor"); and the foreign purchaser/borrower. In undertaking a comparison between GSM 102 fees and fees for comparable ExIm Bank products, Brazil is undertaking to assess a severable "benefit" to the U.S. exporter. The U.S. exporter does not bear the costs or risks of securing or extending financing to the foreign bank or the foreign purchaser/borrower. Indeed, that is the entire point of GSM 102 – it takes the U.S. exporter out of the equation. Thus, the benefit to the U.S. exporter can be measured through an assessment of how GSM 102 fees line up against the fees for similar instruments.

32. Further, the three examples offered by the United States – without any reference to primary documents and based solely on a 2-page letter from an officer of a U.S. bank that participates in the GSM 102 program – do not demonstrate that the GSM 102 program is consistent with market even under the standard in Article 14(c).

33. *Fifth*, the United States argues that, in asserting that GSM 102 ECGs are unique financing instruments with no parallel at market, Brazil failed to consider certain products offered by the Inter-American Development Bank ("IDB"), the International Finance Corporation ("IFC"), and the European Bank for Reconstruction and Development ("EBRD"). The United States also suggests that Brazil should not have restricted its "benefit" assessment to a comparison between GSM 102 fees and fees for similar ExIm Bank products, but instead should also have compared GSM 102 fees to fees for IDB, IFC and EBRD products.

34. Consideration of the IDB, IFC and EBRD products discussed by the United States does not affect Brazil's conclusion that GSM 102 ECGs are unique financing instruments with no parallel at market, because *the IDB, IFC and EBRD are not commercial banks offering market products*. For this same reason, like ExIm Bank fees, IDB, IFC and EBRD fees are distorted by government intervention. Providing additional comparisons between GSM 102 fees and IDB, IFC and EBRD fees is not necessary given the comparison Brazil has already offered to fees charged by U.S.-based ExIm Bank. In that regard, the United States offers no credible evidence to counter the thorough comparative exercise undertaken by Brazil with respect to ExIm Bank products.

ANNEX B-2

EXECUTIVE SUMMARY OF THE REBUTTAL SUBMISSION OF THE UNITED STATES

(Executive summary submitted on 12 February 2007)

1. <u>Preliminary Ruling Requests</u> **– Brazil has failed to rebut the U.S. showing that Brazil's claims relating to GSM 102 guarantees in respect of exports of pig meat and poultry meat are outside the scope of this proceeding.** Brazil concedes that there have never been any findings of WTO inconsistency against the pig meat and poultry meat GSM 102 guarantees, and that there consequently were no DSB recommendations and rulings against these measures with which the United States was obligated to comply. Thus, the claims made by Brazil against these measures are not properly the subject of a compliance proceeding under Article 21.5 of the DSU. Although Brazil contends that "Appellate Body jurisprudence" provides it with the right to "reassert" claims under the Agreement on Agriculture and the SCM Agreement with respect to these measures, Brazil is mistaken. It simply misreads the Appellate Body's report in *EC – Bed Linen (21.5 – India)* and continues to confuse two distinct issues – (a) the scope of a compliance proceeding pursuant to Article 21.5 of the DSU and (b) when a claim against a specific measure or aspect of a measure can be considered to be "finally resolved" for purposes of WTO dispute settlement.

2. – **Brazil has no basis to assert claims against either the marketing loan or counter-cyclical payment programs whether alone or in addition to payments under the programs.** Brazil clarifies in its rebuttal submission that it makes claims against the marketing loan and counter-cyclical payment *programs*, as such, *in addition* to all payments authorized thereunder. Even if so, however, Brazil's claims are outside the scope of this proceeding. <u>First</u>, there is no legal or factual basis for Brazil's argument that "[i]n the circumstances of this dispute, a subsidy 'payment' cannot be divorced from a subsidy 'program'" and the argument is undermined by Brazil's own claims and arguments in the original proceeding. Moreover, contrary to Brazil's assertions, the original panel did not make any finding of WTO-inconsistency against the Step 2, marketing loan, and counter-cyclical payment programs alone or in addition to payments. Consequently, there was also no actionable subsidy-related DSB recommendation with respect to these measures. Brazil's claims on the basis of such a mis-characterized recommendation are not properly within the scope of this compliance proceeding.

3. <u>Second</u>, the measures that Brazil seeks to challenge – marketing loan and counter-cyclical payment programs in addition to payments – are *not* measures taken to comply. Indeed, these measures have not been changed to implement any DSB recommendations and rulings or for any other reason; they remain the same as they were in the original proceeding. Under Article 21.5 of the DSU, claims of consistency with a covered agreement can not be made in respect of measures that are *not* measures taken to comply and that are the same measures as in an original proceeding. For this reason too, Brazil's claims – whether against the marketing loan and counter-cyclical payment programs or the programs in addition to payments thereunder – are not properly within the scope of this proceeding.

4. – **Brazil's claims regarding compliance in past periods remain outside the scope of this proceeding.** Brazil has yet to identify any legitimate textual basis for its claims regarding compliance in past periods. Rather, Brazil continues improperly to conflate Article 7.9 of the SCM Agreement and Article 21.5 of the DSU. Contrary to Brazil's assertions, the former provision does not establish the date for assessing compliance with DSU recommendations and rulings; it simply set the date on

which the complaining Member can seek authorization to take countermeasures "commensurate with the degree and nature of the adverse effects determined to exist," as Brazil alleges. In addition, it is not relevant whether "the assessment [of] whether any proposed countermeasures are commensurate" is "tied to the date on which the implementation period expires." In arguing that this provides a basis for assessing *compliance* as of the date set in Article 7.9 of the SCM Agreement, Brazil confuses the mandate of an arbitrator under Article 22.6 of the DSU with that of a compliance panel under DSU Article 21.5. Neither argument provides a legitimate basis for Brazil's claims regarding compliance in past periods.

5. Export Subsidies **– The United States is not providing export credit guarantees in contravention of Articles 10.1 and 8 of the *Agreement on Agriculture*.** The United States has demonstrated that even before (1) elimination of the GSM-103 program; (2) cessation of the Supplier Credit Guarantee Program ("SCGP"); (3) removal of the highest risk countries from program eligibility and (4) an average fee increase of 46 per cent, premia collected for the GSM-102, GSM-103, and SCGP were more than adequate to cover the long-term operating costs and losses of the programs. Indeed, the current U.S. budget data now reflects that for the cohorts 1992-2005, the applicable total net negative present value amount is **$166,549,780** (*i.e.*, reflecting a 'profit' – excluding administrative costs – to the United States government). Brazil's argument in response – asserting that these results were "specifically created by the United States for purposes of this litigation" – are entirely baseless. Moreover, Brazil's attempts to have the Panel disregard the budget data is inconsistent with the approach taken by the original panel as well as Brazil's positions in the original proceeding. Brazil's own constructed "cash-basis accounting methodology," which Brazil seeks to have the Panel use instead of the budget data provided by the United States, was not accepted by the original panel and is deeply flawed.

6. **– Contrary to Brazil's assertions, the GSM-102 Program is structured and designed to cover long-term operating costs and losses.** First, the size of the cash recoveries in conjunction with the substantial modifications to the export credit guarantee programs belie Brazil's assertion that "the GSM 102 program is not structured or designed to meet long-term operating costs and losses." Contrary to Brazil's assertions, the fact that CCC borrows from the U.S. Treasury in connection with the export credit guarantee programs does *not* mean the programs cannot satisfy the item (j) test. In addition, the fact that there remains a statutory one percent cap on fees under the export credit guarantee programs also does not affect the analysis; CCC has accounted for this fact by eliminating from eligibility **22 countries** with respect to which participation in the program might require fees in excess of the statutory maximum. And, finally, Brazil has no basis to argue that "prudent fiscal management" requires no only imposing the tight exposure limits that CCC employs, but also applying different fees for different banks, as Brazil would prefer.

7. Second, Brazil is incorrect to assert that CCC predicts every year, including for FY 2006 and 2007, that the export credit guarantee programs will incur losses. Brazil assumes (1) the specific experience of the CCC programs in particular are the historical experience used in the calculation of the original subsidy rates and (2) CCC itself provides the principal factors used in the calculation of the original subsidy rates. Both of these assumptions are false. It is the Office of Management and Budget ("OMB") that determines expected loss rates for CCC – and other government agencies – on a government-wide basis. These rates – which are applied to virtually all U.S. agencies providing international credits – are based on assumptions regarding risk and recovery rates involving the highest-risk countries and overstate possible losses in respect of CCC's export credit guarantees programs.

8. **– Whether or not any debt has been rescheduled under the SCGP is irrelevant to whether the United States has "withdrawn" any subsidy under the program.** There are currently no claims "outstanding" under the SCGP. This means that the United States has paid all claims that were payable and is no longer exposed to any further potential liability under the SCGP. Brazil's

argument to the effect that claims may still be outstanding under the program if the United States has rescheduled debt under the program either before or after 1 July 2005 are baseless. They betray a fundamental misunderstanding of the nature of rescheduled debt, which is a *receivable*, pursuant to which CCC expects to *receive – not pay* – money; rescheduled debt is *not* an outstanding *claim*.

9. **– The GSM 102 Program does not confer any benefit under Articles 1 and 3 of the SCM Agreement.** Although Brazil continues to pursue its "claim" under item (j) in the "alternative," it provides no textual basis for doing so. Brazil's approach does not comport with the text of the SCM Agreement or Brazil's own arguments in other disputes that, in the case of measures identified in the Illustrative List, it is the specific provisions of the Illustrative List – and not the general subsidy provisions in Articles 1.1 and 3.1(a) – that govern when the measures may be considered export subsidies. Nonetheless, the United States also shows that GSM 102 export credit guarantees do not confer a "benefit" within the meaning of Article 1.1(b) of the SCM Agreement. This further confirms the fact that item (j) correctly illustrates that GSM 102 export credit guarantees are not export subsidies.

10. Although it purports to make a showing under Article 14(c) of the SCM Agreement, Brazil has made no attempt to make a particularized showing that the overall cost, including fees, of *a loan* guaranteed by the government is less than that the firm receiving the guarantee would pay on a *comparable* commercial loan. Instead, Brazil seeks to advance a flawed "severable 'benefit'" approach that ignores the fundamental fact that costs are distributed among the parties involved. Because costs and potential benefits can both be shared in various ways among all participants in a loan transaction covered by a government guarantee, Article 14(c) focuses on the overall costs of the loan, including the guarantee fees, rather than any single "severable" component of the entire transaction. Brazil's approach is, thus, undermined by the text itself.

11. Unlike Brazil, the United States has provided specific information to demonstrate that sources of financing and guarantees comparable to GSM-102 guarantees are available in the marketplace. Brazil's attempts to discredit the specific, real-world evidence submitted by the United States are entirely unavailing. For example, Brazil attempts to dismiss the numerous examples of commercial products offered by the International Finance Corporation ("IFC"), Inter-American Development Bank ("IDB"), and the European Bank for Reconstruction and Development ("EBRD") that are directly comparable to GSM 102 guarantees. Brazil asserts that, by definition, anything that the IDB, IFC, and EBRD do in the market cannot be commercial and cannot be considered as a benchmark. Once again, Brazil's argument is baseless as a matter of logic and – given the clear evidence of the commercial and profitable nature of these organizations – as a matter of fact.

12. **<u>Actionable Subsidies</u> – Brazil's arguments about the "relatively modest" effects of the elimination of the Step 2 program continue to be unsubstantiated and inconsistent with its earlier positions.** Brazil's fails to substantiate its arguments aimed at minimizing the effects of eliminating the Step 2 program. <u>First</u>, regardless of whether one considers Brazil's "present" or "threat" of serious prejudice claims, there is no merit to Brazil's suggestion that an increase in counter-cyclical payments will offset any positive impacts of terminating the Step 2 program. To the contrary, terminating the Step 2 program *does* result in a decline in marketing loan payments in the few remaining years in which marketing loans are even projected to be paid. Moreover, any increase is counter-cyclical payments is unlikely to take place in the "present" marketing year (MY 2006) and, in future marketing years, it is unlikely to be substantial. This is irrelevant, in any regard, as both marketing loan and counter-cyclical payment programs are scheduled to expire at the end of MY 2007.

13. <u>Second</u>, Brazil continues to argue that the termination of the Step 2 program has had allegedly "relatively modest" *effects* because of the relatively smaller *size* of outlays under the Step 2, marketing loan, and counter-cyclical payment programs. However, Brazil fails to explain why *size* is the

determinative consideration in assessing their *effects*, especially given Brazil's arguments to the contrary to the Appellate Body as well as the *disproportionate* effects that Brazil attempted to attribute to the Step 2 program in the original proceeding.

14. Third, Brazil's new emphasis on the allegedly "modest revenue-enhancing effects" of the Step 2 program is undermined by its own arguments to the original panel that effects on revenue are only one way in which, in Brazil's view, Step 2 payments could have affected world market prices. Brazil argued before that "the *export-enhancing nature* of the Step 2 program" was the other, primary, way in which the Step 2 program affected world marketing prices. Indeed, although Brazil now attempts to downplay its attribution of an "export-enhancing" effect to the Step 2 program, these arguments are simply not credible.

15. Finally, data showing historically low export levels for MY 2006 continue to undermine Brazil's theory of a "relatively modest" impact of eliminating the Step 2 program. Brazil points to the importance of other factors – including the "specific needs of China" – in assessing changes in the world cotton market since MY 2006. However, even taking into consideration the impact of China's demand, U.S. exports appear to be at unusually low levels. Moreover, U.S. *share* of China's imports following termination of the Step 2 program are at unusually low levels. Similarly, the data do not support Brazil's suggestion that the low export levels can be explained by "a temporary surge of U.S. exports in the months just prior to the elimination of the Step 2 subsidy with exporters cleaning out the stocks in their warehouses to take advantage of the Step 2 subsidy."

16. **– Brazil has failed to make a *prima facie* case of "present" serious prejudice within the meaning of Articles 5(c) and 6.3(c) of the SCM Agreement.** As a preliminary matter, the United States notes that the marketing year relevant to Brazil's "present" serious prejudice claims is MY 2006. Where there is reliable data available for MY 2006, or any part thereof, there is no reason why the Panel should not consider that data and Brazil has no basis for suggesting that the data is not relevant.

17. *Brazil has not provided evidence regarding the structure, design, and operation of the marketing loan and counter-cyclical payment programs that supports its claims of significant price suppression:* Brazil has yet to submit any credible evidence confirming the significant production effects from counter-cyclical payments or marketing loan payments that it alleges. Moreover, Brazil has failed to rebut the U.S. evidence showing, with respect to the counter-cyclical payment program, that the recent studies show, at most, minimal production effects. Brazil attempts to discredit the U.S. studies by arguing, *inter alia*, that the studies do not deal specifically with upland cotton production. However, that is not a reason to preclude the Panel from considering the studies as being highly probative. Moreover, Brazil submits *no empirical evidence* of its own relating to upland cotton production that supports it claims. Indeed, the only study that it submits that even deals with counter-cyclical payments is not based on empirical evidence but, instead, was conducted in a computer lab at the University of Wyoming to test the responses of economics students under certain parameters that were necessarily abstracted from actual features of the 2002 Farm Act and imposed a number of limiting assumptions that the authors themselves recognized affected the results of the study.

18. In addition, Brazil fails to rebut the evidence showing that a substantial amount of government payments, including counter-cyclical payments, are "passed-through" to non-operator landowners in the form of higher land rent. Brazil's response confuses the issues and asserts, without basis, that uncertainty about receiving payments precludes capitalization into land values. That argument is inconsistent with the economic literature, Brazil's own arguments regarding U.S. producers' decisions to plant on the expectation of counter-cyclical payments, and the original panel's own findings. Brazil's assertions about the **"relatively minor" effects of decoupled payments on land values are equally unfounded.**

19. Brazil also fails to rebut the acreage data showing that, in fact, *holding upland cotton base acreage has not induced upland cotton production* as Brazil alleges. Brazil's attempts to dismiss these facts as "unimportant" are inexplicable and baseless. In fact, these facts *are* "important" and undermine Brazil's theory of significant production effects, especially Brazil's unfounded assertions regarding producing for the possibility of base updating.

20. With respect to marketing loan payments, Brazil fails to demonstrate that – taking into account the particular structure and design of the marketing loan program, and the way that it operates under the current market conditions – payments thereunder *are* in fact causing production effects that are so significant as to be suppressing the world market price for cotton. In particular, Brazil fails to analyze properly the planting decisions made by U.S. producers in light of the market conditions and considerations that they *actually* faced at the time of planting, even as Brazil concedes that this is the appropriate inquiry. Moreover, while Brazil attempts to discredit the U.S. analysis of producers' planting decisions, it has provided no legitimate basis for its arguments.

21. <u>*Brazil fails to provide any credible evidence showing that U.S. producers and exporters do not respond to market signals:*</u> The empirical evidence fatally undermines Brazil's theory that marketing loan and counter-cyclical payments insulate U.S. producers and exporters from market signals. Brazil has yet to provide any credible answer to the fundamental question in this regard: *if U.S. producers continue to plant and produce, and U.S. exporters continue to export, in circumstances where "any rational non-subsidized producer" would have "reduced plantings, production, and exports," <u>why has U.S. share of world production and world exports not increased over the life of the FSRI Act of 2002</u>?* Rather, Brazil attempts to confuse the issues by suggesting that the determinative question is whether marketing loan and counter-cyclical payments provide *income* support to U.S. producers. It is not; in fact, there is no WTO obligation to abstain from providing such support. The question is whether a subsidy causes one or more of the four types of "effects" reflected in Article 6.3 of the SCM Agreement. Brazil has submitted *no* empirical evidence that the marketing loan and counter-cyclical payments causes these effects and, indeed, the empirical evidence that the United States has submitted flatly contradicts Brazil's arguments in this regard. Brazil's attempts to rebut that evidence – for example, by asserting that the stability in U.S. share of world production and exports are themselves evidence of significant price suppression – are entirely unfounded.

22. In addition, Brazil's attempts to demonstrate an alleged absence of a "link" between "prices, on the one hand, and [U.S.] planted acreage, production, and exports, on the other hand" do not withstand scrutiny. Every comparison that Brazil has made in this regard has been fundamentally flawed, including its latest attempt to plot U.S. *planted* acreage against foreign *harvested* acreage and upland cotton futures; an approach that (a) improperly compares planted and harvested acreage, (b) ignores the fact that producers look at more than upland cotton futures prices in determining what to plant, and (c) attempts to capitalize on differences that appear to exist solely because of the particular graph utilized. Brazil's attempts to compare *changes* in U.S. *planted acreage,* changes in foreign *harvested* acreage, and *changes* in the futures prices for upland cotton are equally flawed. What that comparison shows is that *neither* U.S. nor foreign harvested acreage moves closely with futures prices of cotton *alone*. Nonetheless, even if the comparison were valid (and it is not), it would show that, where changes in U.S. and foreign area diverge, U.S. harvested acreage tends to react *more conservatively* than foreign acreage to increasing prices.

23. Finally, Brazil continues to assert incorrectly that *increases* in the absolute levels of U.S. production over the period from MY 2002-2005 were the effect of the marketing loan and counter-cyclical payment programs. Brazil's arguments in this regard are not even internally consistent, let alone supported by the facts.

24. *Brazil Fails to Show Any "Discernible Temporal Coincidence":* Contrary to its assertions, Brazil had not "reinforce[d] the original panel's finding . . . of a discernible temporal coincidence of suppressed world market prices and the price-contingent U.S. subsidies." To the contrary, the factors considered by the original panel do *not* support finding of a "discernible temporal coincidence" between the marketing loan and counter-cyclical payment programs and any "present" significant price suppression. Brazil's new assertion that it should be excused from making even the minimum showing of a "discernible temporal coincidence" as conducted by the original panel would effectively eviscerate the balance of rights and obligations struck in Articles 5(c) and 6.3(c) of the SCM Agreement and the requirement that a complaining party make a *prima facie* case of breach.

25. *Brazil has not shown that U.S. producers would switch to other crops or exit cotton farming without marketing loan and counter-cyclical payments:* There is no basis for Brazil's argument that marketing loan and counter-cyclical payments are necessary to fill an alleged "gap" between costs of production and market revenue, without which U.S. producers would cease farming cotton. First, the economic literature makes clear that producers make year-to-year planting decisions with reference primarily to *variable* costs of production (among other factors) and that *total* costs (among other factors) are relevant with respect to longer-term decisions, such as whether to exit the cotton sector. Second, the evidence shows that U.S. producers *covered their variable costs* in every year that the FSRI Act has been in effect and that, therefore, it was economically rational for U.S. producers to have produced upland cotton in these years. Brazil efforts to inflate variable costs by including land, labor, and capital recovery costs as variable costs are not supported by the economic literature. Further, Brazil has not shown that farmers actually take these costs – for example, an "imputed cost of unpaid labor" – into account in each year in deciding between planting cotton or some other crop or putting the land to some other use.

26. Third, Brazil's arguments against adjusting the seed cotton (i.e., cotton lint plus cottonseed) costs and revenues to isolate the revenue and costs for cotton lint (the product that is at issue under Brazil claims) are baseless. Contrary to Brazil's assertions, the evidence shows the common practice in the United States of paying ginning costs out of the proceeds gained by the gin from sale of the cottonseed separated out in the ginning process. This supports the U.S. approach of excluding both ginning costs and revenue from sale of cottonseed. However, even using a more conservative methodology that (a) excludes ginning costs only up to the amount of cottonseed revenue; and (b) including hired labor as a variable cost shows that U.S. producers have not only made their variable costs in all years but their total costs in many years as well.

27. Fourth, with respect to longer-term decisions, such as whether to continue or exit upland cotton farming, the United States has explained that the total cost of producing upland cotton is not the *sole* consideration. As the economic literature confirms, whole-farm costs and revenues – including off-farm revenue and revenue from other sources – are also important considerations in making those kinds of decisions. Brazil's attempts to show that U.S. producers would have exited upland cotton production in the long-term solely on the basis of a comparison of costs and revenues for cotton are, thus, not sound. To date, Brazil has not submitted any literature, study, report, or empirical evidence that contradicts the evidence submitted by the United States regarding the consideration of whole-farm costs and revenues. Nor has Brazil provided any evidence taking into account whole-farm costs and revenues that show that, absent the marketing loan and counter-cyclical payment program, U.S. upland cotton producers would have exited upland cotton farming.

28. *Neither Brazil's New Modeling Exercise Nor the Studies It Selectively and Misleadingly Cites Supports Its Claim of Significant Price Suppression:* Brazil's new econometric model – on which most of Brazil's arguments critically depend – substantially overstates any possible effects on world market prices from the removal of the marketing loan and counter-cyclical payment programs. It is based on a series of untenable economic assumptions that are *not* consistent with those used by FAPRI or USDA economists and were not even used *by Brazil* in its own analysis before the original

panel. When certain basic assumptions in the model are changed to *actually* reflect FAPRI and other well-established parameters, the effects predicted by Brazil's model decline sharply.

29. Brazil now attempts to justify its novel modeling assumptions by criticizing the FAPRI-based model – and assumptions – that it used in the original proceeding as being "unnecessarily complicated and cumbersome" and "not directly appropriate to the issue at hand." These assertions directly contradict the arguments made by Brazil to the original panel. Moreover, their grossly inflated nature is evident when one considers that Brazil has – by using this new model – increased the asserted price effects *almost three-fold*. There is no reason for this other than the use by Brazil of unreasonable, unsupported modeling assumptions for purposes of this proceeding.

30. Brazil's efforts to justify its flawed modeling results by comparing them to the results of studies examining completely different factual scenarios are logically unsound. In fact, it is evidence of the *unreasonableness* of Brazil's approach that Brazil ascribes to marketing loan and counter-cyclical payments, alone, similar (or in some cases, *greater*) price effects than (a) a 2006 World Bank study estimates for the elimination of *all* subsidies and tariffs across *all* countries; (b) a 2004 study by the Overseas Development Institute ("ODI") estimates for the elimination of domestic supports in China, Greece, Spain, and the United States; (c) and a study by FAO estimates for the elimination of all domestic support in all countries. Even less persuasive is Brazil's attempt to place its results "in the mid-range" of the studies surveyed by the FAO, World Bank, and International Food Policy Research Institute ("IFPRI"), all of which examine the effects of a much different "basket" of measures that those examined by the Panel here. Finally, Brazil does not undermine recent studies showing that the marketing loan and counter-cyclical payment programs likely only have *minimal effects* on world market price.

31. *Brazil Has Not Ensured that the Price Effects Of Other Factors Are Not Attributed to the Marketing Loan and Counter-cyclical Payment Programs:* Brazil fails to undertake any meaningful assessment of the world upland cotton market, of actual world market prices, or of the factors that are observed to be affecting U.S. and foreign supply and demand and, ultimately, world market prices. The Appellate Body underscored the importance of such an assessment in this dispute, explaining that in order to prove a claim under Article 5(c) and 6.3(c) of the SCM Agreement, "it is necessary to ensure that the effects of other factors on prices are not improperly attributed to the challenged subsidies." *Upland Cotton (AB)*, para. 437. Brazil has not carried its burden in this regard.

32. For example, although China is the world's *largest producer* of upland cotton, the world's *largest consumer* of upland cotton, and the world's *largest importer* of upland cotton, Brazil does not assess and distinguish any impacts of China's trade on world market prices. Instead, Brazil seeks to mischaracterize the U.S. arguments as being against the original panel's finding that the United States exerts a substantial proportional influence on the world market price of upland cotton. Moreover, Brazil argues that the United States is confusing Brazil's claims of price *suppression* with claims of price *depression*. Neither argument is valid; the former is simply erroneous and the latter overlooks the fact that the market reports and data that the United States submits are relevant to price *suppression*, not price *depression*. By contrast, Brazil has submitted no empirical evidence itself that confirms its claims of price suppression. And Brazil's attempts to dismiss the evidence showing the importance of China's trade on world market prices are without merit.

33. *Brazil Fails To Provide Any Evidence or Arguments Regarding "Significant" Price Suppression In Its Rebuttal Submission:* The United States explained in its first written submission that Brazil has not demonstrated either through empirical evidence, or through its modeling exercise, that the marketing loan and counter-cyclical payment programs have had any appreciable impacts on price in MY 2005, let alone caused any "significant" price suppression within the meaning of Article 6.3(c) of the SCM Agreement. Brazil does not even address the question of "significance" in

its rebuttal submission and, thus, fails to prove a critical element of its claims of "significant" price suppression under Articles 5(c) and 6.3(c) of the SCM Agreement.

34. **– Brazil has failed to make a *prima facie* case of breach under Articles 5(c) and 6.3(d) of the SCM Agreement.** Brazil had not made a *prima facie* case that the marketing loan and counter-cyclical payment programs breach Articles 5(c) and 6.3(d) of the SCM Agreement. First, Brazil provides no legitimate empirical evidence to support its assertion that the slight increase in the U.S. share of the world market in MY 2005 over the average for MY 2002-2004 was "the effect" of the marketing loan and counter-cyclical payment programs. Moreover, Brazil analysis is premised on the incorrect assumption that Article 6.3(d) is concerned with absolute market share and whether or not, in any given year, a Member's market share would have been lower if subsidies were removed. It is not; by its terms, Article 6.3(d) applies only in those situations where there is an increase from the previous three-year average and it is this *increase* over time that is "the effect" of subsidies. Thus, Brazil's argument is entirely off the mark.

35. Second, Brazil's arguments assume that Article 6.3(d) requires a showing of an *upward trend* in market share. However, Article 6.3(d) requires a showing that "this increase" – *i.e.*, "the increase in the world market share of the subsidizing Member . . . as compared to the average share it had during the previous period of three years" – "follows a consistent trend over a period when subsidies have been granted." Brazil does not even provide relevant data in this regard, let alone make the required demonstration. Nor could it; there simply is no such "consistent trend." Brazil has, thus, failed even to submit a proper analysis, let alone established a *prima facie* case of breach under Articles 5(c) and 6.3(d) of the SCM Agreement.

36. **– Brazil has failed to make a *prima facie* case of threat of serious prejudice under Articles 5(c) and 6.3(c) of the SCM Agreement.** Brazil's claims of "threat" of serious prejudice fail because they are based on a legally erroneous standard and are factually unsubstantiated. First, there is no basis for Brazil's argument that "the precedent interpreting the terms 'threat' and 'threaten' suggests that the appropriate standard of threat in Part III [of the SCM Agreement] is one in which there is a significant likelihood, based on the nature of subsidies and particular conditions of competition, that serious prejudice will occur in the future." This "significant likelihood" standard is not found in the text of the SCM Agreement. Moreover, even leaving aside that there is no basis to attempt to interpret a treaty in accordance with "precedent" rather than "in accordance with customary rules of interpretation of public international law," Brazil does not in fact identify any "precedent" that "suggests" that the appropriate standard for "threat" of serious prejudice is "a significant likelihood." As Brazil's claims are based on an erroneous legal standard, Brazil fails to make a *prima facie* case of threat of serious prejudice within the meaning of Article 5(c) and footnote 13 of the SCM Agreement.

37. Moreover, Brazil's threat claims are also factually unfounded. For example, given the prices that are expected to prevail in MY 2007 (well above 52 cents/lb), it is unlikely that marketing loans will have any significant effects on planting, production, exports, or world market prices in MY 2007. Indeed, recent estimates project that any marketing loan payments are likely to be small in MY 2007 and not even paid out in MY 2008. Moreover, counter-cyclical payments are likely to be paid in near-fixed sums at least through MY 2007 (i.e., meaning that they are likely to behave much like fixed, direct payments which have been found not to cause any significant price suppression). Projections for MY 2007 U.S. plantings, production, and exports – all of which show declines – also undermine Brazil's claims of "threat of serious prejudice." Moreover, cost data for future marketing years show that U.S. producers will likely cover their variable, or operating, costs as well as a large share of total costs in MY 2007.

ANNEX B-3

EXECUTIVE SUMMARY OF BRAZIL'S SUBMISSION REGARDING U.S. REQUEST FOR PRELIMINARY RULING

(Executive summary submitted on 23 January 2007)

1. Brazil addresses the four requests for preliminary ruling included in the United States' First Written Submission and asks that the compliance Panel reject each of the United States' requests.

1. USE OF GSM 102 TO SUPPORT EXPORTS OF PIG MEAT AND POULTRY MEAT ARE PROPERLY BEFORE THE COMPLIANCE PANEL

2. In this dispute, Brazil claims that the United States has applied General Sales Manager 102 export credit guarantees ("ECGs") in a manner that circumvents U.S. export subsidy commitments with respect to "unscheduled" products and three "scheduled" products – rice, pig meat and poultry meat.

3. According to the United States, Brazil cannot assert claims about ECGs for pig and poultry meat in an Article 21.5 proceeding, allegedly because "the Appellate Body made no findings against those guarantees [for exports of pig meat and poultry meat] and the DSB thus issued no rulings and recommendations addressed to them." The United States concludes that Brazil's claims are outside the scope of these proceedings.

4. The United States advances an incorrect interpretation of Article 21.5 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU"). The scope of Article 21.5 proceedings is not limited in this regard by the scope of the original proceedings in this dispute. As affirmed by the Appellate Body in *EC – Bed Linen (21.5)*, "an *unappealed* finding included in a panel report that is *adopted* by the DSB must be treated as a *final resolution* to a dispute between the parties in respect of the *particular* claim and the *specific* component of a measure that is the subject of that claim."[1] Brazil successfully appealed the original panel's finding that the United States had not circumvented its export subsidy commitments with respect to ECG support for exports of pig meat and poultry meat, but the Appellate Body was unable to complete the analysis. Thus, unlike in *EC – Bed Linen (21.5)*, there has been no "final resolution" to the question whether the United States circumvents its export subsidy commitments with respect to ECGs for pig meat and poultry meat. The scope of the original proceedings does not, therefore, limit the scope of the Article 21.5 proceedings in this respect. Hence, Brazil's claim concerning the consistency with Article 10.1 of the ECG programs with respect to pig meat and poultry meat is properly within the scope of these Article 21.5 proceedings.

5. Accordingly, Brazil requests that the compliance Panel reject the United States' request for preliminary ruling.

[1] Appellate Body Report, *EC – Bed Linen (21.5)*, para. 93 (emphasis in original). *See also* Appellate Body Report, *U.S. – Softwood Lumber VI (21.5)*, para. 102 (footnote 150).

2. THE MARKETING LOAN AND COUNTER-CYCLICAL PAYMENT PROGRAMS ARE PART OF THE U.S. "MEASURE TAKEN TO COMPLY"

6. The United States requests a preliminary ruling that the marketing loan and counter-cyclical payment programs are not "measures taken to comply," within the meaning of Article 21.5 of the DSU.

7. With its request for preliminary ruling, the United States appears to suggest that, since it chose to implement the recommendations and rulings of the Dispute Settlement Body ("DSB") by solely removing the Step 2 program, these Article 21.5 proceedings can only address the effects of the removal of the Step 2 program, without regard to the other two measures that formed the "basket of measures" to which the findings, conclusions and recommendations of the original panel relate. The U.S. position ignores the context of the original panel's rulings, as well as the text of Article 21.5.

8. First, the U.S. argument ignores that the findings, conclusions and recommendations of the original panel apply to a "basket of measures."[2] U.S. statements at the time the Step 2 program was repealed indicate that the repeal of the Step 2 program was intended to comply with the adverse effects-related recommendations and rulings of the DSB, which apply to a "basket of measures."

9. Second, by repealing the Step 2 program, the United States changed the "basket of measures" to which the adverse effects-related recommendations and rulings of the DSB apply. The question before the compliance Panel is whether this *new* basket of mandatory and price-contingent measures, which constitutes the "measures taken to comply," is "consistent with the covered agreements."

10. Brazil notes that Australia, Canada, Chad, China, the European Communities, New Zealand and Japan disagree with the U.S. arguments that its failure to change a non-compliant measure means that such a measure should fall outside the scope of proceedings under Article 21.5 of the DSU and request that the compliance Panel reject the U.S. request for preliminary ruling.

11. Accordingly, Brazil requests that the compliance Panel reject the United States' request for preliminary ruling.

3. THE MARKETING LOAN AND COUNTER-CYCLICAL PAYMENT PROGRAMS ARE PROPERLY WITHIN THE SCOPE OF THESE ARTICLE 21.5 PROCEEDINGS

12. The United States argues that Brazil's claims in these Article 21.5 proceedings concerning the serious prejudice and threat of serious prejudice caused by the marketing loan and counter-cyclical programs are outside the scope of these proceedings, because the original panel "either rejected or declined to address" claims against those programs.

13. *First*, the United States argues that Brazil raises improperly an "as such" claim in these Article 21.5 proceedings. Yet, contrary to the US's assertions, Brazil does not raise a claim against U.S. marketing loan and counter-cyclical payment programs "as such." Rather, Brazil challenges these programs inasmuch as they cause adverse effects, within the meaning of Articles 5 and 6 of the *Agreement on Subsidies and Countervailing Measures* ("*SCM Agreement*"). Indeed, Brazil makes no distinction between the serious prejudice caused by the statutory and regulatory framework of the FSRI Act of 2002 and the serious prejudice caused by the mandatory and price-contingent payments flowing from that statutory and regulatory framework.

[2] Panel Report, *U.S. – Upland Cotton*, paras. 7.1502 and 7.1503.

14. In the circumstances of this dispute, a subsidy "payment" cannot be divorced from a subsidy "program." The original panel made it very clear that its "present" serious prejudice finding *pertains* to *both* the FSRI Act of 2002 subsidy programs and the payments mandated by those programs.

15. The United Stated did not appeal this particular element of the original panel's report, which was, therefore, adopted by the DSB. Consequently, the United States "is obliged to take action concerning its present statutory and regulatory framework as a result of [the original panel's] 'present' serious prejudice finding."[3] The U.S. arguments regarding the "as such" versus "as applied" distinction reflect a fundamental misconception concerning the nature of the obligations Articles 5, 6 and 7.8 of the *SCM Agreement*, and the DSB recommendations and rulings in this dispute.

16. *Second*, application of WTO jurisprudence regarding the limits imposed on the scope of Article 21.5 proceedings by the scope of the original proceedings[4] makes it clear that Brazil's claims against the U.S. marketing loan and counter-cyclical payment programs, and the payments flowing from such programs, are properly before this compliance Panel.

17. Brazil's claims regarding the adverse effects flowing from both the programs and payments mandated thereunder were identified in Brazil's request for establishment of this compliance Panel. Brazil's claims involve U.S. measures "taken to comply" with the recommendations and rulings of the DSB – specifically, the new "basket of measures" providing for mandatory and price-contingent domestic support for upland cotton created by the repeal of the Step 2 program. Moreover, as demonstrated in more detail below, the original panel did not reject, as the United States argues, Brazil's claims that the marketing loan and counter-cyclical payment programs, or the mandatory and price-contingent payments made thereunder, cause serious prejudice or a threat thereof.

18. Brazil's claims concerning the marketing loan and counter-cyclical payment programs and the payments flowing from such programs in these Article 21.5 proceedings, therefore, fall squarely within the limits set by panels and the Appellate Body in their jurisprudence.

19. Furthermore, as clarified by the original panel, its "'present' serious prejudice findings include findings of inconsistency that deal with the FSRI Act of 2002 and subsidies granted thereunder in MY 2002 [and that] the United States is obliged to take action concerning its present statutory and regulatory framework as a result of our 'present' serious prejudice finding." Indeed, the original panel made findings that explained that its present serious prejudice conclusions "pertain" to both "measures in force" and "subsidies paid." This is consistent with the original panel's identification of both payments and the statutory and regulatory framework providing for these payments as the "measures at issue."

20. Numerous other statements by the original panel confirm this. For example, the original panel recognized that price-contingent *payments* are inextricably linked to the mandatory statutory and regulatory framework, *i.e.*, the *programs*, providing for them. In discussing the nature of the subsidies at issue, the original panel referred numerous times to the statutory and regulatory framework providing for these payments.

21. Additionally, the original panel repeatedly stated that its "present" serious prejudice finding were premised upon effects generated from *both* the FSRI Act of 2002 *and* the payments flowing from the FSRI Act of 2002. Its statements show that it was convinced that the United States could only comply with its Article 7.8 obligations by changing the mandatory and price contingent "basket of measures" of the FSRI Act of 2002.

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[3] Panel Report, *U.S. – Upland Cotton*, para. 7.1501.
[4] *See US – Softwood Lumber VI (21.5)* and *Chile – Price Band Systems (21.5).*

22. The original panel also left no doubt that it considered the "basket of measures" alleged by Brazil to cause a *threat* of serious prejudice during MY 2003-2007 to overlap with the same "basket of measures" that the United States was obliged to change as part of its obligation, pursuant to Article 7.8, to comply with the original panel's *present* serious prejudice findings.

23. For these reasons, the original panel did not find it "necessary or appropriate" to rule on Brazil's "threat" claims. This finding did not constitute a rejection of those claims. The original panel's statements regarding the United States' *obligation* to "make changes to its statutory and regulatory framework" were a direct response to a request by Brazil to address future adverse effects flowing from the FSRI Act of 2002.

24. Finally, the original panel did not reject Brazil's *per se* claim. Indeed, it exercised judicial economy over that claim. In doing so, the original panel cross-referenced to Sections G and H of its report making it clear that no *additional* findings were necessary.

25. In light of the foregoing, Brazil requests that the compliance Panel reject the United States' request for preliminary ruling.

4. THE COMPLIANCE PANEL IS NOT BARRED FROM MAKING FINDINGS WITH RESPECT TO THE U.S. FAILURE TO IMPLEMENT BETWEEN 21 SEPTEMBER 2005 AND 31 JULY 2006

26. The United States asserts, first, that Brazil cannot raise a claim, under Article 21.5 of the DSU, if there is no disagreement between the parties concerning the existence of measures taken to comply. In doing so, the United States seems to acknowledge the absence of measures to comply between the end of the implementation period on 21 September 2005 and 31 July 2006. Brazil thus requests the compliance Panel to make a finding to that effect.

27. Second, the United States asserts that the compliance Panel is barred, by Article 21.5 of the DSU, from making findings on a situation of non-compliance by the United States between 21 September 2005 and 31 July 2006.[5] The United States errs. Brazil has the right to challenge the "existence" and "consistency" of "measures taken to comply", in accordance with Articles 7.8 and 7.9 of the *SCM Agreement*. A finding that the United States failed to implement in a timely manner will be relevant to the resolution of this dispute.

28. Should Brazil prevail in the adverse effects-related portion of this dispute, the quantification of any countermeasures it seeks will be assessed by an arbitrator as of the date the United States was required to "remove the adverse effects of the subsidy or withdraw the subsidy." Arbitrators refer to "the date on which the implementation period expired, as the date on which to assess whether the proposed suspensions of concessions or other obligations were equivalent to the level of nullification or impairment or constitute appropriate countermeasures."[6]

29. Accordingly, Brazil's right to pursue the United States' failure to remove the adverse effects or withdraw the subsidy, and the assessment whether any proposed countermeasures are commensurate, *are tied to the date on which the implementation period expires*. That the United States, on 1 August 2006, took measures to comply is relevant before this compliance Panel solely in connection with Brazil's claims that these measures result in inconsistency with Articles 5 and 6 of the *SCM Agreement*.

[5] U.S. First Written Submission, paras. 51-56.
[6] Arbitrator's Report, *U.S. – FSC*, paras. 2.14(a) (and footnote 25), 2.15.

30. Brazil notes that Australia similarly points out to the impact the U.S. interpretation would have on Members' rights under Article 7.9 of the *SCM Agreement* and Article 22 of the DSU.

31. Brazil therefore requests that the compliance Panel reject the United States' request for preliminary ruling.

5. CONCLUSION

For the reasons set forth in Sections 1 to 4 above, Brazil requests that the compliance Panel reject all four U.S. requests for preliminary rulings.

ANNEX C

ORAL STATEMENTS OF PARTIES AND THIRD PARTIES AT THE MEETING WITH THE PANEL

ANNEX C-1

EXECUTIVE SUMMARY OF THE OPENING STATEMENT OF BRAZIL

(27 February 2007)

1. Brazil's "oral statement" addresses the following issues. First, Brazil deals with preliminary rulings arguments. Second, Brazil highlights key aspects of Brazil's present serious prejudice claims and responds to selected arguments raised by the United States in its Rebuttal Submission. Third, Brazil reiterates its claims with respect to export credit guarantees ("ECGs") and rebuts the United States' principal defenses.

1. PRELIMINARY RULINGS ARGUMENT

2. Brazil provided extensive answers to the Panel's questions regarding the preliminary ruling requests of the United States. In considering these arguments, Brazil asks the Panel to consider the following questions. When the original panel issued its report, did it intend to leave Brazil with no implementation rights for serious prejudice caused by mandatory and price-contingent marketing loan and Counter-Cyclical Payment ("CCP") program payments made after marketing year (MY) 2002? Further, did the original panel intend that the United States would have no obligation to take appropriate steps under Article 7.8 of the *SCM Agreement* concerning its statutory and regulatory framework mandating price-contingent marketing loan and CCP subsidies?

3. The original panel expressed very clearly the U.S. obligation to take steps to limit and control marketing loan and CCP subsidies made after 31 July 2003. In addressing Brazil's arguments about the mandated future marketing loan and CCP subsidies made during MY 2003 and to be made beyond, the original panel found that "[b]ecause the Panel's 'present' serious prejudice findings include findings of inconsistency that deal with the FSRI Act of 2002 and subsidies granted thereunder in MY 2002, the United States is obligated to take action concerning its present statutory and regulatory framework as a result of our 'present' serious prejudice findings." This finding provided considerable assurance to Brazil that the United States was required to significantly change and transform the Farm Security and Rural Investment Act of 2002, the Farm Bill.

4. The United States argument that General Sales Manager ("GSM") 102 ECGs for pig meat and poultry meat are not properly within the scope of these Article 21.5 proceedings confounds Brazil's claims and the measure that is the subject of those claims. Brazil's claims concerning these two "scheduled" commodities are product-specific, as they must be under the *Agreement on Agriculture*. The measure subject to those claims is indeed the United States' "measure taken to comply" – the GSM 102 program "in its totality," as amended by the modified GSM 102 fee schedule. As we demonstrate in our answers to the Panel's questions, neither the amended GSM 102 program in its totality, nor the individual amendments, set out terms or conditions that differ as between any eligible products. Brazil's claims are product-specific, but the U.S. "measure taken to comply" is not.

2. PRESENT SERIOUS PREJUDICE CLAIMS

5. Brazil initiated this proceeding due to the failure of the United States to withdraw the subsidies or to take appropriate steps under Article 7.8 of the *SCM Agreement* to remove the adverse effects of the subsidies, in a timely and complete fashion, pursuant to the recommendations and rulings of the Dispute Settlement Body ("DSB") in this dispute. While Brazil raises four claims in

this proceeding, the focus of this Oral Statement is Brazil's claims of present serious prejudice from the U.S. marketing loan and CCP subsidies.

Cross-Cutting Serious Prejudice Related Arguments

6. Initially, Brazil addresses a number of cross-cutting arguments. First, the appropriate reference period to assess the effects of marketing loan and counter-cyclical payments is MY 2005, the last recent marketing year for which essentially complete data exists. However, it is appropriate for the Panel to assess, where credible and reliable, evidence concerning time periods *after* 31 July 2006.

7. Second, this Panel should follow the findings of the original panel. Brazil fully agrees with the United States that the original panel's findings "are taken as a given for purposes of this Article 21.5 proceeding." The Panel should, therefore, reject the U.S. efforts to have it dismiss practically all of the original panel's findings as irrelevant because allegedly all of its findings relate only to a basket of three measures – marketing loan, CCP and Step 2 subsidies.

8. Third, as every other panel assessing a serious prejudice claim, this Panel must necessarily conduct a counterfactual "but for" analysis. This approach requires it to assess what production, exports, and world prices would be in a world in which U.S. marketing loan and CCP subsidies did *not* exist.

The Nature, Magnitude and Effects of Marketing Loan Subsidies

9. The largest and most trade-distorting subsidy at issue in this dispute is the marketing loan subsidy. The original panel found as follows: "we have no doubt that the [marketing loan] payments stimulate production and exports and result in lower world market prices than would prevail in their absence." The United States now asks this Panel to find that since the adoption of the panel's marketing loan findings by the DSB on 21 March 2005, the nature of marketing loan subsidies has totally changed. However, both the available data and testimony of cotton producers and their representatives shows that marketing loans are crucial for the continued production of cotton. Further, marketing loan payments in MY 2005 were 29 percent *larger* than in MY 2002.

The Nature, Magnitude and Effects of CCP Subsidies

10. CCP subsidies play a similarly crucial role in U.S. cotton producers' ability to grow cotton profitably. According to data produced by the United States for MY 2005, 95 percent of U.S. cotton acreage was planted on farms holding cotton base. These farms receive large amounts of CCP subsidies. These facts alone demonstrate the "strongly positive relationship" between receipt of CCP subsidies and the continued production of cotton. CCP subsidies have production, export and price effects, as they restrict planting flexibility of farmers. They reduce the risk associated with producing the base crop, in this case cotton. CCP subsidies also increase the ability of farmers to invest in production-enhancing equipment. In general, they smooth the revenue flow to farmers and ease access to credit.

11. Representatives of the National Cotton Council ("NCC") of America testified to the U.S. Congress that "during the past three years, many cotton farmers have avoided bankruptcy only because Congress has authorized emergency relief to supplement the FAIR Act's inadequate fixed payments." This statement offers a number of valuable insights also for CCPs. As the original panel found, "United States upland cotton producers rely on … subsidies to cover their cost of production." Second, contrary to U.S. arguments, U.S. producers could not perceive direct payments ("fixed payments") and CCP subsidies as fully capitalized into land values.

Combined Effects of Marketing Loan and CCP Subsidies Result in Increased U.S. Supply of Cotton

12. But for U.S. price-contingent cotton subsidies, the majority of cotton farms would incur huge losses nearly every year. Faced with the prospect of such losses, many farmers would cease producing cotton. Neither the U.S. criticisms of Brazil's cost of production analysis, nor the new factual information provided by the United States, detracts from the core reality that U.S. cotton farming is unprofitable without subsidies.

13. The key question in any business is whether market returns exceed costs and generate sufficient profit. While a business with reserves may sustain losses in some years, even the United States recognizes that "in the long run, producers will have to cover asset and overhead costs, as well as variable costs." Data from USDA indicates that cotton farmers lost an average of $837 for each acre planted to cotton in the past seven years (MY 1999-2005). In only one of these years – MY 2003 – did farmers' market returns exceed production costs. Based on the total amount of acres planted to cotton, the U.S. cotton industry lost $12.4 billion during the past seven years. Yet, over the same period, marketing loan and CCP subsidies provided cotton farmers with price-contingent subsidies amounting to $13.5 billion.

14. The United States claims that Brazil "fails to analyze properly the planting decisions made by U.S. producers in light of market conditions and considerations they *actually* faced at the time of planting." In response, Brazil compared the net revenue (or loss) that a typical farmer holding cotton base expected in the spring of 2005 from growing an acre of cotton, or two common substitute crops, soybeans and corn. The analysis demonstrates that subsidized U.S. cotton farmers did *not* have an incentive to switch from cotton to corn or soybean production. Rather, they expected that cotton marketing loan and cotton CCP payments linked to the cotton base acre at issue would allow them, at a minimum, to break even. Had cotton marketing loan and CCP subsides not existed in MY 2005, upland cotton farmers would have had every incentive to switch to the production of other crops, for which marketing loan subsidies would still be available, to cut its losses.

15. The fact that U.S. marketing loan and CCP subsidies "numb" U.S. cotton farmers' responses to market price signals is also demonstrated by more recent evidence. In February 2007, the NCC announced that U.S. cotton farmers intend to plant 12.8 million acres in MY 2007, or 14 percent *less* than in MY 2006, largely because expected prices for corn are the highest on record. The evidence shows that farmers expect to incur large losses from growing cotton in MY 2007 if they had to consider solely cotton market revenue. By contrast, farmers can expect to earn a profit from growing both soybeans and corn, <u>even without considering U.S. subsidies</u>. Based on these considerations alone, it is remarkable that the NCC predicts that *only* 14 percent of cotton acreage shifts out of growing cotton.

16. Examining actual total costs and returns in MY 2002-2006 demonstrates that only U.S. subsidies made growing cotton economically rational, and very profitable. Again, price-contingent cotton marketing loan and CCP subsidies are the main reason for cotton farmers achieving profitability. The marketing loan subsidy alone almost entirely erased losses that cotton farmers would have incurred based solely on market revenue. It also almost equalized the returns from growing cotton, corn or soybeans. Cotton direct and CCP subsidies then turned growing cotton into a very profitable business.

17. Brazil recalls that even if U.S. cotton farmers expected prices to be above the Adjusted World Price at the time of planting, they "were also aware that if actual prices were ultimately lower, they would be 'insulated' by government support, including not only marketing loan program payments but also counter-cyclical payments, which were based on a target price of 72.4 cents per pound." This is exactly what happened in MY 2004. Futures prices during the planted period indicated high prices at the time of harvest. But soon after planting, prices began to plunge far below the loan rate.

18. Finally, the United States claims that Brazil has failed to show that the effects of marketing loan and CCP subsidies are to *increase* U.S. acreage, *increase* U.S. production, and *increase* the U.S. share of world exports and production. This argument erroneously assumes that there was a recent marketing year, month, or even day without effects from the U.S. subsidies. Such a time period does not exist. Given the original panel's findings regarding the structure, design and operation of the mandatory and price-contingent subsidies in the FSRI Act of 2002, it is sufficient for Brazil to show that those subsidies have sustained and maintained high levels of acreage, production and exports of U.S. cotton that would otherwise be uneconomical.

Statement of Professor Daniel Sumner

19. Professor Sumner provided the Panel with a straightforward and robust model appropriately tailored to the questions before this Panel. The parameters used fit specifically the market and policy setting for cotton and the question that this Panel is tasked to assess – the impacts on cotton market prices, quantities and exports of removing very large cotton subsidies. The United States has raised many complications, yet each of its objections fades away upon scrutiny. The model provided to the Panel and the economic reasoning that guides its application to the issues of U.S. cotton subsidies are sound. The results provided are sound and directly useful for this case.

20. The analysis discusses why the CCP affects acreage decisions of cotton farmers. These payments affect cotton production because they are large, they are tied to the cotton price, they restrict what can be grown, and they are tied to cotton production through expectations about future base updates. The importance and relevance of these arguments are reinforced by the evidence that has accumulated since 2003. It is instructive to note that in its reparameterization of the model by the United States, it abandons its previous claim that the CCP is completely decoupled from production.

21. The basic set of equations was adapted from a research report published by the Cato Institute. While built upon the basic algebraic foundation published as an appendix in my 2005 study, the cotton model used by Professor Sumner for this dispute involves considerable elaboration from the Cato publication.

Production and Export Effects Cause Significant Price Suppression in the World Market and an Increase in the U.S. World Market Share

22. Brazil has demonstrated that excess U.S. production causes significant price suppression in the world market for cotton. Evidence supporting this assertion includes the fact that Brazilian and U.S. cotton is a fungible and widely traded commodity and that "the United States exerts a substantial proportionate influence in the world market for upland cotton." As in MY 2002, the United States accounts for about 20 percent of world production and 40 percent of world exports. Price suppression in the world cotton market today continues to be linked to the U.S. position as the world's largest exporter by far.

23. Furthermore, the evidence demonstrates that the price effects of the U.S. marketing loan and CCP subsidies are "significant." Professor Sumner finding of a 9-11 percent price effect in the world market for cotton in MY 2005 is supported by the academic literature.

24. The price effects from marketing loan and CCP subsidies found by Professor Sumner and others constitute "significant" price-suppression. Given the conditions of competition in the world market for cotton, price effects of 1 or 2 percent would be significant. Contrary to the U.S. arguments, the evidence before the Panel demonstrates that the effect of the U.S. marketing loan and CCP subsidies and the payments made thereunder is (i) significant price suppression in the world

market for cotton, in violation of Articles 5(c) and 6.3(c) of the *SCM Agreement*, and (ii) an increase in the U.S. world market share, in violation of Articles 5(c) and 6.3(d) of the same *Agreement*.

Removal of Step 2 Did Not Impact the Price Suppressing Effects of Marketing Loan and CCP Subsidies

25. In the context of this Article 21.5 proceeding, the repeal of the Step 2 program constitutes a non-attribution factor. In the words of the original panel, the issue is whether the Step 2 program in MY 2005 "would have the effect of attenuating th[e] causal link, or of rendering not 'significant' the effect of" marketing loan and CCP subsidies.

26. The U.S. Government itself confirms that the repeal of Step 2 has minimal effects on the revenue protection enjoyed by U.S. cotton producers. Other independent studies also find relatively modest effects from the repeal of Step 2. The United States argues that the smaller amount of U.S. exports in MY 2006 is evidence of the removal of adverse effects by the repeal of Step 2. This is largely false. According to USDA, the decline in U.S. exports is "almost entirely attributable to reduced sales to China," partially due to decreased demand from China and increased exports from India. Second, as the United States has conceded, there was a large and unnatural surge in U.S. exports at the end of MY 2005 just before the termination of the Step 2 program. Nevertheless, USDA's current projections of MY 2006 exports remain at the second highest level in history, at levels that are comparable to MY 2004 and 22 percent above MY 2002 levels.

Statement of Andrew Macdonald

27. Due to its large size and the availability of reliable information, the U.S. cotton market is the single most important market influencing cotton prices throughout the world. China has undoubtedly an influence on the world market, but it does not lead world market prices. India is another example of an important cotton-producing and -consuming country. Brazil, like most other cotton producing countries, is a relatively small producer of cotton and its domestic market consumes the majority of its production. None of the other cotton-producing countries individually have the export potential needed to assert a substantial influence on price trends.

28. The U.S. elimination of the Step 2 program for cotton on 1 August 2006 was well received by the cotton producers outside of the United States. The effect of Step 2 on the international market is extremely difficult to judge under such a complex system. Yet, Macdonald believes that international cotton prices were initially somewhat higher than they would have been if the Step 2 program had been maintained. However, what might have been gained in terms of increased price levels from its elimination has most likely been lost by the accumulation of larger stocks in the United States. Under normal circumstances, such increased stocks would result in a reduction of production in the United States, which would be the only way for U.S. prices to rise. However, the remaining domestic support programs give U.S. producers little incentive to react to such price signals.

3. EXPORT CREDIT GUARANTEES

29. With respect to three ECG programs maintained by the U.S. Commodity Credit Corporation – GSM 102, GSM 103 and SCGP – the DSB recommended that the United States withdraw the subsidy and otherwise bring itself into compliance with its obligations by the implementation deadline of 1 July 2005. However, U.S. "measures taken to comply" with the DSB's ECG-related recommendations do not exist in some respects. To the extent they do exist, they are not consistent with the export subsidy rules of the *Agreement on Agriculture* and the *SCM Agreement*.

30. Brazil has demonstrated that there is no credit protection product available in the marketplace that is comparable to a GSM 102 ECG. Accordingly, the GSM 102 program offers a unique financial

instrument without any parallel at market, and therefore confers "benefits" *per se*. In Brazil's view, that is the beginning and the end of the analysis.

31. Brazil has also demonstrated quantitatively that GSM 102 fees are lower than fees for comparable products offered by ExIm Bank, by an average of over 100 percent of the GSM 102 value. The United States has never disputed the accuracy of Brazil's ExIm Bank comparison. Instead, it criticizes Brazil for not benchmarking GSM 102 fees against fees for products offered by three multilateral institutions – the EBRD, the IDB and the IFC. The United States criticizes Brazil for arguing that because these three entities are public rather than private, they cannot offer commercial products. The United States goes on to argue that fees charged by these entities are market-based or "commercial" (without providing any indication of what these fees are, or how they compare to GSM 102 fees). This argument is peculiar, for at least two reasons.

32. **First**, it may or may not be true that public entities like the EBRD, IDB and IFC can offer commercial products. Brazil tends to think it is not true. However, the exhaustive evidence offered by Brazil to demonstrate that GSM 102 fees fall far below fees for comparable ExIm Bank products stands. Like the EBRD, IDB and IFC, the ExIm Bank is a public entity. Despite its status as a public entity, the United States presumably considers that the ExIm Bank offers commercial products, including the products used by Brazil in its benchmarking analysis. If so, then Brazil fails to understand why the ExIm Bank benchmarking analysis provided by Brazil is any less probative than would be an analysis involving EBRD, IDB and IFC fees. Brazil has demonstrated that GSM 102 fees fall below ExIm Bank fees for comparable products. If the United States believes that the result would be different in a comparison between GSM 102 fees, on the one hand, and EBRD, IDB or IFC fees, on the other, it is up to the United States to prove it. If the United States does not consider that the ExIm Bank products used by Brazil in its benchmarking analysis are provided on terms consistent with market, then those products themselves confer a "benefit". In that case, by using ExIm Bank products as a reference point for assessing GSM 102 ECGs, Brazil is being unduly generous to the United States.

33. **Second**, the United States has previously argued that export credits offered by public entities can not be considered commercial products. The Panel can therefore understand Brazil's surprise at the United States' insistence that EBRD, IDB and IFC products provide relevant benchmarks. Brazil tends to agree with the standard the United States apparently applies to WTO Members other than itself – that is, that a public or government entity is not the commercial market. While the United States finds significance in the fact that public entities like the EBRD, IDB and IFC are "profitable" (whatever the definition of that term), making a "profit" does not mean that fees charged by a public entity are consistent with market. A public entity can charge below-market fees and still make a "profit", particularly because its costs are below those faced by its market-based counterparts. A market-based entity must charge fees high enough to make a profit on costs higher than those faced by its public or government counterparts, and the profit must offer a sufficient return to attract capital from investors. "Profitability" of a public entity is not an adequate measure of the full extent of the "benefit" conferred by a government financial contribution.

34. Turning to the role of Article 14(c) of the *SCM Agreement*, the United States criticizes Brazil for not having undertaken a quantitative assessment of "benefit" under the calculation methodology included in Article 14(c). In the United States' view, the only way to determine whether a "benefit" has been conferred by a guarantee subject to export subsidy claims under the *Agreement on Agriculture* and Part II of the *SCM Agreement* is to assess the effect of the guarantee on the price of an underlying loan.

35. Article 14(c) is not the sole standard to determine whether a government guarantee confers a "benefit" in a dispute under the *Agreement on Agriculture* and Part II of the *SCM Agreement*. Article 14 applies solely "[f]or the purpose of Part V" of the *SCM Agreement*, or in other words, for

proceedings involving countervailing measures, where calculation of a duty is required. The "guidelines" in Article 14 support the conclusion that Article 1.1(b) of the *SCM Agreement* embodies a "benefit to recipient" standard. Unlike in countervailing duty proceedings, where a duty must be calculated, disputes under Part II of the *SCM Agreement* do not require quantification of the "benefit" found under Article 1.1(b). Thus, Article 14 does not prescribe hard and fast rules, even in countervailing measure disputes, to which the provision is explicitly applicable. Outside the context of countervailing measure disputes, this flexibility to account for the factual circumstances at hand is at least as important to preserve.

36. Brazil makes an alternative argument under item (j) in the event the Panel does not consider Brazil's evidence and argument to be sufficient to show that GSM 102 fees confer "benefits" and constitute subsidies under Article 1.1 of the *SCM Agreement*. Brazil asks the Panel to determine whether the GSM 102 program constitutes an export subsidy under the so-called "break even" standard in item (j). This evidentiary point stands, without painting Brazil into the imaginary interpretive quandary constructed by the United States.

37. Even if the United States has withdrawn the elements of the GSM 102 program that made it an export subsidy under item (j) (a proposition with which Brazil does not agree), it has "replace[d] the original subsidy with yet another" prohibited subsidy – the provision of export-contingent GSM 102 ECGs at below-market fees. It has, therefore, failed to achieve "full withdrawal" of the subsidy consistent with the Article 4.7 recommendation. In urging the Panel not to examine whether its replacement measure confers export-contingent "benefits", the United States seeks precisely to escape its obligation under that provision to fully withdraw the prohibited subsidy.

38. Contrary to the U.S. position, item (j) does not, *via* an *a contrario* reading, constitute the only evidentiary path by which an export credit guarantee or an ECG program can be shown to constitute an export subsidy. There is one very important reason for this conclusion – item (j) does not satisfy the terms of footnote 5 of the *SCM Agreement*. Footnote 5 expressly identifies the only circumstances in which the Illustrative List can be relied upon to identify measure that are not prohibited. Item (j) does not in any way affirmatively refer to any ECGs as "not constituting export subsidies." It therefore cannot be read *a contrario*, as the United States wishes. This same conclusion was reached by the panel in *Korea – Vessels*, which considered item (j) in light of footnote 5.

39. The first category of evidence relates to the *structure and design* of the GSM 102 program. This evidence is critical, because it is an ECG program's structure and design that ultimately determine whether the fees charged will, over the long term, cover operating costs and losses. Viewed alone, historical data about an ECG program's performance is potentially unreliable, because it may reflect accidents of good fortune over a given period of years.

40. Brazil has identified at least five aspects of the GSM 102 program that establish that it is not structured and designed to meet its long-term operating costs and losses. All of these structural features were considered by the original panel to support its conclusion that the ECG programs constituted export subsidies within the meaning of item (j). All of these structural features persist in the amended GSM 102 program.

41. Brazil turns now to the second category of evidence that is relevant to the compliance Panel's analysis under item (j) of the Illustrative List, should the Panel deem it necessary to proceed to that alternative basis for finding GSM 102 to be an export subsidy. That second category comprises Brazil's evidence that, as a matter of *historical* performance, the GSM 102 program has not met its operating costs and losses. Brazil has offered such evidence using both a net present value methodology, and a cash basis accounting methodology. Viewed using either methodology, the GSM 102 program does not survive scrutiny under item (j).

42. To close, Brazil made a brief observation on its claim that no measures taken to comply exist with respect to ECGs for unscheduled products and rice outstanding on 1 July 2005. Brazil's claim is supported by the compliance panel and Appellate Body reports in *Brazil – Aircraft (21.5)*. These reports concluded that in continuing, after the implementation deadline, to perform on financial instruments concluded before adoption of the DSB's recommendation, Brazil was not fully withdrawing the subsidy. Analogously, in continuing, after the implementation deadline, to perform on ECGs issued before adoption of the DSB's recommendation, the United States has not fully withdrawn the subsidy. We believe that as a result, the United States can neither pay claims under these outstanding ECGs, nor reschedule those outstanding ECGs.

ANNEX C-2

CLOSING STATEMENT OF BRAZIL

(28 February 2007)

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1. INTRODUCTION

1. Thank you Mr. Chairman, Members of the Panel and Members of the Secretariat. In our Closing Statement, we would like to touch upon a few issues in the U.S. Oral Statement of yesterday.

2. RELATIONSHIP OF ARTICLE 21.5 OF THE DSU AND ARTICLE 7.8 OF THE *SCM AGREEMENT*

2. This Panel is well aware that this is the first Article 21.5 proceeding to deal with implementation of rulings related to adverse effects under the *SCM Agreement*. Brazil cannot over-emphasize the importance of an interpretation that safeguards the effectiveness and legal integrity of the provisions under Part III of the *Agreement*. As the United States reminded us in its Oral Statement, "[a]n interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility."[1]

3. I recall the question that I posed yesterday in our Oral Statement: When the original panel issued its report on 18 June 2004, did the original panel intend to leave Brazil with no implementation rights for serious prejudice caused by mandatory and price-contingent marketing loan and CCP program payments made after 31 July 2003 – the end of MY 2002?

4. If the United States were to prevail on its view that subsequent mandatory and price-contingent marketing loan and CCP payments are not properly before this Panel, the grant of annual recurring subsidies becomes "a moving target that escape from [the WTO subsidy] disciplines."[2] Subsequent mandatory subsidies would always have to be subject to new dispute settlement proceedings, and by the time these proceedings were completed, the effects of the latest subsidies would be superseded by yet more subsidies, which could in turn only be challenged in yet another original panel process. WTO dispute settlement would dissolve into a "Groundhog Day" situation, with no remedy available to Members suffering adverse effects.[3]

3. PRICE TRANSMISSION AND MARKET INTEGRATION

5. In its Oral Statement, the United States claims that Brazil makes conflicting arguments by arguing (i) for a rapid price transmission in an integrated world cotton market and (ii) for a much slower predicted reaction by farmers outside the United States to higher prices from the elimination of U.S. cotton subsidies. Andrew Macdonald and Professor Sumner both discussed these issues. The United States confuses two related, but distinct issues.

6. Much of world's cotton is produced in relatively remote areas, often lacking strong infrastructure. Further, information systems for farmers are often limited and in some cases policies restrict the ability of farmers to respond to world market prices. These conditions mean that farmers' planting decisions in some countries respond incompletely, or with some delay, to observed changes in world market prices for cotton.

7. At the same time, the world market for cotton is well integrated. Prices are highly correlated over time across various country markets. The CIF price charts that the United States exhibited with its Oral Statement show that prices for cotton in different countries move together. But those CIF prices are not the prices that farmers observe directly in those countries. In fact, there is a major step

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[1] Appellate Body Report, *U.S. – Gasoline*, p. 23.

[2] Panel Report, *U.S. – Softwood Lumber IV (21.5)*, para. 4.30.

[3] Panel Report, *U.S. – Softwood Lumber IV (21.5)*, para. 4.30, quoting arguments of the European Communities.

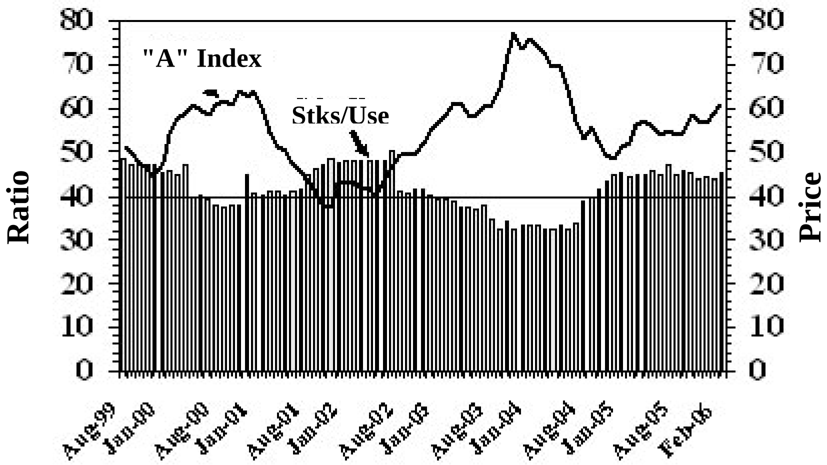
from the CIF export price at the border and retransmissioning those price signals back to individual farmers. Hence, these prices confirm market integration, but do not reflect the slow and limited price transmission that affects cotton farmers' planting decisions.

8. Consequently, the United States, in paragraph 80 of its Oral Statement[4], misinterpreted a statement by Professor Sumner regarding the transmission of prices. The statement at paragraph 28 of Annex I notes that "there is an imperfect transmission of price changes generated by U.S. cotton policy changes to cotton producers in certain cotton producing regions." As I think we can agree, foreign growers will react more slowly to "policy changes" taking place in the United States than would a U.S. cotton farmer faced with the imminent elimination of its own revenue from marketing loan and CCP subsidies. This is obviously different from the daily price fluctuations of the New York futures or "A Index."

4. BRAZIL'S CAUSATION ANALYSIS, EXPORTS AND THE EFFECTS OF STEP 2

9. In its Oral Statement, the United States claims that Brazil has shifted position from asserting that exports cause price suppression, to asserting that stocks and production cause price suppression. The United States misinterprets Brazil's claims. Production, stocks and exports are in fact interlinked; any production not consumed domestically must eventually be exported. Moreover, as the graph in the written version of my statement demonstrates[5], cotton prices and the relative amount of stocks are closely correlated. In other words, subsidy-fueled production that results in stocks impacts market prices, much as subsidy-fueled production that results in exports.

Cotton: "A" Index and World Stocks/Use,
August 1999 – February 2006



10. As Andrew Macdonald has explained, for purposes of price effects, U.S. stocks and exports are one and the same. In light of declining U.S. domestic use, U.S. stocks must eventually be exported. The transparency of the U.S. market means that market participants are fully aware of this fact. Whether U.S. supply ends up temporarily in a warehouse, or is exported immediately, the U.S. subsidies-generated supply suppresses world market prices.

[4] Check against delivery version.
[5] Exhibit Bra-660 (http://www.cottoninc.com/CottonMarketComments/ChinaStocksRevisedUpward/).

11. Further, the United States claims that the repeal of the Step 2 program has reduced U.S. exports, as allegedly shown by MY 2006 year-to-date data. Yet, the data show that after years of increases, exports from almost all the large exporting countries (except India, which is a special case given the improvements in the Indian cotton industry) are projected to fall in the current marketing year.[6]

EXPORTS	2000-2001	2001-2002	2002-2003	2003-2004	2004-2005	2005-2006	2006-2007	05/06 v 06/07 % Change
WORLD	5881	6449	6645	7233	7780	9645	8769	-9.99
USA	1472	2395	2591	2995	3143	3821	3418	-11.79
CFA	755	756	815	1957	936	1031	971	-6.18
UZBEK	800	810	783	659	850	1000	946	-5.71
AUSTRALIA	849	662	575	470	435	538	483	-11.39
BRAZIL	68	147	107	110	339	456	330	-38.18
GREECE	270	250	280	247	321	355	243	-46.09
INDIA	n/a	n/a	11	119	136	600	894	32.89

in '000 metric tons Source ICAC – World Cotton Statistics – Review of Cotton Situation[7]

12. USDA itself has stated what many independent market analysts, including Andrew Macdonald, confirm: that Chinese demand for imports has fallen considerably as China is apparently using up "a large supply of cotton imported prior to the expiration of the Step 2 program."[8] Increasing Indian exports have added to export declines in the United States and other exporting countries.[9]

13. Nevertheless, USDA (and ICAC) currently project U.S. exports in MY 2006 to be the *second highest in history* and comparable to MY 2004 levels. The United States has conceded that MY 2005 saw a large and unnatural surge in exports just prior to the repeal of Step 2.[10] Thus, the level of exports would probably have been lower in MY 2005 and higher in MY 2006 *but for* the unusual end of MY 2005 surge of exports taking advantage of the last Step 2 subsidies. Indeed, U.S. MY 2007 exports are projected to increase again.

14. In sum, there is no evidence that the elimination of Step 2 has any significant impact on U.S. exports.

5. COST OF PRODUCTION

15. The United States claims that Brazil's "theory" of a cost-revenue gap "fails as a matter of fact"[11] because of newly-presented cost/revenue data for MY 2003. As Brazil noted in its

[6] Exhibit Bra-652 (International Cotton Advisory Committee Review, Volume 60, Number 3 January-February 2007, accessed February 2007, p. 4).

[7] Exhibit Bra-661 (Export Statistics, ICAC, February 2007).

[8] Exhibit Bra-662 (Elton Robinson, "High certificated cotton stocks slow trade, weigh on prices," Delta Farm Press, 1 December 2006, accessed February 2007 at http://deltafarmpress.com/mag/farming_high_certificated_cotton/).

[9] Exhibit Bra-652 (International Cotton Advisory Committee Review, Volume 60, Number 3 January-February 2007, accessed February 2007, p. 4.

[10] Exhibit Bra-651 (Cotton and Wool Outlook, USDA, 12 February 2007, p. 4, accessed February 2007 at http://usda.mannlib.cornell.edu/usda/current/CWS/CWS-02-12-2007.pdf).

[11] U.S. Oral Statement, para 71 (Check against delivery version).

Oral Statement[12], MY 2003 was characterized by unusually high prices. Over the past seven years (*i.e.,* MY 1999-2005), MY 2003 is the only year, in which the average U.S. acre planted to cotton happened to make a profit based on market revenue. That said, even the United States admits that in MY 2003 fully 8 percent of U.S. cotton production was unable to cover its variable and total costs. Based on this MY 2003 data, the United States implies that over the lifetime of the 2002 Farm Act, "fully 92 percent of U.S. upland cotton is produced without the help of subsidies."[13] However, this is wrong even for MY 2003. The average middle cost farm covered costs, but within the group, there is also a wide range an many of those farms (about a third depending on the precise nature of the variation of those farms) failed to cover costs. This means that, even in MY 2003 almost half of the U.S. production failed to cover costs.

16. Moreover, as we demonstrated yesterday and in previous submissions, this is false. MY 2003 is the odd year in which the U.S. cotton industry earned $864 million. In the four years prior to MY 2003 and the two years thereafter, it lost $13.2 billion. Unless my math is wrong, a profit of $864 million hardly offsets a loss of $13.2 billion, but results in long-term net *losses* of $12.4 billion that were covered by marketing loan and CCP subsidies.[14] There is no basis for the U.S. assertion that U.S. cotton production is economically viable.[15]

6. "SIGNIFICANT"

17. The United States argues that Brazil failed to establish that the world market price effects from marketing loan and CCP subsidies are "significant." We have addressed this issue in our submissions, and again in yesterday's statement. According to the original panel, "significant" means "important; notable … consequential"[16] and must be assessed in light of the market and product at issue.[17] The original panel moreover clarifies that for cotton "a relatively small decrease or suppression of prices could be significant because … profit margins may ordinarily be narrow" and "because of the sheer size of the market in terms of the amount of revenue involved in large volumes traded."[18]

18. We have presented quantitative evidence of price effects based on Professor Sumner's study. His results fall right in the middle of a range of work by other economists. In light of the product and market at issue, the price effects he finds are "significant." For example, in MY 2005, the value of total cotton production was $31 billion.[19] Applying Professor Sumner's average price effect of about 10 percent represents revenue of $3.1 billion – a result that is significant by any measure.

19. By contrast, the United States has presented a remarkable economic conclusion to the Panel that is clearly at odds with mainstream economics. It claims that U.S. marketing loan and CCP subsidies cause price suppression of between 0.96 and 2.26 percent depending on the time period examined and the U.S. parameter set selected. Compare these numbers to the helpful table prepared by FAO listing a variety of estimates from a variety of sources.[20] The U.S. estimates are not just at the low end of the table. They have fallen off the table below the lowest points in the range of even

[12] Brazil's Oral Statement, para. 84.
[13] U.S. Oral Statement, para. 86 (Check against delivery version)
[14] Exhibit Bra-477 (U.S. Upland Cotton Costs and Returns).
[15] Exhibit Bra-477 (U.S. Upland Cotton Costs and Returns).
[16] Panel Report, *U.S. – Upland Cotton*, para. 7.1325.
[17] Panel Report, *U.S. – Upland Cotton*, para. 7.1329.
[18] Panel Report, *U.S. – Upland Cotton*, para. 7.1330.
[19] Brazil's First Written Submission, para. 190.
[20] Exhibit Bra-579 ("Cotton: Impact of Support Policies on Developing Countries – Why Do the Numbers Vary?" FAO Trade Policy Brief, p. 2, accessed December 2006 at ftp://ftp.fao.org/docrep/fao/007/y5533e/y5533e00.pdf).

the lowest estimates of any other analyst. As Professor Sumner points out in his supplementary statement in Exhibit Bra-659, the set of parameters put forward by the United States as the basis for these estimates is not credible. Their results are incredible actually.

20. In any event, in light of the product and market at issue, even the price effects found by the United States must be considered "significant." In light of the very competitive nature of the cotton market, profit margins of developing country cotton producers, including in Brazil and in West African countries, are generally low. Assuming conservatively that they reach 5 percent, a one percent price effect would increase farmers' net income by 20 percent. Very small price effects, therefore, have a large impact on their income and livelihood, as is evident from Chad's presentation this morning.[21] The United States appears to argue that these effects are "unimportant," "not notable," or "inconsequential." The United States is wrong.

Finally, the original panel also noted that the 5 percent *ad valorem* subsidization rate set out in Article 6.1(a) of the *SCM Agreement* may be relevant in assessing "significance."[22] In this regard, I note that the subsidization rates of U.S. cotton from marketing loan and CCP subsidies alone averages 40 percent over the period MY 2002-2005, and reaches 61 per cent in MY 2004.[23]

7. EXPORT CREDIT GUARANTEES

21. I have a few closing comments on ECGs. The United States has not demonstrated that the amended GSM 102 program meets its long-term costs and losses, under item (j). Applying a net present value (NPV) methodology, as did the original panel, the CCC continues, every year, to project that GSM 102 ECGs issued in that year will result in losses.

22. The NPV calculation used to arrive at initial projections of losses on ECGs actually issued in a given year is critical, whether or not re-estimates are made over time. U.S. law requires NPV projections because they "measure more accurately the costs of Federal credit programs" than does cash-basis accounting.[24] Similarly, bank regulators all over the world use projections of default probabilities and losses-given-default – the core of NPV methodology – to gauge the adequacy of a bank's capital.[25] If historical experience truly establishes that a methodology overstates the risk of default, the methodology may be adjusted accordingly for the purpose of calculating future projections on new commitments. The CCC makes such adjustments; FAS has stated that "credit models used to calculate the subsidy for the guaranteed credits were revised in FY 2001 and FY 2003 and currently provides reliable estimates".[26] Despite these adjustments, the CCC continues to project cohort-specific long-term losses upon issue of each new GSM 102 cohort.[27]

23. But let us assume, for the sake of argument, that the United States has amended the GSM 102 program so that it now meets its costs and losses. This does not mean that the United States has lived up to its obligation to "withdraw the subsidy", for two reasons.

[21] *See* Panel Report, *U.S. – Upland Cotton*, para. 7.54 and additional references thereto.
[22] Panel Report, *U.S. – Upland Cotton*, footnote 1432.
[23] Brazil's First Written Submission, Table 6.
[24] Exhibit Bra-545 (2 U.S.C. § 661(1)).
[25] *See* "Internal Ratings-Based Approach" of the Basel Committee on Banking Supervision", described at http://www.bis.org/publ/bcbs128.htm.
[26] Exhibit Bra-588 (Agricultural Export Credit Guarantee Programs Assessment, ExpectMore.gov, Section 3.CR2) (emphasis added).
[27] *See* evidence cited in Brazil's Opening Statement, para. 253.

24. First, the United States is wrong that item (j) "demonstrates dispositively the circumstances under which export credit guarantees are considered export subsidies".[28] This argument would transform an "illustrative" into an exhaustive, dispositive list. The U.S. interpretation also fails to give full effect to footnote 5. A provision that tells us what is an export subsidy does not automatically tell us what is not an export subsidy. For example, all we know from item (j) is that, if a program fails to meet its costs and losses, it is an export subsidy. It is neither correct interpretively, nor logically valid, to conclude that if an ECG program breaks-even, it is not an export subsidy. Mere implication, through *a contrario* reasoning, does not satisfy footnote 5. Rather, to satisfy that footnote, the item must actually contain language that "refer[s]" to a measure as "not constituting" an export subsidy.

25. Second, the Appellate Body has found that "full *withdrawal* of a prohibited subsidy … cannot be achieved by a 'measure taken to comply' that replaces the original subsidy with yet another subsidy found to be prohibited."[29] Thus, even if the amended GSM 102 program clears item (j), the United States has merely replaced it with another export subsidy. Under the amended fee schedule, GSM 102 ECGs are export-contingent contributions that confer "benefits", in two senses.

26. First, GSM 102 ECGs confer "benefits" *per se*, because they are unique financial instruments with no parallel at market, and because they enable credit that would not otherwise be available.[30] The United States has not provided a single example of a product offered by a market-based entity that imparts the essential qualities of a GSM 102 ECG cited by Professor Sundaram.[31] The United States has offered precisely one example of a bank that was able to secure a commercial loan without a GSM 102 ECG. Even that one example involved an investment grade bank, rather than the non-investment grade foreign obligors targeted by GSM 102.[32] Brazil's evidence and argument stand.

27. Second, Brazil has demonstrated that GSM 102 fees are dramatically lower than fees for essentially identical products offered by a non-market U.S. government entity, ExIm Bank. The sole U.S. response is that other non-market entities – the EBRD, IFC and IDB – also offer products that it alleges are similar to GSM 102 ECGs. The United States does not, however, explain why these non-market benchmarks would offer a better comparison than that offered by Brazil's ExIm Bank exercise. Nor has the United States demonstrated that GSM 102 fees are higher than fees for these allegedly similar products offered by the EBRD, the IFC and the IDB.

28. According to the United States, the only way to determine the existence of a "benefit" from an ECG in an export subsidy case is through a quantitative assessment under what it deems the "total cost of funds" approach in Article 14(c).[33] However, this overlooks the wording and role of Article 14. That provision sets forth only "guidelines" that the Appellate Body, at the United States' urging, has concluded must not be followed rigidly, even in countervailing measure disputes to which the provision expressly applies.[34] That flexibility is even more important to preserve in an export subsidy case, where Article 14 does not directly apply, precisely because the quantification foreseen by the provision is not required. All Brazil need show is that some "benefit" flows from a GSM 102 ECG.

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[28] U.S. Opening Statement (Check against delivery version), heading III.A.1 (emphasis added).

[29] Appellate Body Report, *U.S. – FSC (21.5 II)*, para. 83 (italic emphasis in original; underlining supplied).

[30] *See* Brazil's Opening Statement, paras. 174-177.

[31] Brazil's First Written Submission, Annex III (Statement of Professor Rangarajan Sundaram), para. 7.

[32] Brazil's Opening Statement, paras. 218, 223.

[33] U.S. Opening Statement (Check against delivery version), paras. 31-39; U.S. Rebuttal Submission, paras. 137-144; U.S. First Written Submission, paras. 107, 133-134, 138.

[34] Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 92.

29. Two panels have held that a guarantee confers a "benefit" if it is offered at fees that are not consistent with market.[35] In the particular factual circumstances of this case, where the U.S. exporter does not bear the cost of extending or securing credit, an evaluation of the GSM 102 fees paid by the exporter is particularly appropriate.[36] Insisting on the rigid "total cost of funds" approach supported by the United States would be interpretively wrong, and would also risk the very "circumvention" of the subsidy disciplines that led the Appellate Body to its flexible approach to Article 14.[37]

30. I offer a closing note on our claim that no measures taken to comply exist with respect to certain ECGs outstanding on 1 July 2005. The original panel found that the ECG programs were export subsidies within the meaning of item (j). The recommendation that the United States "withdraw the subsidy" therefore applied to the ECG programs. However, the recommendation also includes the subsidiary obligation to withdraw certain outstanding ECGs issued under those programs.[38] Continuing to perform on such ECGs, defined in Article 1.1 as contingent liabilities, does not satisfy the definition of "withdraw" offered by the Appellate Body in *Brazil – Aircraft (21.5)* (or, for that matter, by the United States in its opening statement). Paying a claim on default of a GSM 102 credit does not "remove" or "take away" the subsidy[39], or "cause" that subsidy "to decrease or disappear".[40]

8. CONCLUSION

31. Thank you Mr. Chairman and Members of the Panel for your time and attention. We look forward to provide responses to answer your written questions.

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[35] Panel Report, *EC – CVDs on DRAMs*, para. 7.189; Panel Report, *Canada – Aircraft Credits and Guarantees*, para. 7.345.

[36] Brazil's Opening Statement, para. 205; Brazil's Rebuttal Submission, paras. 402-407, 411-413.

[37] Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 100.

[38] Appellate Body Report, *U.S. – FSC (21.5)*, paras. 2, 223-231 (recommendation to withdraw a subsidy in the form of an overarching measure, the FSC, includes the obligation to stop making pre-committed payments to existing FSCs); Appellate Body Report, *Brazil – Aircraft (21.5)*, para. 45 ("… to continue to make payments under an export subsidy measure found to be prohibited is not consistent with the obligation to 'withdraw' prohibited export subsidies, in the sense of 'removing' or 'taking away'.").

[39] Appellate Body Report, *Brazil – Aircraft (21.5)*, para. 45.

[40] U.S. Opening Statement (Check against delivery version), para. 42.

ANNEX C-3

EXECUTIVE SUMMARY OF THE OPENING STATEMENT OF THE UNITED STATES

(27 February 2007)

1. This is a compliance proceeding. The question for this Panel is whether Brazil has established that the U.S. measures taken to comply with the DSB's recommendations and rulings are inconsistent with the covered agreements cited by Brazil.[1] The burden is on Brazil to prove its claims in this regard. The United States has taken numerous steps to comply: (a) the United States stopped operating the Supplier Credit Guarantee Program (or "SCGP"); (b) the United States ceased operating the GSM 103 program; (c) the United States overhauled GSM 102, the remaining export credit guarantee program; and (d) the United States eliminated the Step 2 program. As a result, the United States is in compliance with its WTO obligations.

I. CLAIMS IN RESPECT OF EXPORT CREDIT GUARANTEES FOR EXPORTS OF UNSCHEDULED PRODUCTS AND RICE

2. **– GSM 102 Guarantees Issued Subsequent to 1 July 2005 Are Provided Consistently with Item (j) of the Illustrative List.** Brazil argues that, notwithstanding any U.S. measures taken to comply, GSM 102 guarantees are inconsistent with Articles 10.1 and 8 of the *Agreement on Agriculture* and 3.1(a) and 3.2 of the *SCM Agreement*. These claims turn largely on a single question – whether the GSM 102 guarantees are "export subsidies" under the *SCM Agreement*.

3. There is only one definition of "export subsidy" in the *SCM Agreement* and its elements are set out in Articles 1.1 and 3.1(a) of the *SCM Agreement*. To show how *these* definitional elements apply in particular circumstances, Article 3.1(a) refers to the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*. In the case of export credit guarantees, it is item (j) that applies. Item (j) "illustrates" – or "clarifies" – those export credit guarantees that *are* export subsidies (*i.e.*, those that are provided under programs "at premium rates which are inadequate to cover the long-term operating costs and losses of the programs") from those that are not. This was how the original panel determined whether the GSM 102, GSM 103, and SCGP export credit guarantees were providing "export subsidies" in the original proceeding. This was also the basis for the DSB's recommendations and rulings regarding the guarantees. And this was the analysis that the United States observed in implementing the DSB's recommendations and rulings.

4. The United States has taken a number of measures to increase the premiums and lower the potential long-term operating costs and losses of the portfolio of export credit guarantee programs examined by the original panel. The financial data in the U.S. budget shows now that the export credit guarantee programs operate at entirely profitable levels, consistent with item (j).

5. **– Articles 1.1 and 3.1(a) Do Not Establish a "Different Benchmark" From the One in Item (j) For Establishing Whether Export Credit Guarantees Are Export Subsidies.** Brazil has provided no credible rebuttal to the U.S. evidence regarding item (j). It has concentrated its efforts, instead, on finding a "back-door" way to attack the guarantees. Toward this end, it has claimed an "entitlement" to challenge GSM 102 guarantees under the general definitional elements in Articles 1.1

[1] DSU Article 21.5.

and 3.1(a) and then, if it fails in that regard, to raise an argument under item (j) "in the alternative."[2] Brazil's approach is based on an incorrect interpretation of the *SCM Agreement*. Contrary to Brazil's arguments, "Articles 1.1/3.1(a) and item (j)" do *not* "offer . . . *different benchmarks* to demonstrate that a measure is an export subsidy."[3] Indeed, such an interpretation leads to entirely untenable results.

6. Brazil argues that the U.S. approach would require what Brazil terms an "*a contrario*" reading of item (j). According to Brazil, footnote 5 of the *SCM Agreement* allegedly "definitively forecloses" such an interpretation.[4] This is incorrect, as Brazil itself has recognized in other disputes.[5] Contrary to Brazil's arguments, footnote 5 does not require an "affirmative statement" that a measure is *not* a prohibited export subsidy, and an "affirmative statement" is not required under the ordinary meaning of the term "refer." To the contrary, the ordinary meaning confirms that "referred to" can include measures that are either *expressly* or *implicitly* "referred to" as not constituting export subsidies.[6] Brazil explained to the Appellate Body, in *Brazil – Aircraft (21.5)* that item (j) contains just such an implicit reference.[7] Moreover, the Appellate Body indicated that it accepted Brazil's argument that the first paragraph of item (k) could be read *a contrario* to determine when measures are "justified."[8] That result is equally appropriate here.

7. Brazil's interpretation of footnote 5 is undermined also by the negotiating history, which shows that Members agreed to delete from an earlier draft language that would have required an *express* reference in order for the provisions of the footnote to apply.[9] Moreover, that interpretation would – if applied – nullify or render redundant a number of provisions of the *SCM Agreement*, including footnote 5 itself. As the Appellate Body has explained, "[a]n interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility."[10]

8. **– Brazil Has Not Shown That GSM 102 Guarantees Provide a "Benefit."** The Panel's analysis properly ends with an assessment under item (j). Any further examination, however, would only confirm that the GSM 102 guarantees are not prohibited export subsidies, as Brazil fails to demonstrate any distinct "benefit" under Article 1.1(b). Indeed, Brazil attempts to show a "benefit" based on a theory that, if credited, would undermine not only item (j) and other provisions of the *SCM Agreement* – for the reasons noted above – but also the logic of Articles 1.1(a) and Article 14(c) of the *SCM Agreement*.

9. Article 14 does not apply directly in this context; it applies, instead, "for the purpose of Part V" of the *SCM Agreement*. Nonetheless, because it interprets and applies the definition of "benefit" set out in Article 1.1, it has been relied upon by the Appellate Body as important contextual guidance in interpreting "benefit,"[11] and, indeed, it has been invoked by Brazil to justify its approach here.[12] Article 14(c) provides that a government loan guarantee confers a benefit for countervailing

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[2] Brazil Rebuttal Submission, para.457.

[3] Brazil Rebuttal Submission, para.470 (emphasis in original).

[4] Brazil Rebuttal Submission, para.563.

[5] *See e.g., Brazil – Aircraft (AB)*, paras. 14 and 19.

[6] *See* Oxford English Dictionary, p. 2520 (Exhibit US-116).

[7] *Brazil – Aircraft (AB)*, para. 19.

[8] *Brazil – Aircraft (21.5) (AB)*, para. 80.

[9] *Compare* MTN.GNG/NG10/W/38/Rev. 2 (2 November 1990) and MTN.GNG/NG10/W/38/Rev. 3 (6 November 1990).

[10] *United States – Gasoline (AB)*, p. 23.

[11] *Canada – Aircraft (AB)*, para. 155.

[12] Brazil First Written Submission, paras. 371-375

duty purposes *only* where there is "a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee." The "benefit" is measured as "the difference between these two amounts adjusted for any differences in fees."

10. Article 14(c), thus, recognizes that the provision of a loan guarantee is fundamentally different from the provision of other government services. In the case of government services, Article 14(d) applies and provides that a "benefit" may be calculated only where "the provision [of the service] is made for less than adequate remuneration." Article 14(c) specifically *precludes* such an approach for loan guarantees. Instead, it recognizes that a loan guarantee is made for the sole purpose of *supporting a loan transaction*; the guarantee becomes an integral part of that transaction and has no value beyond it. An assessment of the total costs of the transaction is necessary to assess whether a "benefit" is actually conferred by the guarantee. A simple comparison of the fee charged for the issuance of one loan guarantee to the fee charged for another may provide an incomplete and distorted picture in this regard.

11. Brazil purports to invoke Article 14(c) of the *SCM Agreement* to support its approach.[13] But under the guise of identifying a "severable benefit," Brazil actually attempts to conduct the kind of simple comparison of fees that *Article 14(d)* allows for assessing whether a government-provided service confers a benefit, but that *Article 14(c)* specifically *precludes* with respect to loan guarantees.

12. Brazil has not even attempted to make the kind of particularized showing contemplated under Article 14(c) of the *SCM Agreement*. Instead, Brazil relies on sweeping and erroneous assertions that obligors on loans guaranteed under the GSM-102 program can *never* obtain any other financing of any kind and that the United States could *never* provide an export credit guarantee without also providing an export subsidy. These arguments simply do not square with the evidence submitted by the United States showing that such obligors are, in fact, able to obtain financing even without GSM 102 guarantees and on terms better than those available *with* GSM 102 guarantees. The declining level of use of the GSM 102 program in recent years is even further evidence of this.

13. Moreover, even though they are not part of the inquiry under Article 14(c), Brazil's other sweeping theories – including of GSM 102 guarantees being a unique financial instrument – have been shown to be factually unsupported. These arguments too are unavailing in the face of the evidence of financial products entirely comparable with those offered by the United States from private, profit-seeking entities that are not agencies or instrumentalities of any government. In short, Brazil has not demonstrated that GSM-102 guarantees presently confer export subsidies.

14. **– Measures Taken to Comply Exist With Respect to GSM 102, GSM 103, and SCGP Guarantees Issued Prior to 1 July 2005.** With respect to these measures, the U.S. obligation was to "cause to decrease or disappear" or "take away" the provision of "the service under the export credit guarantee programs" at a "net cost to the government, as the service provider."[14] The United States has done so.

15. There is no merit to Brazil's attempts to call into question the fact that SCGP guarantees have expired on the basis that the United States is continuing to *recover* money on claims that it has paid out on SCGP guarantees in the past. Nor is there any basis for Brazil's argument that the United States is not permitted to make itself whole by collecting on claims paid out on export credit guarantees that were issued prior to 1 July 2005.

[13] Brazil First Written Submission, paras. 371-375

[14] *Upland Cotton (Panel)*, para. 7.804.

16. Moreover, nothing in the *SCM Agreement* provides that "withdrawing" a "subsidy" allegedly "taking the form of a program" "includes an obligation to abstain from performing on commitments outstanding under that program as of the deadline for implementation."[15] That argument improperly equates "performing on commitments under the program" with the "subsidy" itself. Such an equation was appropriate in *Brazil – Aircraft (21.5)*, where Brazil continued to issue new WTO-inconsistent bonds even after the period of implementation on the basis that it had pre-existing contractual obligations to do so.[16] However, it is not accurate here, where the guarantees are not themselves prohibited subsidies.

IV. ACTIONABLE SUBSIDY RELATED CLAIMS

17. A number of erroneous assumptions must be made even to get to the merits of Brazil's actionable subsidy related claims in this proceeding. The Panel must simply assume, despite the express statements to the contrary in the original panel report, that the original panel's "present" serious prejudice finding extends to the Step 2, marketing loan, and counter-cyclical payment *programs* and *all payments* authorized thereunder. Moreover, despite the fact that the original panel could not have known the *actual* market conditions – and did not examine the *likely* market conditions – in MY 2006, the Panel must also assume that the original panel made a finding that "present" serious prejudice would exist at this time as a result of the measures challenged in the original proceeding. As there is no basis on which to make any of these assumptions, Brazil's claims fail at the outset. There are also more flaws if one probes further.

18. **– Brazil Fails to Substantiate Its Arguments That Termination of the Step 2 Program Was Effectively Meaningless**. The evidence and arguments submitted by Brazil regarding the termination of the Step 2 program are difficult to credit. They are unsubstantiated, internally contradictory and inconsistent with arguments that Brazil made in the original proceeding on such fundamental issues as the effects of Step 2 payments on exports and world market prices.

19. Indeed, Brazil's submissions are almost devoid of any acknowledgment that Brazil argued and, indeed, convinced the original panel to declare the Step 2 program to be a prohibited export subsidy. Export subsidies are prohibited because they are "dependent for [their] existence on export performance" and are specifically "'tied to' the export performance."[17] They are, thus, by definition expected to induce exports and deemed so likely to distort trade that no examination of their actual trade effects is required under the *SCM Agreement* in order for a finding against them.

20. Having convinced the original panel to make an export subsidy finding against the Step 2 program – in response to which the United States eliminated the program completely – how can Brazil now allege that termination of the program has "no impact on the level of U.S. . . . exports"? Moreover, given that Brazil's theory of price suppression centres on whether U.S. upland cotton is exported, how can Brazil now allege that elimination of that allegedly *export-contingent* subsidy has "little positive impact on the world price for cotton in the long term"?[18] These are questions to which Brazil has yet to provide a credible answer.

21. Moreover, while Brazil may now consider termination of the Step 2 program to be inconsequential, the loss of the program has not been meaningless to U.S. producers and exporters. Since the termination of the program, U.S. exports are at exceptionally low levels – the United States

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[15] Brazil Rebuttal Submission, para. 396.

[16] *Brazil – Aircraft (AB)*, para. 45.

[17] *Canada – Aircraft (21.5 – Brazil) (AB)*, para. 47.

[18] Brazil First Written Submission, para. 206 (quoting Brazil First Written Submission, Annex II, paras. 41-43).

discussed some of these statistics at start of this presentation – and the forecasts for this marketing year and the next continue to be poor. It is simply too early to know precisely how much of this decline is attributable to the loss of the Step 2 program. Undoubtedly some of it is not. But what is clear is that Brazil's assertion that termination of the Step 2 program has "no impact on the level of U.S. production or exports" and "little positive impact on the world price for cotton" finds little basis in the empirical evidence. The evidence, in fact, supports exactly the opposite conclusion.

22. **– Brazil Does Not Demonstrate That Marketing Loan and Counter-Cyclical Payments Are Causing "Present" Significant Price Suppression.** Nor are marketing loan and counter-cyclical payments presently significantly "suppressing" world market prices within the meaning of Articles 5(c) and 6.3(c) of the *SCM Agreement*. Brazil's theory, in general terms, is that "payments-cause-overproduction-cause--price-suppression." To support its theory, though, Brazil would have to: (a) submit persuasive evidence showing that marketing loan payments and counter-cyclical payments are *actually* inducing U.S. farmers to plant more cotton than they otherwise would; (b) show that the *degree* of effect on U.S. farmers' planting decisions, production, and export is such as to have impacts on world market prices; and (c) submit evidence to show that the *degree* of effect on world market prices is "significant" within the meaning of Article 6.3(c). Brazil has not done so.

23. **Evidence Regarding *Actual* Production Decisions and Effects of Payments Undermines Brazil's Claims.** In assessing the evidence and arguments submitted by Brazil, it is important to bear in mind that a claim of "present" serious prejudice under Articles 5(c) and 6.3(c) requires a showing that significant price suppression *actually* exists under the prevailing market conditions. Brazil cannot simply allege – or attempt to show – that marketing loan and counter-cyclical payments have the *potential* to induce production. It is also important to note that Articles 5(c) and 6.3(c) are concerned with the *effects* of subsidies, not their form. Thus, Brazil's efforts to show that marketing loan and counter-cyclical payment programs provide income support in times of low prices do not go far. Nothing in the *SCM Agreement* or any other agreement prohibits income support categorically.

24. Given Brazil's particular theory of planting effects leading to price effects, it is necessary to examine the actual planting decisions made by U.S. farmers. At a minimum, any assessment must be grounded in the understanding that in each year when a farmer sits down to decide whether to plant cotton, he does not *know* with certainty (a) what prices will be for cotton at the time of harvest, (b) what prices will be for competing crops at that time, (c) what his yields will ultimately be, (d) whether he might ultimately get a marketing loan payment on cotton or other crops, and (e) whether the season-average farm price for the upcoming marketing year will ultimately be below the threshold at which he might receive a counter-cyclical payment with respect to any upland cotton *base acres* that he holds. The farmer's planting decision *must* be made on the basis of *expectations*.

25. While Brazil has acknowledged (at least some) of these basic facts of upland cotton production[19], little of the evidence and arguments submitted by Brazil actually take these facts into account and show – on the basis thereof – significant production effects under the market conditions prevailing at present. By contrast, the United States has submitted evidence that takes into account the actual operation of the marketing loan and counter-cyclical payment programs and shows *minimal* effects on production, including (a) recent studies, (b) a nationwide survey of farmers' planting considerations, (c) evidence that much of counter-cyclical payments is passed through to non-operator landowners in the form of higher rents and land values, data showing that substantially less upland cotton (40 percent less) is planted by holders of upland cotton base acres today than at the time base acres were set, (d) data showing that a significant and growing portion of U.S. upland cotton planted acreage is on farms with cotton planted acreage that exceeds cotton base acres, or, indeed, on farms with no cotton base acres, and (e) evidence showing that futures prices for harvest-time contracts were

[19] *See e.g.,* Brazil First Written Submission, Annex I, para. 36 (emphasis added).

above the marketing loan rate in MY 2006 and that, even in earlier years when they were not, the evidence shows that U.S. farmers' planting decisions were driven by market factors, not expectation of payments under the marketing loan program. This evidence contradicts Brazil's theory that marketing loan and counter-cyclical payments have significant effects on planting.

26. Brazil purports to demonstrate *indirect* production effects through its claim that U.S. planting, production, and exports are not responsive to prices. However, Brazil's comparisons are flawed in that they ignore basic facts of upland cotton production; for example, by comparing planting decisions in a marketing year to the *actual* prices that develop many months later[20] or to the futures prices of upland cotton *alone*.[21] Moreover, the theory that Brazil advances of alleged market insulation is at variance with the empirical evidence. Indeed, Brazil's theory depends on the notion that the income support provided by marketing loan and counter-cyclical payments causes U.S. farmers to produce and U.S. exporters to export when anticipated low prices cause producers and exporters elsewhere to pull back. If that were true, one would expect to see U.S. share of world production and world exports increase. But that is not what one finds. Rather, U.S. share of world production and exports has been stable over the entire period of the FSRI Act and, indeed – in terms of production – for many years before that as well. This shows that, contrary to Brazil's arguments, U.S. producers and exporters have reacted to market signals in their production and exports in a similar way to their foreign counterparts.

27. Brazil has argued that U.S. producers cannot meet their total costs without marketing loan and counter-cyclical payments. Brazil asserts that this shows that without marketing loan and counter-cyclical payments, many U.S. producers would not have remained in business and continued planting upland cotton. **Table A.1**[22] shows, however, that the overwhelming majority of U.S. production (*92 per cent*) takes place on low- and mid-cost farms that meet both their variable (or operating) costs and also their total costs of production. This means that, for *92 percent of U.S. production* of upland cotton, Brazil's theory of a cost-revenue gap fails as a matter of fact. In other words, with respect to 92 percent of U.S. production, it is not necessary even to reach the arguments regarding the other flaws in Brazil's reasoning regarding the alleged cost-revenue gap. That gap simply does not exist.

28. There *are* other problems in Brazil's analysis as well, including the fact that Brazil incorrectly assumes that total costs of producing upland cotton are determinative for both year-to-year planting decisions and for longer-term decisions, such as whether to continue or exit upland cotton farming. In the former case, it is variable costs that are relevant and, in the latter, it is the *total* cost/revenue balance of the farm – of which costs and revenues for upland cotton is one factor – that is relevant. Moreover, the evidence shows that U.S. producers not only meet their variable costs with market revenue from sales of upland cotton, but also their total costs.

29. **Brazil Has Not Submitted Reliable Evidence Regarding the Degree of Any Price Effect.** The *only* evidence that Brazil has submitted purporting to examine the price effects of marketing loan and counter-cyclical payments specifically are the results of the modeling exercise that it has conducted for purposes of this proceeding. That exercise is conducted using a model that is entirely different from the one advanced by Brazil in the original proceeding, but that is virtually identical to one that was published in 2005, in a CATO institute publication, by Dr. Sumner, Brazil's economist. In the CATO publication, Dr. Sumner warned that his model "abstract[s] from many complexities that would be important to get more precise estimates" and that "[t]he simple model laid out here does not

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[20] *See e.g.,* Brazil First Written Submission, paras. 144-145.

[21] *See e.g.,* Brazil First Written Submission, paras. 142-143 and Brazil Rebuttal Submission. paras. 221-224.

[22] Exhibit US-119.

represent the depth of analysis that would be appropriate to support a trade remedy proceeding or a serious prejudice claim before a WTO panel."[23] The United States agrees.

30. We have identified a number of the key problems with Brazil's new model. These include that the model: (a) lacks cross-commodity impacts and cross-price elasticities, potentially leading to biased price effects; (b) is static with no explicit relationships for changes in cotton stock levels and no stocks equation; (c) contains foreign supply elasticities that are different from FAPRI that underestimate the response of foreign producers to changes in world prices; (d) treats production flexibility payments and direct payments differently even though they operate in the same way; (e) incorporates Step 2 payments directly into the producer revenue function as fully coupled payments, and (f) appears to ignore statutory parameters, for example by including counter-cyclical payment rates in each of the various price expectations that sometimes exceed the statutory maximum. These are just some of the problems that stem from the structure of the model itself, and the simplified, reduced nature of the assessment it attempts to conduct.

31. Even more significant biases result from the flawed econometric parameters used by the Sumner II model. Although Brazil has indicated that its new model "employs many of the same parameters used in the model and analysis submitted to the original panel, as well as parameters commonly used by USDA and Food and Agricultural Policy Research Institute ("FAPRI") economists,"[24] this is untrue. As shown in Table A-2 (Exhibit US-120), the elasticity estimates used by the Sumner I model (which were purported to be "FAPRI-based") and the Sumner II model differ in each case except for the estimate of the U.S. mill demand elasticity.

32. These differences matter because they can – and do – have dramatic effects on the estimated outcomes. As shown in Table A.2, not only does the Sumner II model use different elasticities than the Sumner I model, but, in each case, the Sumner II model elasticity results in a greater effect on world price due to an elimination of marketing loans and counter-cyclical payments. Moreover, the Sumner II model simply ignores the demand for US and world cotton stocks. Yet, as Brazil has acknowledged, year-to-year fluctuations in stock levels are important factors in any credible analysis of world cotton markets.[25] The modifications made by Brazil exaggerate the effects of the elimination of marketing loans and counter-cyclical payments on world cotton price.

33. Brazil has not provided any valid basis for discarding the generally-accepted economic parameters that it recognized, itself, as being appropriate in the original proceeding. As Brazil argued at that time, the FAPRI econometric model is well-established, well-known and widely used.[26] It is also valuable inasmuch as its calculations and parameters have not been developed in conjunction with any specific dispute or on behalf of any specific party. The FAPRI model has a strong foundation within economic circles and is well-respected. The Sumner II model, by contrast, has no foundation within economic circles. Although Dr. Sumner argues that the departures from FAPRI-based parameters indicate "improvements based on . . . continued research," Brazil has not identified that "research" and has provided no citation to any independent literature or other established or accepted bases for the new parameters.

34. Brazil has also attempted to justify a number of its flawed econometric parameters on the basis that it is looking to assess the impact of eliminating the marketing loan and counter-cyclical

[23] Daniel A. Sumner. "Boxed In: Conflicts Between U.S. Farm Policies and WTO Obligations." Center for Trade Policy Studies, The Cato Institute, December 2005. (Exhibit US-108)

[24] Brazil First Written Submission, para. 168.

[25] Brazil Oral Statement, 27 February 2007, para. 160.

[26] Brazil Further Submission to the Panel, 9 September 2003, para 214.

payment programs in the short-run, while leaving all else equal.[27] However, under Article 6.3(c) the question is what, if any, degree of price suppression exists *presently* as a result of the marketing loan and counter-cyclical payment programs and whether this degree of price suppression is "significant." To the extent a counterfactual assessment is undertaken, it is only to assess what the price equilibrium would be at present if marketing loan and counter-cyclical payments had been lower, different, or did not exist. Article 6.3(c) does not ask what prices will look like in the short-run adjustment period if the marketing loan and counter-cyclical payments are suddenly eliminated. Indeed, Members are not even required to eliminate measures found to be actionable subsidies; they are given a choice between "withdrawing" the subsidy or removing its adverse effects. Thus, in addition to the fact that the economic literature supports a long-term assessment, Brazil's argument that it is necessary to look at the short-run effects of total elimination of the programs cannot be accurate as a textual matter.

35. Second, it is not credible for Brazil to argue for a disproportionately small rest-of-world supply response on the basis that "there is imperfect transmission of price changes" because "market institutions, centralized crop marketing, government policies, limited information, and high per-unit transportation costs partially insulate producers in certain regions of the world" from any alleged price changes.[28] The United States recalls that Brazil insisted in the original proceeding that different domestic prices were intimately connected and that a change in U.S. prices would be reflected fairly immediately in the prices of all major cotton producers. Moreover, even Brazil has recognized that, in the mid to long run, there is price transmission. It is that response that is properly captured here.

36. **To capture the long run effects of removal of marketing loans and counter-cyclical payments, the United States has also applied parameter estimates taken from the UNCTAD-FAO Agricultural Trade Policy Simulation Model.** The summary results are presented in table A.4 (Exhibit US-122) for the periods MY 2002-2005 and MY 2006-2008. These conservative results – in the range of 0.96 to 2.26 percent – which obtain from some very basic changes to the parameters of Brazil's new model illustrate that the estimates provided by Brazil of price effects in the range of 9-11 percent substantially overstate any possible impact on world market price.

37. **– Brazil Has Not Shown That the Degree of Effect on World Market Prices Is "Significant" Within the Meaning of Article 6.3(c).** In Brazil's first submission, Brazil simply referred back to the same evidence it had submitted purporting to show price suppression and argued that "even a fraction of the effects found by Professor Sumner would constitute price suppression, based on its effect on [the] large volume of sales in the world market."[29] In its rebuttal submission, Brazil did not address the issue at all.

38. There is no textual basis for Brazil's lone theory of "significant" price suppression – that, effectively, any amount of price suppression is "significant" because the world upland cotton market is a high volume market. Brazil's approach would effectively create a *per se* rule of "significant" price suppression for certain markets involving large volumes of sales. Such a rule is not found in Articles 5(c) or 6.3(c) of the *SCM Agreement* or any other provision.

39. Contrary to Brazil's assertions, it is necessary to make a *showing* on the facts of a dispute that any proven price suppression is "significant." Brazil has not attempted to make such a showing here. And, in any event, a finding of "significant" price suppression is not justified under the circumstances. Brazil has provided no basis for its claims that this degree of price suppression – even less than a cent per pound, in conservative terms – constitutes "significant" price suppression. If such unfounded assertions were to prevail, they would effectively write "significant" out of Article 6.3(c) entirely.

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[27] *See e.g.*, Brazil First Written Submission, Annex I, 25-26.

[28] Brazil First Written Submission, Annex I, para. 28.

[29] Brazil First Written Submission, para. 190.

ANNEX C-4

CLOSING STATEMENT OF THE UNITED STATES

(28 February 2007)

1. Mr. Chairman, we will end in this meeting where we started, recalling that this is a compliance proceeding pursuant to Article 21.5 of the DSU. The question in this proceeding is whether Brazil has shown that U.S. measures taken to comply with the DSB's recommendations and rulings are inconsistent with the covered agreements cited by Brazil.

2. The United States has taken measures to comply with the recommendations and rulings of the DSB. Let us recall what they are:

- The longer term GSM-103 program is gone.

- The Supplier Credit Guarantee Program is gone.

- The old fee schedule that did not take into account relative risk is gone, replaced by a fee schedule graduated by both risk and tenor, comprised of 6 risk grades of ever-increasing fees. As a result, fees under the schedule have increased 46 percent.

- Obligors in countries that present a worse risk than permitted under the fee schedule are excluded entirely from the GSM-102 program. This is not a static determination simply to exclude certain countries on 1 July 2005. Rather, any country that falls to an unacceptable risk grade will be excluded from eligibility.

3. As a result of the reforms, total guarantees have declined over *63 percent* from $3.7 billion in FY 2004 to $1.36 billion in FY 2006.

4. Mr. Chairman, the United States is fully in compliance with item (j) of the SCM Agreement. Indeed, the data show that the United States was in compliance even before making all of these changes. Certainly, the imposition of these further disciplines only further confirms that.

5. Brazil urges this Panel to ignore the analytical basis for the Panel's original decision, and the clear textual guidance indicating that item (j) "illustrates" dispositively how the general definition of "export subsidy" in Articles 1.1 and 3.1(a) apply. The United States does not agree, but, nonetheless, has shown that – even under Article 14(c) of the SCM Agreement, which Brazil has invoked as context in assessing "benefit" under Article 1.1 – Brazil, which bears the burden of proof in this case, has failed to identify any distinct benefit under Article 1.1.

6. The United States has supplied other real-world examples of commercial banks providing financing comparable to that under the GSM-102 program, but Brazil derides these examples as irrelevant because, despite the explicit language of Article 14(c) of the SCM Agreement, Brazil considers the proper comparison is not of the total costs of the guaranteed loan transaction, but whether only one component of all the elements of the transaction – fees – are on terms more favorable than those provided by a private commercial bank.

7. There is no basis for that interpretation. Brazil is urging the Panel to ignore *both* of the two provisions of the SCM Agreement that specifically talk about the conditions under which export

credit guarantees may be considered subsidies – prohibited export subsidies in the case of item (j) and subsidies subject to CVD actions in the case of Article 14(c). Brazil would have the Panel overlook the fact that *neither* calls for a comparison to fees alone.

8. Mr. Chairman, the market for export credit guarantees is not – and has never been – one in which purely private banks – like Citibank, for example – operate. Indeed, against this background, one can understand why the drafters would – in both item (j) and Article 14(c) use a benchmark *other* than one looking to fees charged for purely private market-provided guarantees.

9. By insisting that the Panel simply ignore the provisions expressly agreed upon by the drafters in item (j) – and, indeed, in Article 14(c) – Brazil is effectively urging the Panel to find that *all* export credit guarantees are *per se* prohibited. Such an interpretation is simply untenable.

10. Returning to the issue of the U.S. measures taken to comply, the United States recalls that it also has eliminated the Step 2 program. This program was found to be a prohibited export subsidy, as well as a prohibited import substitution subsidy, and payments thereunder in MY 1999-2002 were found to cause adverse effects in the same period.

11. These measures – the measures in respect of the export credit guarantee programs and the Step 2 program – are the measures that the United States has taken to comply. Brazil has sought in this proceeding to diminish and dismiss each and every one of these measures while simultaneously attempting to broaden the scope of this proceeding so that the United States will be considered to have failed to have met its implementation obligations. For example, Brazil argues that the marketing loan and counter-cyclical payment programs are "measures taken to comply."

12. Mr. Chairman, this is just a fiction. The Appellate Body has recognized before that measures taken to comply are ordinarily changes made subsequent to the issuance of DSB recommendations and rulings. The marketing loan and counter-cyclical payment programs were in existence at the time of the original proceeding, were even challenged by Brazil in the original proceeding, and they remain the same now. These are not measures that the United States has taken to comply with any recommendations and rulings.

13. The question then is whether they were subject to the original panel's findings of "present" serious prejudice. The United States has submitted detailed arguments as to why they were not. In doing so, the United States has taken into account the fact that Brazil made no "present" serious prejudice claims against the marketing loan and counter-cyclical payment *programs*, that the only claims made by Brazil in respect of those measures were "threat" of serious prejudice claims, and that the original panel expressly stated that it was declining to make even that finding.

14. Nonetheless, the United States has shown that even if one considers Brazil's arguments on the merits, it is without basis. The argument, in essence, is that elimination of the Step 2 program does not eliminate any adverse effects of the "package" of Step 2, market loan, and counter-cyclical payment programs. But, as we discussed yesterday, Brazil's arguments in that regard fail to address the actual market facts that have prevailed since termination of the Step 2 program and are not consistent with Brazil's own arguments in the original proceeding.

15. Like its shifting arguments regarding the impact of the Step 2 program, Brazil's counterpart argument – that the marketing loan and counter-cyclical payment programs continue to have adverse effects – continues to shift. Yesterday we heard – I believe for the first time in this proceeding – that it is *unsold stocks* and not exported surplus that is responsible for the alleged price suppression. The fact is, Mr. Chairman, it is too late in the day for Brazil to be altering such fundamental factors as its theory of price suppression. And, in any event, Brazil has submitted no evidence or argument to substantiate this new assertion.

16. Brazil's claims regarding the marketing loan and counter-cyclical payment programs fail for a single fundamental reason. They are not supported by the evidence. Much of Brazil's oral presentation again stressed its premise that large payments necessarily show large effects. As Brazil admitted before the Appellate Body, however, this is not correct. While the size of payments is undoubtedly a consideration – and likely an important one – the focus of an adverse *effects* claim is, not surprisingly, on *effects*.

17. We pointed out before that empirical evidence does not support Brazil's arguments regarding price effects (*i.e.*, that payments-cause-production-cause-exports-cause-price suppression). Presumably, in response to this, Brazil, in its presentation yesterday, supplied a slew of charts purporting to show that year-to-year decisions to plant upland cotton are economically irrational. As we discussed earlier, Brazil's analysis fails because it relies on an inappropriate measure of costs that is not relevant to U.S. farmers' planting decisions year-to-year.

18. Beyond this, the only real "evidence" that Brazil presents appears to highlight are the results of the *new* Sumner model, one that abandons most of the economic constructs that Brazil previously argued were accurate and superior. Brazil has offered an economic model without foundation or publication in any peer reviewed journal. Then, Brazil altered virtually every critical economic parameter used by that model to inflate its result. The United States has shown why the model is flawed and why its economic parameters are unreliable.

19. Using reasonable and realistic parameters, even Brazil's model shows small effects from the U.S. programs.

20. Indeed, this confirms what other evidence – recent studies of the empirical data, actual assessments of year-to-year planting decisions (taking into account proper variable costs), and evidence of the stable share of U.S. production and export market share – already shows; namely, that payments under the marketing loan and counter-cyclical payment programs are not having the kind of significant price effects that Brazil has alleged.

ANNEX C-5

THIRD PARTY ORAL STATEMENT OF ARGENTINA

28 February 2007

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Mr Chairman, members of the Panel:

I. INTRODUCTION

1. Argentina is grateful for this opportunity to give its views on the issues raised in the present Panel proceedings. In this oral statement, we wish to address some of the parties' arguments that we did not discuss in our written submission and which concern the United States' submission of preliminary issues to the Panel.

2. Argentina would like in particular to refer to the United States' objection to the inclusion of the marketing loan and counter-cyclical payments programmes in these Article 21.5 proceedings.

II. ARGUMENTS

THE MARKETING LOAN AND COUNTER-CYCLICAL PAYMENTS PROGRAMMES ARE WITHIN THE SCOPE OF THE PRESENT DSU ARTICLE 21.5 PROCEEDINGS

3. The United States asserts in its submissions[1] that many of Brazil's claims are beyond the scope of Article 21.5 proceedings. In particular, in response to Brazil's claims against the <u>programmes</u> authorizing marketing loan and counter-cyclical payments, it states:

- (a) That they are not original measures that were subject to Panel findings and recommendations, and

- (b) that they are not measures the United States took to comply with DSB recommendations.

4. For the reasons set out below, Argentina strongly disagrees with both assertions and with the United States' arguments supporting them:

A. THE <u>PROGRAMMES</u> AUTHORIZING MARKETING LOAN AND COUNTER-CYCLICAL PAYMENTS ARE <u>ORIGINAL MEASURES</u> THAT WERE <u>SUBJECT TO FINDINGS AND RECOMMENDATIONS</u>

5. First, in Argentina's view it is obvious that the original Panel considered these programmes as *measures at issue* in its final Report (section G) when discussing Brazil's actionable subsidies-related claims and allegations of serious prejudice.

6. In particular, in paragraph 7.1107 of its Report, in identifying the measures at issue the Panel includes under (ii) marketing loan programme payments; under (iv) counter-cyclical payments; and specifically, under (ix), the last indent, "**legislative and regulatory provisions currently providing for the payment of measures in (i), (ii), (v), (vi) and (vii) above**."[2]

7. Accordingly, in Argentina's view, to the question whether the programmes ordering marketing loan payments and counter-cyclical payments were part of the "matter at issue" in the original proceedings, the only valid reply is an affirmative one.

8. Secondly, Argentina observes that, contrary to what the United States contends, not only were the programmes among the measures at issue, they were also subject to the Panel conclusions and

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[1] First Written Submission of the United States, Section IV(B) and (C); United States' Rebuttal Submission, Section II(B).

[2] Emphasis added.

recommendations, subsequently confirmed by the DSB, as can be seen from Chapter VIII of the Report, which sets out the Panel's conclusions and recommendations. Specifically, the Panel concludes, in paragraph 8.1(g):

> "[…]
>
> (g) concerning serious prejudice to the interests of Brazil:
>
> (i) the effect of the **mandatory price-contingent United States subsidy measures**[3] – marketing loan programme payments, user marketing (Step 2) payments, MLA payments and CCP payments – is significant price suppression in the same world market within the meaning of Article 6.3(c) of the *SCM Agreement* constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*; […]"

9. Then, at paragraph 8.3(d), regarding the subsidies that are the subject of the above-mentioned conclusion the Panel states, citing Article 7.8 of the *SCM Agreement*:

> "[…], upon adoption of this report, the United States is under an obligation to 'take appropriate steps to remove the adverse effects or … withdraw the subsidy'".

10. Consequently, as emerges from the text of the Panel's report, the mandatory price-contingent United States subsidy measures, i.e. *the legislative and regulatory provisions* for payments under the marketing loan and counter-cyclical payments programmes are subject to Panel recommendations.

11. Thirdly, and as confirmation of the foregoing, what the Panel said in paragraphs 7.1499 and 7.1501 – cited by Brazil in its submission of 16 January last – is most enlightening: it states unequivocally that:

> "[…] our finding of "present" serious prejudice thus pertains also to measures in force and subsidies paid in MY2002, the first year of the FSRI Act of 2002."
>
> And goes on to say:
>
> "Because the Panel's "present" serious prejudice findings include findings of inconsistency that deal with the FSRI Act of 2002 and subsidies granted thereunder in MY 2002, the United States is obliged to take action concerning its present statutory and regulatory framework as a result of our "present" serious prejudice finding. We recall that, pursuant to Article 7.8 of the *SCM Agreement*, the United States is under an obligation to "take appropriate steps to remove the adverse effects or … withdraw the subsidy"."

12. In the light of the foregoing, Argentina sees no merit in the United States' assertion that the <u>programmes</u> authorizing marketing loan and counter-cyclical payments were not subject to findings and recommendations by the original Panel.

[3] Emphasis added.

B. THE PROGRAMMES AUTHORIZING MARKETING LOAN AND COUNTER-CYCLICAL PAYMENTS ARE PART OF THE NEW BASKET OF MEASURES TAKEN TO COMPLY

13. As to the second point, the United States contends that Brazil's claims against the marketing loan and counter-cyclical payments programmes are beyond the scope of the present proceedings because they are not United States "*measures taken to comply*"; and that they are unrelated to the existence or consistency with a covered agreement of measures taken to comply with recommendations and rulings of the DSB, as the programmes remain unchanged.[4]

14. Argentina agrees with Brazil that what we have here is a new basket of mandatory price-contingent measures as a result of the cancellation of the Step 2 programme, one of the measures the United States took to comply with the DSB's recommendations.

15. In Argentina's view it is also worth pointing out that there is no claim seeking to challenge some unchanged aspect of the measure which was not already challenged in the original proceedings, or which was challenged but found to be consistent – rather the contrary. Nor is there a claim that seeks to impugn separate measures which have undergone no change since the original proceedings. As Brazil says, what we have here is a new measure or "new basket of measures", to use the Panel's expression.

16. Furthermore, given the particularities of subsidy regulation, the *SCM Agreement* does not require an analysis of the adverse effects of actionable subsidies to be carried out for each and every programme or payment. Rather, it focuses on the "collective effect" of the subsidies, the approach the Panel followed. Otherwise, there is every likelihood that individually, they would not be sizeable enough to cause adverse effects. Consequently, the finding of serious prejudice affects "a basket of measures" and cannot be split so as to relate to each one separately.

17. Argentina takes issue with the United States' assertion that the fact that the Panel considered the effects of the programmes and payments cumulatively in determining the existence of present serious prejudice does nothing to change the fact that they are separable.[5] Argentina believes that although they may be separated for the purpose of a descriptive study of their structure, design and operation, they are not separable from the legal standpoint of establishing the makeup of the serious prejudice, in accordance with the terms of the Panel's collective finding.

18. Consequently, bearing in mind the Panel's conclusion that "**the effect** of the mandatory price-contingent United States subsidy measures […] is **significant**[6] price suppression […] within the meaning of Article 6.3(c) of the *SCM Agreement* constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*", it is necessary to reconstruct the collective analysis in order to ascertain whether the change brought about to this set of measures by the cancellation of the Step 2 programme is sufficient to conclude that the United States has complied with the DSB's recommendations in this regard.

19. The Panel's conclusion in paragraph 7.1503 of the report is enlightening here:

> "We consider that, upon required implementation by the United States of this Panel's prohibited subsidy findings and present serious prejudice findings, the basket of measures in question may be so significantly transformed or manifestly different from the measures that are currently in question that it is not necessary or appropriate to

[4] Rebuttal Submission of the United States, paragraph 18.
[5] Rebuttal Submission of the United States, paragraph 61.
[6] Emphasis added.

address Brazil's claims of threat of serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*."

20. It may properly be concluded from the above that the Panel's recommendations were directed to a "basket of measures" and not to measures taken individually.

21. Argentina therefore takes the view that the programmes authorizing marketing loan and counter-cyclical payments are part of the new basket of measures taken to comply, and as such fall within the scope of the Article 21.5 proceedings.

III. CONCLUSION

In the light of all the foregoing, Argentina respectfully asks the Panel to take into consideration the arguments and views expressed above when reaching its decision on the preliminary issues raised by the United States.

Thank you very much.

ANNEX C-6

THIRD PARTY ORAL STATEMENT OF AUSTRALIA

28 February 2007

Members of the Panel,

1. Thank you for the opportunity to present the views of Australia.

2. This proceeding raises a number of important issues concerning the scope of Article 21.5 proceedings and the appropriate steps that must be taken by a Member to comply with Articles 4.7 and 7.8 of the *Agreement on Subsidies and Countervailing Measures (SCM Agreement)*.

3. Australia has provided a written submission addressing some of these issues and will not repeat those arguments today. Rather, Australia will concentrate on whether the United States, by repealing the Step 2 programme, but maintaining the two other price-contingent subsidies (that is, the marketing loan programme payments and counter-cyclical payments), has taken appropriate steps to remove the adverse effects or to withdraw the subsidies under Article 7.8 of the *SCM Agreement* in accordance with the recommendations and rulings of the Dispute Settlement Body (DSB). In considering this question, it is important to bear in mind the nature of Article 21.5 proceedings.

Nature of Article 21.5 proceedings

4. The role of an Article 21.5 panel is to determine the existence or consistency with a covered agreement of measures taken to comply with DSB recommendations and rulings. Its mandate does not extend to relitigation of issues that have been conclusively determined in the original dispute. Such is the case in the present proceedings, where measures continue in existence that have been previously ruled upon and remain unchanged. It is uncontested that two of the challenged price-contingent subsidies, which are by far the largest of the subsidies that were challenged in the original proceedings relative to the subsidy that has been withdrawn, have continued under programmes that have not been changed since the recommendations and rulings in the original dispute were adopted by the DSB. In this situation, the Panel's task is limited to a factual determination to that effect.

5. Should it make this determination, the Panel will then need to consider, on the basis of the supporting economic evidence, whether the maintained subsidies continue to cause adverse effects within the meaning of Article 5 of the *SCM Agreement*.

6. This question cannot be answered by confining the Panel's examination to the effect of the subsidies made in 1999-2002. Such an approach, which appears to be advocated by the United States[1], would undermine the remedy that is provided by Article 7.8 of the *SCM Agreement* – that is, to compel the subsidizing Member to take appropriate steps to remove the adverse effects or withdraw the subsidy. This approach would require a successful complainant to bring a fresh actionable subsidies claim with respect to each set of

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[1] *See*, for example, First Submission and Request for Preliminary Rulings of the United States, paras. 45, 146-148; Rebuttal Submission of the United States of America, paras. 17; 33-34.

subsidies made subsequently to those originally found to cause adverse effects. This cannot be the remedy that was contemplated by Article 7.8. Moreover, such an approach would also be contrary to Article 21.1 of the DSU, which recognises that prompt compliance with the recommendations and rulings of the DSB is essential to ensure effective resolution of disputes. Article 21.5 of the DSU promotes this aim.[2]

Turning to Brazil's actionable subsidies claim

7. The question that is central to Brazil's actionable subsidies claim is whether discontinuation of one price-contingent subsidy but continuation of two other price-contingent subsidies meets the requirements of Article 7.8 of the *SCM Agreement*. In examining this question, Australia submits that the analytical approach adopted in the original proceedings is an appropriate one to be followed by this Panel. The original Panel, after making explicit findings as to the trade-distorting effects of each of the challenged price-contingent subsidies individually, [3] found that the effects of these subsidies, considered collectively, caused significant price suppression in the same world market.[4]

8. Taking the original Panel's findings as to the trade-distorting effects of these subsidies into account, this Panel may then consider whether the collective effect of the continuing subsidies (that is marketing loan programme payments and counter-cyclical payments) is significant price suppression in the same world market.

9. Australia notes that if this approach is followed, then the findings in the original proceedings as to the effect of other causal factors that the United States asserts affect the causal link between the United States' subsidies and the significant price suppression cannot be overlooked.[5] Many of those factors are the <u>same</u> factors that were relied upon by the United States in the original proceedings. Australia submits that it is open to this Panel to reach the same conclusions in relation to those factors as were drawn in the original proceedings. Those conclusions were that these factors did not sever the causal link between United States' subsidies for upland cotton and significant price suppression in the same world market. That is, these factors did not "reduce the effect of the mandatory price-contingent subsidies to a level which cannot be considered 'significant.'"[6]

10. Furthermore, Australia agrees with Brazil that in order to determine whether the effect of the two continuing price-contingent subsidies is "present" serious prejudice, it is necessary to examine a recent period for which essentially complete data exists. That period is, according to Brazil, data for marketing year 2005, there being no complete data as yet for marketing year 2006.[7] In fact that year has not yet finished. In agreeing with Brazil's submission, Australia notes that this approach is the one that was adopted by the Panel in the original proceedings.[8]

11. In finding that the effect of the mandatory price-contingent United States' subsidy measures was significant price suppression in the same world market within the meaning of

[2] *United States – Softwood Lumber IV (Article 21.5 – Canada)*, Report of the Appellate Body, WT/DS257/AB/RW, para. 72.

[3] *See*, for example, WT/DS267/R, paras. 7.1295, 7.1302, 7.1303, 7.1308.

[4] *Ibid*., para. 7.1349.

[5] *Ibid*., paras. 7.1344-46; 7.1357-63; *See* also WT/DS267/AB/R, para. 437.

[6] WT/DS267/R, para. 7.1363; WT/DS267/AB/R, paras. 455-457.

[7] Rebuttal Submission of Brazil to the Panel, paras. 23-24.

[8] WT/DS267/R, paras. 7.1198-9.

Article 6.3(c) of the *SCM Agreement*[9], the Panel at first instance had the benefit of extensive economic analysis and modelling presented by Brazil.[10] Updated economic analysis and modelling has been submitted by Brazil in the present proceedings. In Australia's view, this updated economic analysis and modelling represents the same appropriate and conservative economic methodology as that which was taken into account by the Panel in the original proceedings.[11] This data supports Brazil's central assertion that but-for the domestic subsidies at issue, the world price for cotton would be significantly higher.

12. If, as a result of examining the effects of the continued price-contingent subsidies under the marketing loan and counter-cyclical payments programmes, considered collectively and on the basis of the economic evidence presented, the Panel finds that these subsidies collectively cause significant price suppression, then Australia submits that the only conclusion open to this Panel is that the United States has not complied fully with the requirements of Article 7.8 of the *SCM Agreement*. That is, the United States has failed to remove the adverse effects or withdraw the subsidies that were the subject of the DSB's recommendations and rulings, within the meaning of Article 7.8.

Threat of serious prejudice

13. In relation to Brazil's claim in the alternative that the continued subsidies threaten to cause serious prejudice in marketing years 2006 and beyond, Australia submits that it is beside the point for the United States to argue that the programmes under consideration are due to expire in late 2007. The programmes have not expired. There is no guarantee that they will not be rolled over or maintained in another form with adverse effect. Australia therefore submits that the Panel is entitled to consider whether the continuance of subsidies under programmes whose design, structure and operation remain unchanged, would give rise to a threat of serious prejudice.

14. Australia notes that in the original proceedings, the Panel exercised judicial economy with respect to Brazil's claim of threat of serious prejudice relating to the marketing years 2003-2007. The Panel's approach was based on the assumption, since proved to be erroneous, that the statutory and regulatory framework under which the subsidies were granted would be fundamentally altered in response to the Panel's present serious prejudice finding.[12] It is justifiable that Brazil, by seeking a ruling in the alternative concerning the threat of serious prejudice, should wish to avoid this situation being maintained in the future.

15. In conclusion, Australia submits that it is appropriate for this Panel to adopt the analytical approach that was adopted by the Panel in the original proceedings. Given the fact that two of the price-contingent subsidies have continued in unaltered form, it is also appropriate that the original findings, recommendations and rulings relating to those subsidies should form the starting point for this Panel's analysis. The updated evidence submitted by Brazil supports the conclusion that those subsidies, considered collectively, continue to cause adverse effects to the interests of Brazil. Given the continuing adverse effects of these subsidies, Australia submits that the Panel can only conclude that the United States has failed to take appropriate steps to remove those effects or withdraw the subsidy within the meaning of Article 7.8 of the *SCM Agreement,* and has therefore failed to comply fully with the DSB's recommendations and rulings in this dispute.

[9] *Ibid*., para. 8.1(g)(i).
[10] *Ibid*., paras. 7.1202-9.
[11] *Ibid*., para. 7.1209.
[12] *Ibid*., para. 7.1501.

ANNEX C-7

THIRD PARTY ORAL STATEMENT OF CANADA

28 February 2007

I. INTRODUCTION

1. Good morning Mr. Chairman, members of the Panel, thank you for giving me this opportunity to present Canada's views on particular legal issues raised in this proceeding.

2. Canada's submission addresses three issues. First, Canada submits that the standard for finding a threat of serious prejudice pursuant to Article 5 of the *SCM Agreement* and GATT Article XVI:1 is flexible. In some instances, such as in the case at hand, a threat of serious prejudice may arise when the threat is reasonably foreseeable and ever-present, even if it is not necessarily "imminent". Second, Canada submits that for the purposes of quantifying a benefit under Article 14(c), a commercial comparison is required. Third, Canada submits that the United States' GSM 102 program cannot benefit from an *a contrario* reading of Annex I to the *SCM Agreement*. Item (j) does not allow for an *a contrario* interpretation. The only programs that are excluded by Annex I from the definition of export subsidies in Article 3.1(a) are those explicitly "referred to" in Annex I as not constituting export subsidies.

II. THREAT OF SERIOUS PREJUDICE

3. Allow me, first, to briefly turn to the standard for a finding of threat of serious prejudice. I do not propose to dwell on this issue, but rather refer the Panel to Canada's written submission. However, I will reiterate that the definition of "threat of material injury" in Part V of the *SCM Agreement* should not be imported into the definition of "threat of serious prejudice", in Part III of that *Agreement*. Nothing in Part III of the *SCM Agreement* suggests a strict temporal limitation to the notion of threat of serious prejudice. The standard for threat of serious prejudice is sufficiently flexible to address programs that give rise to an ever-present and reasonably foreseeable probability of massive subsidies to United States' farmers – subsidies that permanently threaten to cause serious prejudice – as well as programs that will imminently cause adverse effects.

4. The U.S. subsidy programs mandate the payment of subsidies upon certain conditions. One of these conditions is the price of cotton falling to a specified level, a condition that has occurred in the past. Given the vagaries of the market, it is probable that the price of cotton will fall again. When that happens, it will again trigger massive subsidy payments. When these payments are made, they *will* again cause WTO Members serious prejudice. The counter-cyclical payment program and the marketing loan program are, therefore, permanently threatening to cause serious prejudice.

III. ARTICLE 14(C)

5. I now turn to Canada's second issue, which involves Article 14(c) of the *SCM Agreement*. Brazil argues that the "GSM 102" program constitutes an export subsidy prohibited by Article 3 of the *SCM Agreement*. In part, Brazil argues that this export credit guarantee, or "ECG", confers a *per se* benefit because it secures financing that would not otherwise be available to the recipient, and that this is contrary to Article 14(c) of the *SCM Agreement.*

6. Canada respectfully disagrees with Brazil. The mere existence of the GSM 102 program is not a *per se* benefit under Article 14(c). Article 14(c) provides that a loan guarantee by a government

does not constitute a benefit unless there is a difference between the amount the recipient would pay on a comparable commercial loan obtained on the market and the amount it pays to the government. The benefit, in such cases, is the difference between those two amounts adjusted for any difference in fees. Brazil may well be correct that GSM 102 confers a benefit within the meaning of Article 1.1(b) of the *SCM Agreement*. However, in accordance with Article 14(c), demonstrating the existence of this benefit expressly requires a comparison with the market.

7. Brazil argues that the GSM 102 program is designed so that the guarantees are provided only in circumstances in which credit would not otherwise be available, that is, where there is no comparable commercial loan. Canada submits that in respect of most financial instruments, it is possible to find a comparable commercial pricing mechanism. In the event that a commercial comparison or evidence of a commercial comparison cannot be found, one can construct a market proxy. Either way, under Article 14(c), one must make a commercial comparison, whether constructed or otherwise.

IV. ILLUSTRATIVE LIST OF EXPORT SUBSIDIES

8. Third, and lastly, Canada submits that item (j) of the Illustrative List contained in Annex I to the *SCM Agreement* does not allow for an *a contrario* interpretation.

9. The United States argues that GSM 102 is not inconsistent with Article 3 of the *SCM Agreement* because the program charges premium rates that are more than adequate to cover the long-term operating costs and losses of the program. As such, the United States argues that GSM 102 is not inconsistent with item (j), and because none of the other items in the Illustrative List are applicable to it, GSM 102 is not an export subsidy prohibited by Article 3.

10. Article 3.1(a) provides that subsidies contingent on export performance, including those illustrated in Annex I, are prohibited. Canada has consistently argued, and at least two panels have agreed, that footnote 5 in the *SCM Agreement* excludes the possibility of implied exceptions to the prohibition on export subsidies. The panels in *Brazil – Aircraft (Article 21.5 – Canada)* and in *Korea – Vessels*, found that, and I quote, "[i]n its ordinary meaning, footnote 5 relates to situations where a measure is referred to as *not* constituting an export subsidy."[1] To this end, those panels considered whether the item at issue of the *Illustrative List* contained one of two things: any affirmative statement that a measure is not an export subsidy or a statement that a measure not satisfying the conditions of that paragraph is not prohibited. The panel in *Korea –Vessels* found that item (j) did not contain such statements, but rather describes certain circumstances in which particular programs do constitute export subsidies. That panel found that item (j) fell outside the scope of footnote 5.

11. The panel in *Brazil – Aircraft (Article 21.5 – Canada)* came to a similar conclusion from the text of Article 3.1(a) itself. The panel found that Annex I contains examples of prohibited export subsidies, and does not purport to be an exhaustive list. The panel found it "highly likely" that there are prohibited export subsidies within the meaning of Article 3.1(a) that do not fall within the scope of Annex I.[2]

12. Thus, even if, as the United States asserts, the fees charged under GSM 102 were sufficient to meet its long-term operating costs and losses, it would mean only that the program is not captured by

[1] *Brazil – Export Financing Programme for Aircraft: Recourse by Canada to Article 21.5 of the DSU*, Report of the Panel, WT/DS46/RW, adopted 4 August 2000 ["*Brazil – Aircraft (Article 21.5 – Canada)*"], para. 6.36. *See* also *Korea – Measures Affecting Trade in Commercial Vessels*, Report of the Panel, WT/DS273, adopted 7 March 2005, para. 7.195.

[2] *Brazil – Aircraft (Article 21.5 – Canada)*, para. 6.30.

item (j) of the Illustrative List. It would not mean that GSM 102 is not a prohibited export subsidy. Quite apart from item (j), GSM 102 could still be a prohibited export subsidy pursuant to Article 3 of the *SCM Agreement*.

13. This concludes Canada's statement. I would like to again thank the panel for the opportunity to present Canada's views.

ANNEX C-8

THIRD PARTY ORAL STATEMENT OF CHAD

28 February 2007

I. INTRODUCTION

1. Mr. Chairman and Members of the Panel,

2. Chad appreciates the opportunity to present its views to you in this dispute. In its written submission of 5 January 2007, Chad set out its understanding of some of the major legal issues that arise in this dispute. I will therefore not repeat all that is contained in that submission. Rather, I will take this opportunity to highlight some additional issues relevant to the resolution of this important dispute.

II. THE IMPORTANCE OF THE DSU TO LDCS

3. According to Article 3.2 of the DSU, security and predictability are the cornerstones of the multilateral trading system. Article 3.2 further stresses the importance of prompt settlement of situations in which benefits are being impaired and the maintenance of the proper balance between the rights and obligations of Members.

4. These principles of the multilateral trading system, Mr. Chairman, together with the prohibition against unilateral actions to resolve disputes, found in Article 23 of the DSU, provide the foundation for the WTO's rules-based dispute settlement system. This is intended to be a rules-based system in which might does not trump right, in which the law is applied regardless of the economic strength of the parties to a dispute, and in which the smallest actors in international trade can ask for respect of the rule of law and its principles and prevail.

5. Chad's belief in this system motivated it to become a third party when Brazil requested a panel in the original dispute, and it is this same belief that motivates Chad's participation in these proceedings. By this action, Chad has become one of only a handful of least-developed countries that have participated in a WTO dispute settlement proceeding since the establishment of the WTO in 1995.

6. Chad participated particularly *because* it is a least-developed country, and because there are not alternative means for its interests and concerns to be taken into account.

7. Mr. chairman, it is the weakest Members of the WTO that are most dependent on the rule of law in multilateral trade relations. Lacking political or market power, least-developed countries have no other recourse that to ask for respect of the rule of law. As one WTO Member stated in urging a speedy and successful conclusion to the Uruguay Round:

> The least-developed countries, being the weakest and most vulnerable members of the international community, need the rule of law most and are the strongest advocates of multilateralism. ...[1]

8. Without the WTO's dispute settlement system to ensure that rules are obeyed and obligations upheld, therefore, the weak would be at the mercy of the powerful who would be left free to pursue their own individual interest. As former WTO Director-General Moore cogently underlined, the multilateral system "opens up the privileged positions of the powerful to transparency and competition".[2]

9. Rules-based multilateralism demands that WTO Members found to be in violation of their obligations take steps to address those violations. As Brazil has demonstrated, the United States has either taken no steps to implement the rulings and recommendations of the DSB in the original dispute, or where it has taken such steps, it has not fully addressed the adverse effects that continue to affect the farmers of Brazil, Chad, and other African countries.

10. This Panel must therefore send a clear message to the WTO Membership regarding the effectiveness of the dispute settlement system by requiring that the United States, to the extent that it has failed to implement the recommendations and rulings of the DSB, abide by the principles of the rules-based system; principles which, I would add, the United States has repeatedly claimed to endorse.

III. THE IMPORTANCE OF COTTON TO CHAD

11. Chad participated in the original dispute in this case, and continues to participate in these proceedings, because of the critical importance of the cotton sector to Chad's economy and the ongoing damage to that sector caused by US subsidies.

12. Chad is one of the poorest countries in the world. The United Nations Development Programme's Human Development Report of 2005 ranks Chad as the 173rd out of 177 countries based on human development indicators that include like expectancy at birth, the infant mortality rate, and the maternal mortality ratio.

13. It is precisely because of this poverty that Chad is so seriously affected by the US subsidies. The cotton sector in Chad affects approximately 3 million people, out of a total population of about 8.1 million. Cotton exports are the country's third largest export, representing 60 per cent of all non-oil export earnings. Cotton is, therefore, one of Chad's main sources of income, sustains the livelihood of a large portion of its population, and contributes not only to economic development but also to social development. Thus, cotton is a central element in the government's drive towards modernisation, diversification, and the financing of social activities and other needs of Chad's rural citizens.

14. In the Report "*Finding the Moral Fibre: Why reform is urgently needed for a fair cotton trade*", Oxfam concludes the US cotton subsidies have an impact "not simply on balance of payments or debt service."[3] Oxfam states that US cotton subsidies "cause poverty, and Western African farmers

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[1] Statement by Dr. M Isaac Talukdar of Bangladesh to the Forty-Seventh Session of the GATT CONTRACTING PARTIES, SR.47/ST/4, 20 December 1991.

[2] Michael Moore, "Promoting openness, fairness and predictability in international trade for the benefit of humanity", speech delivered to the Inter-Parliamentary Union on 8 June 2001, available at http://www.wto.org/english/news_e/spmm_e/spmm64_e.htm.

[3] Oxfam Briefing Paper Number 69, 18 October 2004, page 2.

are particularly vulnerable." It is for this reason that Chad welcomed the findings of the Panel in this case. The rulings and recommendations of the Panel – if they had been implemented – would have improved the lot of the many poor who depend on cotton production and export.

15. The development and multilateral agencies that have examined this issue have all come to the same conclusion. Respected economic experts from UNDP, the International Cotton Advisory Committee, the World Bank and Oxfam have established the source of the problems facing African cotton farmers are the trade-distorting agricultural subsidies that continue to depress world cotton prices. They have also concluded that the price prospects for cotton and consequently the export shares of low-cost producers, including many African countries, could be improved considerably if developed countries substantially reduced or eliminated support.

16. It is therefore imperative that the cotton farmers of Chad reap the benefits of a prompt implementation of the DSB's rulings and recommendations in this dispute. Proper compliance would not only stabilise and increase the incomes of Chad's cotton farmers but also develop the economy of Chad as a whole.

IV. THE IMPORTANCE OF COTTON TO THE WEST AFRICAN REGION

17. Chad is not the only West African country that has suffered the effects of the US subsidies. The proper implementation of the DSB's recommendations and rulings is of importance to cotton-producing West African countries, which are some of the most vulnerable economies in the world.

18. The Oxfam report to which I referred above concludes: "every season poor cotton farmers face reduced incomes. Each year, developing countries which export cotton suffer declining balance of payments. The central issue is US cotton subsidies."[4]

19. West and Central African cotton producers are among the lowest-cost producers of the crop in the world. Full implementation by the United States of the DSB's recommendations and rulings in this case would have very significant benefits for Chad and the other Sub-Saharan African cotton-producing countries. A recent World Bank project study titled "WTO's Doha Cotton Initiative: A Tale of Two Issues"[5] specifically estimates what is at stake in terms of cotton production, trade, and economic welfare in Sub-Saharan Africa. The study finds that the removal of *all* cotton subsidies and import tariffs would boost global economic welfare by $283 million per year and would raise the price of cotton in international markets by almost 13 per cent.

20. Chad, together with Benin, Burkina Faso and Mali, is a co-sponsor of the sectoral initiative for cotton which encourages WTO Members to address cotton "ambitiously, expeditiously and specifically" with a view to achieving more ambitious reductions of trade-distorting domestic subsidies for cotton production. This initiative covers not only the subsidies of the United States but also those of other Members of the WTO and it was made explicitly without prejudice to actions of the Dispute Settlement Body. Nevertheless, it can be taken by this Panel as a further indication of the importance that Chad and the other sponsors of the initiative attach to the resolution of the cotton subsidy issue.

21. The commitment made by Members in the context of negotiations should not, however, detract from the importance of this dispute settlement process. The negotiating track is one aspect of the WTO system, the dispute settlement system another. No Member should be put in the position of

[4] *Ibid*.

[5] Kym Anderson and Ernesto Valenzuela, "WTO's Doha Cotton Initiative: A Tale of Two Issues", Development Research Group, World Bank, Washington DC, February 2006.

negotiating afresh an outcome that has already been prescribed multilaterally by the Members acting through the Dispute Settlement Body. Chad asks that it benefit from the enforcement of the negotiated rules governing subsidies and, equally, that it be allowed to gain more from an international market without subsidies and therefore subject to true competition.

22. Chad therefore requests the Panel to ensure, through a careful review of the evidence and rigorous application of the law, that the relevant WTO rules and disciplines are fully applied to the cotton sector so that a fair and market-oriented system can prevail.

23. To quote H.E. Blaise Compaoré, President of Burkina Faso, "our countries are not asking for charity, neither are we requesting preferential treatment or additional aid. We solely demand that, in conformity with WTO basic principles, the free market rule be applied. Our producers are ready to face competition on the world cotton market – under the condition that it is not distorted by subsidies."[6]

V. ARTICLE 24 OF THE DSU

24. Article 24 of the DSU stipulates that: "[a]t all stages of the determination of the causes of a dispute, and of dispute settlement procedures involving a least-developed country Member, particular consideration shall be given to the special situation of least-developed country Members". Chad's reliance on its cotton industry to generate exports and fight poverty constitutes a special situation of a least-developed country Member within the meaning of Article 24. Chad requests the Panel to give full effect to this provision in its determination of the causes of this dispute and to indicate in its report how it has done so.

25. In Chad's view, Brazil has produced compelling arguments and evidence to show that the US price-contingent subsidy programs supporting upland cotton under the FSRI Act have not been withdrawn or changed in any significant way. Brazil has also shown that overproduction and excess exports, along with significantly suppressed world market prices for upland cotton, have continued following the adoption of the reports of the original panel and the Appellate Body in this dispute. As explained above, Chad's own experience confirms the evidence submitted by Brazil.

26. This case concerns egregious, WTO-inconsistent measures taken by a developed country WTO Member that continue to cause serious harm to an important subsistence farming sector in the economies of some of the very least-developed countries in the world. The United Nations Development Programme's Human Development Report concluded that in 2005, "the 20,000 cotton farmers in the United States will receive government payments in 2005 equivalent to the market value of the crop and more than US aid in Sub-Saharan Africa."[7]

27. Chad considers that Article 24 of the DSU imposes a duty on the panel that goes beyond a procedural requirement to consider all the views presented to it (which the Panel is in any event required to do under Article 11 of the DSU), by requiring panels to take into account the special situation of least-developed countries when examining substantive issues. Chad believes that, if the Panel were to ignore and be silent on Article 24 of the DSU in this extreme situation, it would fail to carry out the obligations that this provision clearly assigns to it.

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[6] Address to the Trade Negotiations Committee, 10 June 2003, www.wto.org.
[7] UNDP, Human Development Report for 2005, page 132.

VI. CONCLUSION

28. Mr. Chairman, Members of the Panel, it is of critical importance to Chad and other African cotton-producing countries and, indeed, to the multilateral trading system as a whole, that this compliance Panel uphold the rule of law by ensuring that the multilateral rules governing the provision of subsidies are properly applied and followed in this case.

29. In this regard, Chad recalls the statement of the Sutherland Report that:

> The position of the poorest Members of the WTO, the least developed countries, ... has been and should be an issue of increasing concern. If they do not receive real benefit from membership there can be little point in their remaining part of the organization and the moral case for the WTO as a source of good is diminished.[8]

30. In the present case, Chad recalls that Article 7.8 of the SCM Agreement provides that "the Member granting or maintaining such subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy." Article 7.8 therefore requires that the United States take active steps and impose affirmative measures to eliminate adverse effects or withdraw subsidies. The United States cannot comply with the recommendations and rulings of the DSB simply by letting time pass and the adverse effects dissipate.

31. Chad also recalls that the panel stated clearly that "*the United States is obliged to take action concerning its present statutory and regulatory framework as a result of our 'present' serious prejudice finding.*"[9] Accordingly, to conform with the recommendations and rulings of the DSB, the United States must not only stop the challenged payments, but also change its legislative and regulatory system.

32. Accordingly, the Panel should carefully and stringently review the measures taken by the United States and determine that the United States has not properly implemented the recommendations and rulings of the DSB.

33. Chad trusts that these views will assist the Panel in its consideration of these issues. Chad will be happy to respond to any questions the Panel may have.

34. Again, we thank you for this opportunity to present our views.

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[8] *The Future of the WTO – Addressing Institutional Challenges in the New Millennium*, Report by the Consultative Board to the Director-General Supachai Panitchpakdi, 2004, paragraph 40.

[9] Panel Report, paragraph 7.1501 (original footnote omitted) (emphasis added).

ANNEX C-9

THIRD PARTY ORAL STATEMENT OF THE PEOPLE'S REPUBLIC OF CHINA

28 February 2007

1. Thank you, Mr. Chairman and Members of the Panel. On 5 January 2007, China provided its third party submission to you on this case. Today, I would like to highlight the major points on two issues in China's submission: (1) whether the item (j) of the Illustrative List of the SCM Agreement constitutes the complete basis for the analysis of GSM-102; (2) whether the ML/CCP payment programs are outside the scope of this proceeding.

2. Firstly, regarding item (j) issue, China believes that the panel's finding in *Korea – Measures Affecting Trade in Commercial Vessels* has provided a useful guidance. The *Korea – Commercial Vessels* panel points out that Item (j) merely describes certain circumstances in which particular programs constitute export subsidies; and Item (j) simply does not address export guarantee programs that do cover their long-term operating costs and losses. Therefore, item (j) does not provide a basis on which to find that measures do not constitute prohibited export subsidies.

3. In other words, item (j) is only a shortcut to determine that an export credit guarantee constitutes an export subsidy when the guarantee does not cover its long-term operating costs and losses. However, it is not a defense clause. Namely, when fees collected for a credit guarantee do cover long-term operating costs and losses for the guarantee, it is still possible that this credit guarantee constitutes an export subsidy, and the panel still needs to examine whether the measure at issue is consistent with Article 1 and 3 of the SCM Agreement or not. In China's view, the definition of export subsides in the meaning of Article 1 and 3 of the SCM Agreement covers a scope much broader than that of item (j) of the Illustrative List. The complainant may raise a *prima facie* case of export subsidy either by claiming an item (j) violation or an Article 1 and 3 violation of the SCM Agreement. Nevertheless, non-existence of the Illustrative List violation does not mean that it also consistent with obligations under Article 1 and 3 of the SCM Agreement.

4. Thus, China considers that the US's approach with regard to item (j) is incomplete, and inconsistent with the provisions in the SCM Agreement.

5. Secondly, regarding ML/CCP payment issue, China cannot endorse the US's arguments. On the one hand, contrary to what the US asserted in its Written Submission, the DSB did make rulings and recommendations in respect to ML/CCP programs in many occasions. For examples, the Original Panel found that: (1) legislative and regulatory provisions of ML/CCP were measures subject to rulings and findings; (2) a textual analysis of the statutes supported that such subsidy programs were 'specific', and (3) ML/CCP payments, among others, were *directly linked to* world prices for upland cotton, and *the structure, design and operation of these measures* constituted evidence supporting a causal link with significant price suppression. In short, the Original Panel did make finding on the ML/CCP programs.

6. In addition, the Original Panel also found that in light of its findings with regard to present serious prejudice, it did not believe that it was necessary to address *Brazil's "threat" claim and "per se" claims relating to these measures*. It is clear that the Original Panel assumed the statutory and regulatory framework of the US mandatory price-contingent subsidy programs should be changed and the Panel therefore refrained itself from making further elaboration in these regards.

7. As to the US's claim that Brazil may not make claims against unchanged measures, China notes that the Original Panel found that the effect of the mandatory price-contingent subsidies was significant price suppression in the same world market and gave rise to serious prejudice to the interests of Brazil. The recommendations and rulings of the DSB accordingly obliged the United States to remove the adverse effects caused by these subsidies, or to withdraw these subsidies.

8. Furthermore, the terms of reference of a compliance panel is not limited to what the responding party claims to be the measures taken to comply. In China's view, since this Compliance Panel is requested to examine whether the measures taken by the United States are consistent with the covered agreement, it is legitimate for the Compliance Panel to examine whether or not the remaining two subsidies (ML/CCP programs) are still causing serious prejudice.

9. This concludes China's oral statement and I thank you very much for your attention, Mr. Chairman and distinguished Members of the Panel.

ANNEX C-10

THIRD PARTY ORAL STATEMENT OF THE EUROPEAN COMMUNITIES

28 February 2007

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Mr. Chairman, distinguished Members of the Panel.

I. INTRODUCTION

1. The European Communities makes this oral statement because of its systemic interest in the correct interpretation of the *SCM Agreement*, the GATT 1994 and the DSU. The European Communities addresses the following issues:

- Panel composition;
- The US requests for preliminary rulings concerning:
  - Export credit guarantees for pig meat and poultry meat under the GSM 102 programme;
  - The marketing loan programme and the counter-cyclical payment programme;
  - Compliance in past periods;
- Certain aspects of the export contingent subsidies claims; and
- Certain aspects of the actionable subsidies claims.

II. PANEL COMPOSITION

2. The European Communities again most respectfully urges the Panel in the strongest terms to exercise its inherent jurisdiction under the *HFCS* case law, and rule on the propriety of its own composition, following the *Australia Automotive Leather II* precedent.[1] This is all the more imperative in the present circumstances because of the obvious and acutely important systemic interest; and the entirely understandable reticence of either Party to expressly intervene at length.

3. The DSU expressly sets out what the "functions of panels" are; and that expressly includes "to assist the DSB in discharging its responsibilities under th[e DSU] and the covered agreements".[2] Those DSB responsibilities clearly include ensuring that panels are properly composed. Article 2(1) of the DSU states expressly that the DSB is established "to administer the[] rules and procedures" set out in the DSU, and that necessarily includes Article 8(3) of the DSU, which relates to panel composition.

4. Furthermore, Article 11 of the DSU requires this Panel to "*assist* the DSB in making the recommendations or in giving the rulings provided for in the covered agreements". The DSB *cannot possibly* have addressed the question of composition at the time of panel request and establishment, since the former post-dates the latter. Therefore, *the only way* in which this Panel can fulfil its obligation to *assist* the DSB in relation to this matter is to deal with it in its report.

III. US REQUEST FOR PRELIMINARY RULINGS

A. EXPORT CREDIT GUARANTEES FOR PIG MEAT AND POULTRY MEAT UNDER THE GSM 102 PROGRAMME

5. The United States request for a preliminary ruling raises a problem being discussed in DSU proceedings with increasing frequency[3]: what is the relationship between the measure at issue (and elements of it) in an original panel; and the measure taken to comply (and elements of it) in a

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[1] EC Third Party Written Submission, paras. 6 to 30.
[2] DSU, Article 11.
[3] *See*, for a recent example, Panel Report, *Chile – Agricultural Products (Price Band) (Article 21.5 - Argentina)*, paras. 7.121 to 7.162.

compliance panel. The context of this legal problem includes: 1) the fact that measures at issue may be complex and have many different elements, some of which are more closely interrelated or interdependent than others; 2) the fact that measures at issue may be attacked "as such" (or constitute "programmes" under the *SCM Agreement*) or "as applied" 3) that panel's may focus on resolving the dispute, and thus exercise judicial economy, either with respect to certain claims, or with respect to certain elements of a measure, and that successful appeal of the exercise of judicial economy may be difficult[4]; 4) the principle of *res judicata*, according to which once a matter is decided it should not be re-litigated; 5) the fact that a compliance panel may be followed by immediate retaliation; and 6) that the Appellate Body has no legal basis to "remand" matters to the original panel for re-consideration.

6. The European Communities agrees with the United States that the case law to-date does not yet regulate all aspects of this problem. Specifically, the existing case law does not resolve the question of how the scope of a compliance panel should be determined in circumstances where the exercise of "false" judicial economy is successfully appealed and/or the Appellate Body is unable to complete the analysis.[5] However, the European Communities does not consider that it is by reference to such matters that the problem before you is to be resolved. Rather, it appears to the European Communities that the important issue is the *nexus* or the degree of interrelatedness or interdependence between different elements of the measure.

7. It appears to the European Communities that there are essentially two competing models: "the measure model" (supported by Brazil in this case), which tends to fix the parameters of the compliance panel by reference to the original measure at issue – understanding the measure taken to comply accordingly; and the "element of the measure model" (supported by the United States in this case), which tends to fix the parameters of the compliance panel by reference to the *elements* of the original measure at issue in respect of which findings were made by the original panel, and understand the "measure taken to comply" accordingly. One can find examples of both types of approach in the case law.[6]

8. It appears to the European Communities that neither model may provide a satisfactory method for dealing with all cases.

9. For example, the measure model would appear unsatisfactory in cases involving "as such" claims against Member's legislation implementing the *WTO Agreements* by way of municipal law measures intended to have general and prospective application. These might typically consist of hundreds of articles (or elements). Given the seriousness of "as such" claims, to accept that an entirely new article (or element) could be raised in a compliance panel would appear to be unsatisfactory. In fact, in such cases, typically, it is a particular provision or provisions, and not the piece of legislation as a whole, that is described as the "measure at issue".

10. On the other hand, taken to its logical conclusion, it is not clear where the element of the measure model would stop in its deconstruction or atomisation of a measure at issue. In theory, one could deconstruct a measure at issue into one set of legal elements, one set of factual elements, one set of evidence, and (in some cases) into one set of findings concerning the legal characterisation of facts; and there is no limit in theory to the number of "elements" within each set. It seems to the European

[4] *See*, for a recent example, Appellate Body Report, *US-Zeroing*, paras. 225 and 250 (applying the standard reasoning that additional findings are unnecessary to resolve the dispute).

[5] US First Written Submission, paras. 24 to 30; Brazil's Comments On US Request for Preliminary Rulings, paras. 2 to 15; US Rebuttal, paras. 10 to 15.

[6] *See*, for example, Panel Report, *Japan – Apples (Article 21.5 United States)*, paras. 8.28 to 8.30, where, in effect, the United States argued successfully for the "measure model".

Communities that such an approach might encourage litigants to similarly atomise their claims and arguments, provoking more exercise of judicial economy, appeals from which may not be welcomed by the Appellate Body. It might also encourage litigants to request in parallel and in the alternative and in relation to the same matter a compliance panel *and* a new original panel (eventually with the same panellists) in order to ensure that, whichever model prevails, they do not suffer unnecessary procedural delay – something that would only add needless complexity to already complex legal proceedings.

11. The question therefore poses itself, with particular reference to the facts of this case: are there any objective criteria that can be articulated for determining what approach should be applied? In order to answer that question, in the opinion of the European Communities, the Panel should examine the original measure at issue and the "measure taken to comply", and, with particular reference to the "elements of the measure" that the United States argues are outside the Panel's terms of reference, enquire into the extent to which these are inter*related* or inter*dependent* with measures or "elements of measures" that the United States accepts are within the Panel's terms of reference.[7]

12. It appears to the European Communities that, at first sight, the question of whether or not US export credit guarantees under the GSM 102 programme to pig meat and poultry meat circumvent US commitments for those scheduled products, and are inconsistent with Articles 3.1(a) and 3(2) of the *SCM Agreement*, is not ***necessarily*** inter*dependent* with and arguably not even ***necessarily*** inter*related* with the same question regarding, particularly, upland cotton.

13. However, it also appears to the European Communities that there are other factors that merit careful consideration. For example:

- One particular feature of the *SCM Agreement* is that several of its provisions refer to subsidy "programmes", lending support to the view that a subsidy programme can be a "measure at issue", and further lending support to the view that, ***by its own terms***, such a programme may exhibit a degree of interrelatedness or interdependence between its terms and/or its instances of application.[8]

- The United States appears to have admitted that the GSM 102 programme was and is a "programme" within the meaning of the *SCM Agreement*.[9]

- The original panel consistently described the GSM 102 programme as a "measure at issue", and the United States does not appear to have argued that it in fact consisted of a number of different measures at issue.[10]

- In the original panel Brazil attacked the GSM 102 programme both "as such" and "as applied", although the original panel did not consider this distinction to be a determinative one.[11] There is authority for the view that a compliance panel should consider together both a measure and its *application*.[12]

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[7] Appellate Body Report, *US-Softwood Lumber IV (Article 21.5 – Canada)* (DS257), para. 79 "… the Panel employed a nexus-based test … which accords with our own interpretation of Article 21.5".
[8] *See* final bullet point.
[9] Panel Report, *US-Upland Cotton*, para. 7.811.
[10] Panel Report, *US-Upland Cotton*, para. 7.242.
[11] Panel Report, *US-Upland Cotton*, para. 7.763.
[12] Panel Report, *US-Shrimp (Article 21.5 – Malaysia)*, para. 87.

- In the compliance Panel Brazil has again attacked *per se* the programme, that is, the revised fee schedules for export credit guarantees issued under the GSM 102 programme.[13]

- Finally, and *significantly*, as far as the European Communities can ascertain, the US has ***elected*** to revise the fee schedules for export credit guarantees issued under the GSM 102 ***generally***[14], that is, also for pig meat and poultry meat.[15] In this respect the present case is similar to past cases in which the fact that measures have been ***changed***, suggesting the requisite degree of interrelatedness or interdependence, has tended to bring them within the scope of a compliance panel.[16]

14. The European Communities interest in this matter being systemic, we do not venture a final view on whether or not the GSM 102 programme as it relates to pig meat and poultry meat is or is not within the Panel's terms of reference; but we do respectfully invite the Panel to take the foregoing observations into consideration when reaching its findings on this point.

B. THE MARKETING LOAN PROGRAMME AND THE COUNTER-CYCLICAL PAYMENT PROGRAMME

15. The European Communities agrees with the United States[17] that there is a meaningful distinction between an "as such" claim and an "as applied" claim, although, like most distinctions, it is not an absolute one.[18] An "as such" claim operates against a normative measure at a higher level of abstraction, intended to be of general and prospective application (such as legislation). The European Communities views on the so-called mandatory/discretionary distinction[19] do not suggest otherwise.

16. Furthermore, the European Communities agrees with the United States[20] that there is a distinction between a subsidy programme within the meaning of the *SCM Agreement* (which may be a measure at issue) and instances of a subsidy under such programme (each of which may also be a measure at issue). The former may be said to operate at a higher level of abstraction than the latter.

17. The European Communities also agrees with the United States that an actionable subsidies claim under Part III of the *SCM Agreement* refers to a "subsidy" within the meaning of paragraphs 1 and 2 of Article 1, which may be either a programme; or instances of the application of a programme; or both. These measures should not normally be conflated.[21]

18. The European Communities also agrees with the United States that a complaining Member must be especially diligent in setting out "as such" claims in panel requests and first written

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[13] Brazil's First Written Submission, para. 333, second bullet point and footnote 510.

[14] *See* first bullet point.

[15] Brazil's First Written Submission, para. 333, second bullet point and footnote 510; Exhibit Bra-505.

[16] For example, in *Canada – Aircraft*, Canada changed the terms of the TPC programme (which was not an original measure at issue), and did not subsequently contest that it was a measure taken to comply. In *Australia – Automotive Leather II*, Australia changed the 1997 loan (originally found not to be an export subsidy) into a 1999 loan, which the compliance panel found to be within its terms of reference. In *EC – Bananas III (Article 21.5 – Ecuador)*, the EC changed its legislation, which was considered, in its entirety, to be within the compliance panel's terms of reference.

[17] US Rebuttal, paras. 22 to 24.

[18] For example, an original anti-dumping duty measure is often said to be attacked at the "as applied" level, although it is likely to be of general (residual duty per country) and prospective application.

[19] EC Third Party Written Submission, paras. 64 to 69; US Rebuttal, footnote 31.

[20] US Rebuttal, paras. 20 to 21.

[21] US Rebuttal, para. 25.

submissions; and that as long as either the existence or the precise content of the supposed measure is not demonstrated to a high threshold and with particular rigour, any such claims must be dismissed.[22]

19. The European Communities does see a difference between the type of programme, often fiscal, in which entitlement to payment is conditional only upon the fulfilment of certain essentially factual requirements, essentially in the hands of the recipient; and the type of programme in which application in any given instance still depends on considerations (sometimes referred to as "discretion") that are in the hands of the granting authority. In the latter case, the distinction between the programme and an instance of its application must be rigorously maintained.[23] In the former case the distinction may be less clear, and there may be a degree of nexus or interrelatedness or interdependence between the (for example, fiscal) programme and payments under it, such as might justify their treatment as indivisible for the purposes of a compliance panel.

20. The European Communities agrees with Brazil that, if a panel's adverse effects finding relates to a *bundle* of subsidies, the entire bundle will normally fall within the scope of a compliance panel. However, the European Communities agrees with the United States that this observation does not, *in itself*, resolve the question of whether the measures taken to comply relate only to the *payments*, or also the *programmes* themselves.

21. That said, the European Communities agrees with Brazil[24] that the fact that the United States implemented by withdrawing the Step 2 *programme* lends very considerable support to the view that there was at least a sufficient *nexus* between the Step 2 *payments* and the Step 2 *programme*. The Parties also agree that the original panel assessed a *bundle* of *payments* under the three different programmes – that is that the panel's adverse effects assessment assumed a *nexus* between the payments under the three different programmes. If there is sufficient *nexus* between payments and programme for one programme; and if there is sufficient *nexus* between all payments; this in turn suggests a sufficient *nexus* between all three programmes, such that the whole new bundle can and should be treated as indivisible for the purposes of this compliance panel.

22. The European Communities disagrees with the United States that the fact that something has not changed necessarily means that it is outside the scope of a compliance panel.[25] That depends on its relationship with what the Parties agree is within the scope of the compliance panel. And in any event Article 21.5 disputes may also relate to the question of whether or not a required measure taken to comply "exists".

23. Finally, and *significantly*, the European Communities observes that there is support in the case law for the view that claims of present serious prejudice and *threat* of serious prejudice are closely interrelated, such that a threat claim in an original panel may inevitably give rise to a claim of present serious prejudice in a compliance panel. It is not in dispute that Brazil's *threat* claims in the original panel were also made against the *programmes*.[26]

24. The European Communities interest in this matter being systemic, we do not venture a final view on whether or not the marketing loan programme and the counter-cyclical payment programme are or are not within the Panel's terms of reference; but we do respectfully invite the Panel to take the foregoing observations into consideration when reaching its findings on this point.

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[22] US Rebuttal, para. 41.
[23] As in the *Brazil – Aircraft* case, cited in US Rebuttal, paras. 51 to 52.
[24] Brazil's Submission Regarding the US Request for Preliminary Rulings, paras. 16 to 28.
[25] US Rebuttal, para. 18; paras. 53 to 61.
[26] Brazil's Submission Regarding the US Request for Preliminary Rulings, paras. 63 to 69.

C. COMPLIANCE IN PAST PERIODS

25. Paragraph 8.3(d) of the original panel report, as adopted by the DSB, contains a "recommendation or ruling" within the meaning of Article 21.5. Furthermore, one element of that "recommendation or ruling" was that the United States take appropriate steps to remove the adverse effects or withdraw the subsidy; and (by necessary implication) that should the United States fail to do so within six months from the date on which the DSB adopted the panel or Appellate Body Report, the consequences described in Article 7.9 of the *SCM Agreement* would result. In the opinion of the European Communities, it may reasonably be inferred from paragraph 8.3(d) of the original panel report and Articles 7.8 and 7.9 of the *SCM Agreement* that the United States was subject to a "recommendation or ruling" within the meaning of Article 21.5 that it take appropriate steps to remove the adverse effects or withdraw the subsidy at the latest within that six month period of time.

26. The Parties agree that the United States *omitted* to take a "measure taken to comply" during the period identified by Brazil. It follows that, during the period identified by Brazil, the United States did not comply with the "recommendations and rulings" of the DSB.

27. The United States argues that this situation is not within the scope of Article 21.5 because the Parties *agree* that no measure taken to comply existed during that period of time (and there is thus no "disagreement"); and that there could be no "disagreement" as to consistency, because there was no measure taken to comply.[27]

28. The European Communities disagrees. The United States overlooks the fact that any act or *omission* may be a measure for the purposes of dispute settlement.[28] It follows that, within the terms of Article 21.5 of the DSU, Brazil considers that the United States *omission* (in this context, the measure taken to comply within the meaning of Article 21.5) was inconsistent with a covered agreement, including Articles 7.8 and 7.9 of the *SCM Agreement*. This interpretation is consistent with, and indeed necessitated by, the view that, in some circumstances, inaction may be an appropriate method of implementation.[29]

29. The European Communities can find nothing additional in the terms of Article 21.5 that would limit its temporal application in the manner advocated by the United States. On the contrary, it seems to the European Communities that an integral part of a measure, apart from, for example, its material and territorial scope, is its temporal scope; and the European Communities does not see how this latter element could be artificially divorced from the whole. Apart from the fact that a non-compliance finding opens the way for retaliation, whether or not Brazil's request would ever be capable of having any practical utility is a different matter that this Panel does not need to address, being essentially a matter for Brazil, exercising its judgement in good faith.[30] In some instances, for example, it may be quite possible that such a finding could have implications for interested parties in a municipal law jurisdiction.

IV. ALLEGED EXPORT CONTINGENT SUBSIDIES

30. The European Communities does not comment on whether or not the alleged subsidies identified by Brazil are export contingent. However, the European Communities has four comments which relate rather to the question of whether or not the measures in question involve subsidies.

[27] US Rebuttal, paras. 64 to 71.
[28] Appellate Body Report, *US - Corrosion-Resistant Steel*, para. 81.
[29] EC Third Party Written Submission, para. 41.
[30] Appellate Body Report, *US - Corrosion-Resistant Steel*, para. 89.

31. First, the European Communities agrees with the United States that Articles 14(a) to (c) of the *SCM Agreement* presume that the types of financial contribution there enumerated do not confer a benefit, unless the complaining party demonstrates otherwise.[31]

32. Second, the European Communities agrees with the United States that neither the status of bodies executing financial instruments, nor the terms on which they can borrow, determines whether or not such financial instruments confer a benefit.[32]

33. Third, the European Communities agrees with the United States that if estimated projected data indicate a negative net present value, that indicates profit, and there is accordingly no benefit and no subsidy.[33]

34. Fourth, the European Communities agrees with the United States that entities such as the International Finance Corporation (IFC), the Inter-American Development Bank (IDB) and the European Bank for Reconstruction and Development (EBRD) may provide commercial benchmarks that can be used for the purposes of demonstrating the absence of any benefit and thus the absence of subsidy.[34]

35. The European Communities respectfully invites the Panel to take these observations into consideration when reaching its findings on the alleged export contingent subsidies.

V. ACTIONABLE SUBSIDIES

36. The European Communities agrees with the United States that the data that the Panel must consider for the purposes of Brazil's claim of "present" serious prejudice would be the most recent relevant data reasonably available, including, where possible, data for the 2006 marketing year (which runs from 1 August 2006 to 31 July 2007).[35] Brazil agrees that the most recent data is relevant and should be referenced by the Panel.[36]

37. The European Communities further agrees with the United States that any consideration of data trends over time, in order not to be distorted, should be conducted in a meaningful way, that takes into account known exogenous events, or circumstances in which there were "entirely different market conditions", whether in the past or in the immediate future.[37]

38. The European Communities also agrees with the United States that where alleged subsidies are extinguished or extracted by owners not operating in the relevant markets, then there is no basis on which to find adverse effects, or for that matter a subsidy that continues to benefit the relevant company or product.[38]

39. The European Communities also agrees with the United States that, as long as the complaining party has failed to demonstrate that the effects of the subsidies are *significant*, including

[31] US Rebuttal, para. 79.
[32] US Rebuttal, paras. 80 and 104.
[33] US Rebuttal, paras. 84 and 87.
[34] US Rebuttal, para. 154.
[35] US First Written Submission, paras. 160 to 170; US Rebuttal, para. 182 and paras. 215 to 216: "… the period relevant for these claims is the immediate present, not a historical period (regardless of how close in time).".
[36] Brazil's Rebuttal, para. 25.
[37] US Rebuttal, para. 183.
[38] US First Written Submission, para. 215.

with specific reference to the *magnitude* of the subsidy, then the adverse effects claims should be dismissed.[39]

40. The European Communities respectfully invites the Panel to take these observations into consideration when reaching its findings on the actionable subsidies claims.

Mr. Chairman, distinguished Members of the Panel, the European Communities thanks you for your kind and patient attention.

[39] US First Written Submission, para. 236; US Rebuttal, para. 252.

ANNEX C-11

THIRD PARTY ORAL STATEMENT OF INDIA

28 February 2007

Mr. Chairman and Distinguished Members of the Panel,

1. India thanks you for having provided us an opportunity to present our views as a third party in this dispute on the implementation measures by the United States. As a major cotton producing country, with production dominated by low-income, resource poor, subsistence farmers, India has a major substantive interest in these proceedings. As a developing country India has a strong interest in a stable and competitive world market in cotton, unencumbered by trade and production distorting subsidies provided by a few countries. India shares the interests of Brazil and other like-minded parties to this dispute.

2. India fully agrees with Brazil, and those other third parties who have pointed out that the United States has failed to implement the recommendations and rulings of the Dispute Settlement Body in the original proceedings. We also agree with the contention that the United States continues to provide subsidies that either cause serious prejudice or threaten to cause serious prejudice, within the meaning of Articles 5 and 6 of the Agreement on Subsidies and Countervailing Measures (SCM Agreement) and the relevant provisions of the GATT 1994.

3. India proposes to focus on the following two issues:

(i) The implementation with respect to Marketing Loan and Counter-Cyclical Payment (CCP) programmes by the United States; and

(ii) Export credit guarantee (ECG) programmes maintained by the Commodity Credit Corporation (CCC) of the United States.

4. As part of its implementation of the DSB recommendations on serious prejudice claims arising from the original proceedings, the United States claims to have repealed the Step 2 payment programme for upland cotton with effect from 1 August 2006, which was one of the programmes found by the original panel to be causing serious prejudice. The United States has argued that since Brazil had distinguished between claims against programmes *per se* and claims against specific *payments* under the programmes, the US Marketing Loan and Counter-Cyclical Payment programmes were not subject either to a finding of WTO inconsistency or any DSB recommendations. Accordingly, since these programmes have not changed in response to DSB recommendations and rulings or otherwise, the United States has requested this Panel to find that these measures are not within the scope of the present proceedings.

5. India recalls that, as upheld by the Appellate Body, the original panel found several mandatory price-contingent subsidy programmes of the United States, including the Marketing Loan and Counter-Cyclical Payment programmes, to be inconsistent with the obligations of the United States under Articles 5 and 6 of SCM Agreement. In view of the fact that the original panel considered the effect of these programmes separately and jointly, the United States cannot now argue that these programmes are outside the scope of this proceeding. India considers that the original panel examined carefully and separately the individual nature, operation, magnitude, and price-suppressing effect of these subsidies and found that the vast majority of the price suppression and adverse effects were caused by the marketing loan and counter-cyclical payment programmes, rather

than the Step 2 payments. Therefore, the withdrawal of the Step 2 payments for upland cotton cannot be said to have also removed the adverse effects of the Marketing Loan and CCP programmes.

6. Mr. Chairman, India also submits that the original panel clearly described the measures at issue as comprising the "legislative and regulatory provisions currently providing for the payment of measures", including Marketing Loan and Counter-Cyclical Payment programmes. The panel had clearly considered that its findings regarding "present" serious prejudice applied not just to payments, but also to the statutory and regulatory framework of the Farm Security and Rural Investment Act, 2002 and its implementing regulations. Contrary to the arguments put forward by the United States, the U.S. obligations at the implementation period were not circumscribed to "payments" made in a period in the past. Therefore, an examination of the conformity of the legislative and regulatory provisions, under which the mandatory, price-contingent Marketing Loan and CCPs are made, with the rulings and recommendations of the original panel and Appellate Body, falls within the terms of reference of this Panel. An interpretation that would endorse the U.S. arguments on this issue would, in practice, render the whole Part III of the SCM Agreement ineffective. This is not an interpretation supported by the principles and rules of treaty interpretation used in the WTO, and would be of even more concern in light of the specificity of the remedies provided for in that Agreement.

7. Mr. Chairman, with respect to the three export credit guarantee (ECG) programmes maintained by the Commodity Credit Corporation (CCC) of the United States – GSM 102, GSM 103 and SCGP – the Dispute Settlement Body recommended that the United States withdraw the subsidy and otherwise bring itself into compliance with its obligations by the implementation deadline of 1 July 2005.

8. In India's view, in the absence of GSM 102 fees that take full account of all the risks the CCC bears in a transaction, the measures taken by the United States to comply with the DSB's ECG related recommendations are <u>not</u> consistent with the obligations of the United States under the Agreement on Agriculture and the SCM Agreement. In its submission, Brazil has demonstrated clearly that under Article 1.1 and 3.1(a) of the SCM Agreement, GSM 102 ECGs are financial contributions that confer benefits, and that the subsidies are contingent in law on export performance. India also agrees with Chad, who in their written submission has shown why, as a practical matter, only developed country governments can effectively provide ECGs to promote their exports. India also believes that purchases of goods backed by US ECGs benefit from the sovereign guarantee, thereby giving a competitive advantage to US exporters. Therefore, Mr Chairman, India is of the view that the GSM 102 programmes are still not in compliance with the export subsidy disciplines specified in Articles 1.1 and 3.1(a) of the SCM Agreement and the Agreement on Agriculture.

Thank you.

ANNEX C-12

THIRD PARTY ORAL STATEMENT OF JAPAN

28 February 2007

I. Introduction

1. Mr. Chairman and Members of the Panel, we are pleased to have this opportunity to appear before you today to present the views of Japan as a third party in this case. Japan is participating as a third party because of its systemic interest in the proper functioning of the Agreement on Subsidies and Countervailing Measures ("ASCM") and the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU"), in particular, the proper role of Article 21.5 compliance panels. This Panel has an important opportunity to clarify that role. We would like to briefly address, in light of the Written Submissions of Brazil and the United States ("U.S."), three issues concerning the role of Article 21.5 compliance panels under the DSU and one issue regarding the proper interpretation of the ASCM:

- Whether the use by the U.S. of the General Sales Manager ("GSM") 102 program to support exports of pig and poultry meat is within the scope of the Panel;

- Whether the Marketing Loan Program ("MLP") and the Counter-Cyclical Payment Program ("CCP") are part of the U.S. "measure taken to comply" and, therefore, within the scope of the Panel;

- Whether the Panel has the authority to make findings with respect to the U.S. non-compliance between 21 September 2005 and 31 July 2006; and

- The proper standard for assessing "threat of serious prejudice" in the ASCM.

II. The GSM 102 Program for Pig and Poultry Meat Is Within the Scope of the Panel

2. In the original proceedings, the Appellate Body reversed the original panel's finding that Brazil had failed to demonstrate that the U. S. had applied GSM 102 in a manner that circumvented export subsidy commitments with respect to pig and poultry meat, but concluded that there were insufficient uncontested facts in the record to enable it to complete the legal analysis.[1] Based on this fact, the U.S. asserts that Brazil's claim is outside the scope of this Panel. In Japan's view, this assertion by the U.S. is not an appropriate interpretation of Article 21.5 of the DSU.

3. The Appellate Body's inability to complete the analysis concerning a finding it has reversed is similar to an original panel's exercise of judicial economy; both situations mean that there is no "final resolution" with respect to the claim in question, and no reason to preclude its resolution in an Article 21.5 proceeding.[2] Thus, Japan submits that the recent report of the Article 21.5 compliance panel in *U.S. – OCTG Sunset Reviews* is dispositive:

> The fact that a panel, in an original dispute settlement proceeding, did not make findings regarding certain issues relating to the investigating authorities' determination that were raised and argued before the panel, can not preclude a compliance panel, in its assessment under

[1] *United States – Subsidies on Upland Cotton*, WT/DS267/AB (3 March 2005), paras. 689-694.
[2] *See* Submission of Brazil to the Panel Regarding U.S. Requests for Preliminary Ruling, note 14.

Article 21.5 of the DSU of the measures taken to comply with the recommendations and rulings, from reviewing those aspects which have been incorporated by the authorities in the measure taken to comply.[3]

4. Japan respectfully submits that, as indicated by the report of the Article 21.5 compliance panel in *U.S. – OCTG Sunset Reviews*, this Panel has the authority to identify and assess the new U.S. measures taken to comply with the recommendations and rulings of the DSB, *i.e.*, the MLP, the CCP, and the GSM 102, GSM 103 and Supplier Credit Guarantee Programs, including the GSM 102 Program for Pig and Poultry Meat.

III. MLP and CCP Payments Are Part of the U.S. Measure Taken to Comply

5. For the reasons presented by Japan in its Third Party Submission, the assertion by the U.S. that the panel lacks the authority to address Brazil's arguments regarding the U.S. MLP and CCP payments is flawed.[4]

6. Japan agrees with Brazil that the question before the compliance Panel is whether the new basket of U.S. price-contingent measures (MLP and CCP), which constitutes the "measures taken to comply", is "consistent with the covered agreements". This basket includes payments under the programs–actions by the U.S. with an impact on the market for cotton. The focus of the Panel, therefore, should be on the payments made under the programs, rather than the programs as such.[5] To comply with WTO obligations, the U.S. should have taken steps to ensure that the adverse effects no longer exist.[6]

7. Japan thus respectfully submits that the Panel must reject this argument by the U.S.

IV. The Panel Has the Authority to Make Findings With Respect To the U.S. Non-Compliance between 21 September 2005 and 31 July 2006

8. The U.S. submits that there is no "disagreement" between the U.S. and Brazil as to the existence of measures taken to comply with the recommendations and rulings of the DSB as stipulated in Article 21.5 of the DSU.[7] The non-existence of measures taken to comply may not be subject to review by a compliance panel if there is no such "disagreement". However, in this case, a disagreement does exist between Brazil and the U.S.–one party (Brazil) is of the opinion that there is a disagreement. The U.S. cannot simply make the disagreement go away by stating that Brazil agrees with the U.S. Alternatively, one may view the U.S. position as a concession that, indeed, it failed to comply because it took no actions during the period in question. In any case, the U.S. argument must be rejected as an attempt to remove from Article 21.5 review precisely the most egregious violations–cases in which a Member does nothing whatsoever to comply.

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[3] *United States—Sunset Reviews of Anti-Dumping Measures on Oil Country Tubular Goods from Argentina*, WT/DS268/RW (30 November 2006), para. 7.92.

[4] Third Party Submission of Japan, paras. 18-21.

[5] Third Party Submission of Australia, para. 15.

[6] The Third Parties to this dispute are nearly unanimous in taking this view. *See* Third Party Submission of Australia, para. 25-31; Third Party Submission of Canada, para. 14; Third Party Submission of Chad, paras. 35-46; Third Party Submission of China, paras. 9-16; Third Party Submission of New Zealand 4.11.

[7] First Submission of the U.S., paras. 49-56.

9. As Australia notes, a failure to address this claim by Brazil would diminish Brazil's rights under Article 22 of the DSU.[8] Thus, the disagreement on the non-existence of the compliance measures is properly before this Panel.

V. The Panel Should Carefully Consider Any Proposed Standards for Threat of Serious Prejudice

10. Japan is of the view that the most important issue of general interest raised in this dispute is the appropriate standard for establishing threat of serious prejudice under Part III of the ASCM.[9]

11. A threat of serious prejudice standard should contain two elements – a legal standard and an evidentiary requirement. The legal standard should not be based on the standard in Part V of the ASCM. Part III issues are devoid of concerns relating to limiting the discretion of national authorities to prevent misuse thereof in the conduct of domestic CVD investigations that apply to Part V. Therefore, Japan does not agree with the assertion by the U.S. that Article 15.7 of the ASCM and Article 4.1(b) of the Agreement of Safeguards provide important contextual guidance in interpreting "threat" of serious prejudice under Part III of the ASCM.[10]

12. Brazil proposes that the Panel find that a "threat of serious prejudice" exists where there is a "'significant likelihood' of serious prejudice in the future."[11] However, Brazil's proposed standard offers little concrete guidance.

13. The legal standard must be tied to an evidentiary requirement. An explicit evidentiary requirement such as that set forth in the first sentence of Article 15.7 of the ASCM[12] is a crucial component of any "threat" standard. It is necessary to tie to real world facts what otherwise is an amorphous concept.

14. Japan asks the Panel to consider these views when examining the issue of the proper standard for threat of serious prejudice.

VI. Conclusion

15. Japan would like to thank the Panel for this opportunity to raise these issues concerning the proper functioning, as required by the DSU, of the compliance phase of the dispute settlement process.

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[8] Third Party Submission of Australia, para. 21.

[9] *See* ASCM, Article 5(c) and note 13.

[10] Rebuttal Submission of the U.S., para. 411.

[11] First Submission of Brazil, para. 259.

[12] *See also* Agreement on Safeguards, Article 4.1(b) ("A determination of the existence of a threat of serious injury shall be based on facts and not merely on allegation, conjecture or remote possibility"); AD Agreement, Article 3.7 ("A determination of a threat of material injury shall be based on facts and not merely on allegation, conjecture or remote possibility").

ANNEX C-13

THIRD PARTY ORAL STATEMENT OF NEW ZEALAND

28 February 2007

Mr Chairman, Members of the Panel,

Introduction

1. New Zealand has a systemic interest in this dispute and welcomes the opportunity to participate in this oral hearing. We wish to make brief comments on three areas, recognising that our views have been presented to you already in our third party submission. Firstly we will comment on why we believe the marketing loan payments and counter-cyclical payments are indeed within the scope of this Article 21.5 proceeding; secondly we will make a brief comment on the burden of proof in a case such as this; and finally we will explain why we believe the marketing loan payments and counter-cyclical payments continue to cause adverse effects.

The scope of this 21.5 proceeding

2. In our view the payments made under the marketing loan payments programme and the counter-cyclical payments programme are clearly within the scope of this proceeding. The panel was clear in paragraph 8.1(g)(i) of its report that its finding was about the "effect of the mandatory price-contingent United States subsidy measures." A reference to payments does not alter that finding. Payments are not mandatory subsidy measures; they are simply the means by which the subsidy measures are implemented. The distinction made by the United States between payments and programmes would undermine the disciplines on actionable subsidies in the SCM Agreement.

3. Of particular importance is the need to give effect to the remedy provided for in Article 7.8 of the SCM Agreement, as referred to by the original Panel in this dispute. This is the first time the relationship between Article 21.5 of the DSU and Article 7.8 of the SCM Agreement has come before a compliance proceeding. Given that the marketing loan and counter-cyclical payments programmes have not been withdrawn, the United States cannot now avoid its obligation under Article 7.8 of the SCM Agreement to remove the adverse effects of those subsidy programmes by claiming that they are not measures taken to comply within the meaning of Article 21.5 of the DSU. In New Zealand's view, if the measures are not withdrawn Article 7.8 of the SCM Agreement then requires the Panel to determine whether steps have been taken to remove the adverse effects found to exist by the original Panel. It must then determine whether any steps that have been taken are "appropriate", that is whether they are measures that are capable of removing the adverse effects. Article 21.5 of the DSU cannot be invoked as a barrier to such an analysis.

Marketing Loan Payments and Counter-Cyclical Payments continue to cause significant price suppression and increase the world market share

Burden of proof

4. As in our submission, we wish to make a brief comment regarding the burden of proof in a case such as this. The DSB recommendations and rulings of 21 March 2005 covered three programmes: the step 2 payments programme; the marketing loan payments programme; and the counter-cyclical payments programme. Having chosen to remove only one of those programmes the United States now claims that Brazil has the burden of showing that the remaining

two programmes cause serious prejudice. The United States conveniently ignores the fact that the original Panel had already evaluated the evidence and made a finding that all three programmes cause adverse effects. A Member should not have the burden of proving something that has already been decided by the original panel. In this case that would deprive the actionable subsidies provisions of the SCM Agreement of their proper effect.

5. Since an implementing Member has the option of either withdrawing the subsidising measure or removing the adverse effects under Article 7.8 of the SCM Agreement, an implementing Member that fails to withdraw the measure in question then should have the burden of showing that it has removed the adverse effects. Thus, in the present case proof by Brazil that the measures found by the original panel to cause adverse effects have not been withdrawn should establish a prima facie case that implementation has not occurred. In New Zealand's view, the burden would then be on the United States to prove that the adverse effects caused by those subsidising measures have been removed.

The adverse effects from the Marketing Loan Programme and the Counter-Cyclical Programme remain

6. We agree with Brazil that the removal of the Step-2 programme had a relatively modest impact. A comparison of the amounts paid under the various programmes shows significant differences. Step 2 payments are small compared to marketing loan and counter-cyclical payments. In the most recent year, 2005, for example, the Step 2 payments were US$350 million. In the same year, the marketing loan and counter-cyclical programme payments amounted to US$2,170 million. The US cannot ignore the much larger volume of subsidisation under the two programmes that have not been withdrawn or modified.

7. Also, it is possible – and likely – that the counter-cyclical payments could increase to compensate for the removal of the Step 2 programme. The United States argues against this line of reasoning given that there was no increase in counter-cyclical payments in the current year. What the United States fails to make clear is that those payments are already at their maximum rate. If that were not the case there could indeed be a compensatory effect for the removal of the Step 2 programmes.

8. The United States attempts to counter Brazil's arguments about the trade-distorting effects of counter-cyclical payments by blurring the line between counter-cyclical payments and decoupled payments. But, counter-cyclical payments are not real decoupled payments.

9. Real decoupled payments are green box measures and cannot be linked to the type or volume of production or be related to or based on prices. Counter-cyclical payments, by contrast, are clearly and explicitly linked to prices. The fact that in many years such payments are likely to be paid out at the maximum rate does not change the fact that they are linked to prices. The question is, what would farmers do differently if there were no counter-cyclical payments and farmers were, essentially, "guaranteed" 13.73 cents per pound less for their cotton.

10. Indeed, the United States fails to accurately explain the role of expectations in the market place. While it is possible that removal of the Step-2 programme will decrease the marketing loan payments, this argument ignores the fact that these programmes are distorting whether or not payments are made under them. Producers know that the loan rate is there to support them and that there is a target price they will receive either from the market or the government.

11. In fact, the proposition that marketing loan payments are distorting is almost self-evident. Marketing loan payments are amber box measures, the category in which are included the non-prohibited measures with the most trade distorting effect on production and trade. Producer

expectations are generated because of applied administrative prices under a subsidisation programme – because of a guaranteed price, regardless of what happens in the market place – not because of financial transfers in any one year. Producers are aware that they are insulated from the market place by government support and it is this guarantee of insulation that affects producer decision making.

12. The United States tries to convince you that producers respond to market signals, and that the marketing loan programme and counter-cyclical programme do not insulate producers from the market. But, in the absence of the marketing loan and counter-cyclical programmes – programmes that guarantee certain prices to producers of cotton in the US – would the United States market share of cotton be at current levels? The link that is necessary to examine is that between domestic, guaranteed prices and United States production. And that is the source of the problem.

13. The United States contests the Brazilian argument that absent the payments farmers would exit cotton production. This ignores the evidence. Over some years over half of the revenues received by United States cotton farmers has come from subsidisation. The idea that if these subsidies were not there, producers who have been deprived of half of their income would carry on planting cotton is little short of absurd.

14. The United States also claims that the econometric modelling provided by Brazil is flawed, but the arguments of the United States are either an attempt to reargue what was litigated before the original panel and the Appellate Body and lost, or are inconsequential.

15. The United States itself demonstrates that if the marketing loan and counter-cyclical payments programmes were eliminated there would be a reduction in United States cotton exports of up to 25 per cent in 2002-2005 and 17 per cent in 2006-2008. That is a very clear measure of what United States world market share would be in the absence of the marketing loan and counter-cyclical payments programmes.

Conclusion

16. In conclusion, in New Zealand's view, Brazil has demonstrated that the United States has failed to either withdraw the marketing loan and counter-cyclical payments programmes or to remove the adverse effects of those programmes as required by Article 7.8 of the SCM Agreement. Accordingly, the United States has failed to comply with the recommendations and rulings of the DSB.

ANNEX C-14

THIRD PARTY ORAL STATEMENT OF THAILAND

28 February 2007

1. Mr. Chairman and Members of the Panel: Thailand appreciates the opportunity to participate in this proceeding and to present its views to the Panel today.

2. Thailand reserved its right to participate as a third party in this proceeding under Article 10.2 of the *Dispute Settlement Understanding* due to our interest as one of the top global exporters of rice. As demonstrated by Brazil, rice is one of the products affected by the Export Credit Guarantees (ECGs) maintained by the United States Commodity Credit Corporation (CCC) under the GSM 102, GSM 103 and SCGP programs. In fact, according to Brazil's first submission, almost half of the USD 8.5 billion of ECGs outstanding as of 1 July 2005 involved rice and other products.[1]

3. Mr. Chairman, a fair playing field for rice exports is essential to Thailand's development. Not only are Thailand's climate and geography particularly suited to rice cultivation, the farming and production of rice affects over 4 million households located mostly in Thailand's rural areas. We therefore generally share and support Brazil's concerns regarding the United States' implementation in this dispute and its continued provision of ECGs subsequent to the withdrawal date of 1 July 2005 recommended by the Dispute Settlement Body.

4. In particular we find troubling the continued maintenance of GSM 102 ECGs by the United States. Although the United States claims that it has amended the GSM 102 program and that ECGs provided thereunder are now WTO-consistent, Thailand views that the ECGs are still provided on non-commercial terms such as the mandatory one-percent fee cap and failure to take into account all relevant risks faced by the CCC.[2]

5. As Brazil has already submitted comprehensive analyses on the aforementioned aspects of GSM 102 in its submissions, as well as the resultant circumvention by the United States of its export subsidy commitments[3], Thailand will not repeat those arguments here. We would only emphasize Brazil's demonstration that GSM 102 bridges the financial gap between United States exporters and foreign buyers to make the export sale possible. Without such assistance from the United States government, agricultural exports under GSM 102 would not occur.[4]

6. While a large developed country Member such as the United States can afford to finance its agricultural exports through programs such as GSM 102, Thailand empathizes with the concern expressed by Chad in its written submission that developing country and LDC Members "face permanent structural disadvantages compared to developed country Members in providing export credit,"[5] even if such schemes were consistent with WTO disciplines. In light of this concern, and of the persuasive arguments and evidence submitted by Brazil, we urge the Panel to make the relevant findings and recommendations requested by Brazil in its First Submission. Thank you.

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[1] First Written Submission of Brazil, 17 November 2006, paras. 344 and 345.
[2] *Ibid.* paras. 419-421and paras. 445-446.
[3] *Ibid.* paras. 448-452.
[4] *Ibid.* paras. 4356-357.
[5] Written Submission of Chad, para. 53.

ANNEX D

RESPONSES OF PARTIES TO THE PANEL'S QUESTIONS AND OTHER COMMENTS AND DOCUMENTS RECEIVED FROM PARTIES

ANNEX D-1

BRAZIL'S REQUEST FOR THE PANEL TO SEEK PRODUCTION OF DOCUMENTS AND INFORMATION PURSUANT TO ARTICLE 13 OF THE DSU

(1 November 2006)

1. The Government of Brazil would like to thank you, as well as Ambassador Ahn and Ambassador Matus, for agreeing to serve as panelists in *United States - Subsidies on Upland Cotton (Recourse by Brazil to Article 21.5 of the DSU).* We appreciate your willingness to devote time and energy to assisting Brazil and the United States to resolve this matter. Brazil also looks forward to providing you, the panelists and the Secretariat with whatever assistance it can in these proceedings.

2. In this letter, Brazil seeks that the compliance Panel exercise its discretion under Article 13.1 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU")[1] to request the United States to produce documents and information relating to (a) payments to U.S. producers of upland cotton under the U.S. counter-cyclical payment program established by the FSRI Act of 2002, and (b) the U.S. agricultural export credit guarantee programs (principally the General Sales Manager 102 ("GSM 102") export credit guarantee program). **Annex 1** to this letter sets out the precise documents and information that Brazil requests the Panel to seek from the United States.

3. All of the documents and information sought by Brazil is within the exclusive control of the United States. All of it is highly relevant to Brazil's claims and the issues before this compliance Panel. Therefore, Brazil considers that it is "necessary and appropriate" for the compliance Panel to seek the documents and information requested at this early stage of the compliance proceeding. Doing so is also "necessary and appropriate" given the shortened timeframe for the panel procedure, provided for in Article 21.5 of the DSU, and in light of the importance accorded to this information by the panel in the original proceeding.

4. Prior to making this request, Brazil sought to secure the agreement of the United States to produce this information.

5. **Annex 2a** to this letter contains Brazil's letter, dated 7 June 2006, requesting informal discussions on the U.S. implementation of the recommendations and rulings of the Dispute Settlement Body in this dispute; **Annex 2b** contains the questions presented by Brazil prior to and during the informal discussions on this matter on 19 July 2006.

6. In the few instances in which the United States provided documents or information during the informal discussions, Brazil has not repeated the question in Annex 1 to this letter. For the majority of the documents and information requested by Brazil, the United States indicated during the informal discussions that it was not in a position to produce the documents or information. Nor has the United States subsequently offered to produce the requested documents or information. During those discussions, the United States indicated that at least part of the documents or information requested

[1] Article 13.1 provides, in relevant part: "Each panel shall have the right to seek information . . . from any individual or body which it deems appropriate. . . . A Member should respond promptly and fully to any request by a panel for such information as the panel considers necessary and appropriate. Confidential information which is provided shall not be revealed without formal authorization from. the individual, body, or authorities or the Member providing the information."

was confidential and that it was not prepared to provide them in the context of discussions not formally protected by confidentiality. The United States added that the situation would be different if such request was presented during panel proceedings which, pursuant to Article 18 of the DSU, take place under a confidentiality clause.

7. Brazil and its representatives also made requests seeking these documents and information under the U.S. Freedom of Information Act ("FOIA"). In most instances, Brazil has not received documents or information pursuant to those FOIA requests. In the few instances in which Brazil received documents or information in response to those FOIA requests, relevant questions have been eliminated from Annex 1 to this letter.

8. Brazil sets out the requested documents and information regarding the U.S. **counter-cyclical payment** program in Part A of Annex 1. This request is essentially *identical* to the original panel's final request to the United States pursuant to Article 13.1 of the DSU.[2] The United States eventually provided considerable data to the original panel in response to this request. The relevant background concerning the original panel's final request (as well as previous requests) under Article 13.1 of the DSU is set out in paragraphs 7.20-7.42 of the Panel Report in *United States - Subsidies on Upland Cotton.*

9. That data produced by the United States allowed the original panel to make an assessment of both the amount and type of counter-cyclical payments received by current upland cotton producers. For the reasons set out below, it is "necessary and appropriate" for the compliance Panel to exercise its discretion, under Article 13.1 of the DSU, to request the United States to produce an update of this same data.

10. Brazil recalls that the original panel found that the "support delivered to upland cotton by [counter-cyclical payments] is a central issue in this dispute."[3] Using the information on counter-cyclical payments obtained from the United States in response to its Article 13.1 request, the original panel made extensive findings of fact.[4] For example, the original panel found that "the overwhelming majority of farms enrolled in the programmes which plant upland cotton also hold upland cotton base."[5] The original panel further found that the data produced by the United States

> *show a strongly positive relationship between those recipients who hold upland cotton base acres and those who continue to plant upland cotton, despite their entitlement to plant other crops, which is indicative of the relationship between payments calculated with respect to upland cotton base acreage and recipients who plant upland cotton.*[6]

In addition, the original panel found that the magnitude of the price-contingent counter-cyclical payments received by current producers of upland cotton ($869.4 million using Brazil's Methodology, or $864.9 using the Cotton-to-Cotton methodology[7]) constituted "very large amounts of United States government money benefiting United States upland cotton production."[8]

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[2] Panel Report, *United States - Subsidies on Upland Cotton*, Annexes L-1.22, dated 3 February 2004, and L-1.23, dated 16 February 2004.

[3] Panel Report, *United States - Subsidies on Upland Cotton*, para. 7.633.

[4] *See, inter alia*, Panel Report, *United States - Subsidies on Upland Cotton*, paras. 7.608-7.633 and 7.634-7.647.

[5] Panel Report, *United States - Subsidies on Upland Cotton*, para. 7.636.

[6] Panel Report, *United States - Subsidies on Upland Cotton*, para. 7.637.

[7] Panel Report, *United States - Subsidies on Upland Cotton*, Tables A-5, A-6, paras. 7.641-7.647.

[8] Panel Report, *United States - Subsidies on Upland Cotton*, para. 7.1349.

11. Before the compliance Panel, a central question will be whether the failure of the United States to withdraw, or remove the adverse effects of, the counter-cyclical payment program of the FSRI Act of 2002 causes present serious prejudice to the interests of Brazil, or a threat thereof. The existence and strength of a causal link between counter-cyclical payments and serious prejudice is, in part, a function of the magnitude and type of counter-cyclical payments received by current producers of upland cotton. Thus, the magnitude and type of these subsidies continues to be a central issue. As in the original panel proceeding, the data requested by Brazil would constitute the basis for factual findings regarding the magnitude and type of countercyclical payments that continue to support the production and export of U.S. upland cotton.

12. Publicly-available USDA data shows that, in marketing year ("MY") 2005 for example, total counter-cyclical payments to holders of upland cotton base acreage exceeded $1.3 billion. While USDA collects data on plantings of each recipient that allow the calculation of the amount of counter-cyclical payments that were received annually by current upland cotton farmers, these data are not publicly available. They are therefore not available to Brazil or the compliance Panel. Significantly, during the original proceedings, the United States produced these data for MY 2002. The original panel relied on certain methodologies of using the data to calculate the amount of counter-cyclical subsidies received by current U.S. upland cotton farmers for MY 2002.[9]

13. Wile awaiting the production of the requested data by the United States, Brazil, based on the best information currently available to it and the compliance Panel, intends to rely on the methodology found "appropriate" by the original panel.

14. Brazil sets out its questions with respect to the **agricultural export credit guarantee ("ECG") programs, and in particular, the GSM 102 program**[10], in Part B of Annex 1 to this letter. Brazil notes that it has considerably reduced the number of questions compared to those originally requested prior to and during the 19 July 2006 informal discussions. Brazil was able to obtain some of the originally requested documents through FOIA requests, and has taken account of limited responses from the United States in informal discussions on 19 July. (The United States provided no *documents* in connection with these informal discussions.)

15. The documents and information regarding export credit guarantees requested in Annex 1 are exclusively within the control of the United States. The majority of the questions seek documents and information concerning the risk profile of the GSM 102 portfolio, how GSM 102 takes the various risks encountered in guaranteed transactions into account, and default rates on GSM 102 guarantees. The requested documents and information will help the compliance Panel fulfill its mandate to undertake an objective assessment of the United States' ECG-related measures taken to comply, and to consider Brazil's claims that GSM 102 guarantees constitute export subsidies, as well as that they circumvent U.S. agricultural export subsidy commitments. Brazil believes, therefore, that it is "necessary and appropriate" for the compliance Panel to exercise its discretion under Article 13.1 of the DSU, and to request this information from the United States.

16. Finally, Brazil asks the compliance Panel to request the United States to produce this information within three weeks of the date the Panel issues its request.[11] Brazil considers this time period is justified in view of the shortened timeframe provided for in Article 21.5 of the DSU. It is also consistent with the relative importance of the information requested.

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[9] Panel Report, *United States - Subsidies on Upland Cotton*, Attachment to Section VII:D, paras. 7.634-7.647.

[10] Brazil notes that one questions relates also to the GSM 103 and Supplier Credit Guarantee programs.

[11] Brazil recalls that the original panel allotted the United States eight days (until 11 February 2004) to respond to its 3 February 2004 request for information. *See,* Panel Report, *United States - Subsidies on Upland Cotton,* Annex I-1.22.

ANNEX 1

<u>Brazil's Request to the Compliance Panel to Pose Questions to the United States, under Article 13.1 of the DSU</u>

1 November 2006

Part A: Documents and Information on Base and Planted Acres

1. Brazil requests updated information on upland cotton planted and base acres under the <u>Direct</u> and <u>Counter-Cyclical Payment Program</u> for each of the **2003, 2004, 2005 and 2006 marketing years**, showing as many of the underlying calculations as possible. Brazil also requests information on base acreage and planted acreage for other "program crops" (*i.e.*, corn, barley, oats, sorghum, rice, wheat, soybeans, peanuts and minor oilseeds) and other acreage on farms with upland cotton planted acreage in these same years. Finally, Brazil requests the amount of payments units for Direct Payments and Counter-Cyclical Payments by program crop for each category of farms.

Brazil requests this information in the format outlined by the Panel in part (b) of its "Supplementary Request for Information Pursuant to Article 13 of the DSU," dated 3 February 2004.[1] Specifically, Brazil requests that the United States address the following questions:

(A) How many farms that planted upland cotton had fewer upland cotton planted acres than upland cotton base acres, or equal numbers of each? We refer to these as "Category A" farms. What was the total of their upland cotton base acreage? What was the total of their upland cotton planted acreage?

(1) How many farms that have upland cotton base acres did not plant any upland cotton? What was the total upland cotton base acreage on these farms? We refers to these as "Category A-1" farms.[2]

(B) How many farms had more upland cotton planted acres than upland cotton base acres? We refer to these as "Category B" farms. What was the total of their base acreage for each covered commodity, including upland cotton? What was the total of their planted acreage for each covered commodity, including upland cotton? Please also provide the following information concerning these farms:

(1) How many Category B farms had equal numbers of acres planted to all covered commodities and base acres for all covered commodities? We refer to these as "Category B-1" farms. What was the total of the base acreage of Category B-1 farms for each covered commodity, including upland cotton? What was the total of the planted acreage

[1] Panel Report, Annex L, item 22. The Panel's request for information is contained in the Communication from the Panel on 3 February 2004. The full Communication (Panel Report, Annex L, item 22) is attached in Appendix I of this document.

[2] For Category A Farms, the Panel requested "farms [that] had fewer upland cotton planted acres than upland cotton base acres." (*See Panel Report, Annex L, item 22, p. 2*).[2] The United States interpreted this request as covering all farms that had upland cotton base and planted less than their full upland cotton base to upland cotton or that planted no upland cotton at all. (*The full response by the United States is attached in Appendix II of this document*). In its updated request, Brazil would like the United States to separate (i) farms that had upland cotton base acres and planted *fewer* upland cotton planted acres than upland cotton base acres and (ii) farms that had upland cotton base acres but planted *no* upland cotton. *(See also Panel Report, Annex L, item 26, para. 5*)

of Category B-1 farms for each covered commodity, including upland cotton?

(2) How many Category B farms had fewer acres planted to all covered commodities than base acres for all covered commodities? We refer to these as "Category B-2" farms. How much was the total acreage of Category B-2 farms planted to all covered commodities less than their base acreage for all covered commodities? What was the total of the base acreage of Category B-2 farms for each covered commodity, including upland cotton? What was the total of the planted acreage of Category B-2 farms for each covered commodity, including upland cotton?

(3) How many Category B farms had more acres planted to all covered commodities than base acres for all covered commodities? We refer to these as "Category B-3" farms. How much did the total acreage of Category B-3 farms planted to all covered commodities exceed their base acreage for all covered commodities? What was the total of the base acreage of Category B-3 farms for each covered commodity, including upland cotton? What was the total of the planted acreage of Category B-3 farms for each covered commodity, including upland cotton?

(C) How many farms had upland cotton planted acres but no upland cotton base acres? We refer to these as "Category C" farms. What was the total of the base acreage of Category C farms for each covered commodity? What was the total of the planted acreage of Category C farms for each covered commodity, including upland cotton?

(D) In addition, for the marketing years 2003 through 2006, please reply to the above questions with respect to all crops on cropland covered by the acreage reports, not simply commodities covered by the programs.

Brazil requests that the United States continue to provide the requested information on both state level and federal level (*i.e.*, totals). Further, as noted above, Brazil requests that the United States provide aggregate payment unit data by crop for each group of farms.

For convenience, Brazil attaches the Panel's communication dated 3 March 2004, which contains the Panel's "Supplementary Request for Information Pursuant to Article 13 of the DSU," in Appendix I to this document. Brazil further attaches, in Appendix II to this document, an excerpt of the U.S. response to the Panel's data request, dated 3 March 2004.

Part B: Documents and Information on Export Guarantee Programs

2. In the original panel proceedings in WT/DS267, the United States provided, as Exhibit US-150, two memoranda, dated 8 April 2002 and 25 March 2003, titled "Annual Review of Fees for USDA Credit Programs". Please provide any memoranda or similar documents constituting annual reviews for subsequent years.

3. What return does the U.S. government require on capital employed for the GSM 102 program?

4. Please provide data regarding the value of GSM 102 guaranteed transactions, by tenor and by country (rather than by Commodity Credit Corporation ("CCC") regional groupings)[3], for the cohort of GSM 102 guarantees issued in each fiscal year for FY 2002-2006.

5. For FY 2006, please separate GSM 102 ECGs into applications received by individual country (rather than by CCC regional groupings).[4]

6. Please provide data regarding GSM 102 fees collected, by country (rather than by CCC regional groupings), by year for each of FY 2002-2006.[5]

7. For each country eligible for export credit guarantees through the GSM 102 program, please provide the current sovereign-risk rating and the private risk-rating established through the Interagency Country Risk Assessment System ("ICRAS"), as well as any ICRAS papers or analyses justifying those ratings. Please provide the same information and documents for FY 2002-2006, to the extent ratings in that period diverge from current ratings.

8. Please indicate the number of risk categories into which CCC classifies guarantees for the GSM 102 program, and explain: (i) how those risk categories are established; and (ii) how those risk categories correspond to the ICRAS categories.

9. Whether CCC uses the ICRAS risk categories or its own risk categories, please:

(a) provide a correspondence table and documentary support showing the correspondence between the CCC risk categories and the ratings (*e.g.*, BB, BBB, BBB-, etc.) in the Moody's or Standard and Poor's rating systems;

(b) for FY 2002-2006, indicate the value of guaranteed transactions in each CCC risk category for GSM 102 guarantees issued in each of those years;

(c) for FY 2005 and 2006, indicate the value of guaranteed transactions in each CCC risk category for the portfolio of GSM 102 guarantees outstanding on the last day of each fiscal year;

10. For the cohort of GSM 102 guarantees issued in each of FY 2002-2006, please provide data dividing the cohort according to the value of the transactions guaranteed. Please use increments of $1000.

11. For the cohort of GSM 102 guarantees issued in each of FY 2002-2006, please provide data dividing the cohort according to the credit rating of the foreign bank.

12. For the cohort of GSM 102 guarantees issued in each of FY 2002-2006, please provide data dividing the cohort according to the credit rating of the foreign purchaser of U.S. agricultural exports.

13. For the cohort of GSM 102 guarantees issued in each of fiscal years 2002-2006, please provide data dividing the cohort according to the value of the transactions guaranteed, and, further, indicates loss or default rates for each $1000 increment of transaction value.

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[3] Monthly exposure reports for GSM 102 demonstrate that CCC maintains data on a country-specific basis.

[4] Monthly exposure reports for GSM 102 demonstrate that CCC maintains data on a country-specific basis.

[5] Monthly exposure reports for GSM 102 demonstrate that CCC maintains data on a country-specific basis.

14. Please provide data and documentary support addressing default rates for the GSM 102 program for each fiscal year during the period 2002-2006.

15. For each country eligible for export credit guarantees through the GSM 102 program, please provide the Office of Management and Budget's (OMB) default estimate.[6]

16. With respect to the total amount of outstanding principal and interest guaranteed through GSM 102, GSM 103 and SCGP on 1 July 2005:

(a) What proportion of that outstanding principal and interest was associated with exports of unscheduled products, and what proportion was associated with exports of scheduled products?

(b) Of the proportion associated with scheduled products, what proportion was associated with exports of rice?

17. Please provide monthly "Exposure Reports" for GSM 102 all months beginning in July of FY 2006.[7]

18. Please provide the "FAS Risk Assessment Handbook".[8]

19. Please provide any "FAS Portfolio Analysis" of the export credit guarantee programs conducted and/or reported subsequent to 24 March 2003.[9]

20. Please provide the quarterly "Commercial Export Credit Reports" for all quarters from Q2 of FY 2004 to the present.[10]

21. Please provide the quarterly "Geographic and Commodity Analyses" for all quarters from FY 2002 to the present.[11]

22. Please provide the quarterly "FAS GSM to Exports Powerpoints" from Q3 of FY 2004 to the present.[12]

23. Please provide the "Contingent Liability by Country Risk Grade Powerpoints" from FY 2002 to the present.[13]

[Appendix 1 and Appendix 2 omitted.]

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[6] OMB's default estimate methodology is discussed on page 79 of the "Analytical Perspectives" document associated with the U.S. 2007 budget, available at http://www.whitehouse.gov/omb/budget/fy2007/.

[7] Cited as "evidence" in an OMB assessment of the ECG programs, available at http://www.whitehouse.gov/omb/expectmore/detail.10002020.2005.html.

[8] Cited as "evidence" in an OMB assessment of the ECG programs, available at http://www.whitehouse.gov/omb/expectmore/detail.10002020.2005.html.

[9] Cited as "evidence" in an OMB assessment of the ECG programs, available at http://www.whitehouse.gov/omb/expectmore/detail.10002020.2005.html.

[10] Cited as "evidence" in an OMB assessment of the ECG programs, available at http://www.whitehouse.gov/omb/expectmore/detail.10002020.2005.html.

[11] Cited as "evidence" in an OMB assessment of the ECG programs, available at http://www.whitehouse.gov/omb/expectmore/detail.10002020.2005.html.

[12] Cited as "evidence" in an OMB assessment of the ECG programs, available at http://www.whitehouse.gov/omb/expectmore/detail.10002020.2005.html.

[13] Cited as "evidence" in an OMB assessment of the ECG programs, available at http://www.whitehouse.gov/omb/expectmore/detail.10002020.2005.html.

ANNEX 2a

BRAZIL'S LETTER OF 7 JUNE 2006
TO THE UNITED STATES

The Government of Brazil is concerned that measures taken by the United States to comply with the recommendations and rulings adopted by the WTO Dispute Settlement Body ("DSB) on 21 March 2005 in _United States - Subsidies on Upland Cotton_ (DS 267) may not exist or not be consistent with the U.S. obligations under the *Dispute Settlement Understanding*, the *Agreement on Subsidies and Countervailing Measures* and the *Agreement on Agriculture.* In particular, the Government of Brazil believes that it would be useful to hold further substantive discussions concerning ongoing and future efforts by the U.S. Government to eliminate or make significant changes to the marketing loan and countercyclical programs for upland cotton under the Farm Security and Rural Investment Act of 2002, as well as the GSM 102 and SCGP export credit guarantee programs.

Therefore, the Government of Brazil suggests that informal contacts be held at your earliest convenience to provide an opportunity to exchange views and information regarding the above-mentioned concerns. To prepare for this meeting, and in order to facilitate the discussions, Brazil would send in advance a list of questions that could be addressed during the talks. I look forward to your response to this suggestion.

Please accept, Excellency, the assurances of my highest consideration.

ANNEX 2b

BRAZIL'S LETTER OF 29 JUNE 2006 TO THE UNITED STATES

With reference to your letter of 23 June 2006 confirming the disposition of the United States to discuss with Brazil issues related to the implementation of the Dispute Settlement Body's ("DSB") rulings and recommendations in the context of the dispute *United States - Subsidies on Upland Cotton* (DS 267), I would like to propose that representatives of our countries meet on **17 July 2006** in Geneva.

As anticipated in my letter of 7 June 2006, and with a view to ensuring that this exchange of views and information be as valuable and informative as possible, please find enclosed a list of questions.

Please accept, Excellency, the assurances of my highest consideration.

Questions for the United States
29 June 2006

Information on the Amount of Step 2 Payments by Marketing Year

1. Brazil requests information on the annual amount of user marketing (Step 2) payments for upland cotton in marketing years 2002-2005. Brazil requests separate data for Step 2 export payments and Step 2 payments for domestic users.

Information on the United States' Intention to Take Further Implementing Action

2. Does the United States intend to change the Counter-Cyclical Payment Program and/or Marketing Loan Program to bring them/it into conformity with U.S. WTO obligations? If so, what is the envisioned outline and time-frame of such changes. If not, please provide a reasoned and substantiated explanation of why it believes that no further implementing action is needed to comply with the DSB's rulings and recommendations in *United States – Subsidies on Upland Cotton*.

Information on Base and Planted Acres

3. Brazil requests updated information on upland cotton planted and base acres under the Direct and Counter-Cyclical Payment Program for each of the **marketing years 2003, 2004, 2005 and 2006**[1]**,** showing as many of the underlying calculations as possible. Brazil also requests information on base acreage and planted acreage for other "program crops" (*i.e.*, corn, barley, oats, sorghum, rice, wheat, soybeans, peanuts and minor oilseeds) and other acreage on farms with upland cotton planted acreage in these same years. Finally, Brazil requests the amount of payments units for Direct Payments and Counter-Cyclical Payments by program crop for each category of farms.

Brazil requests this information in the format outlined by the Panel in part (b) of its "Supplementary Request for Information Pursuant to Article 13 of the DSU," dated 3 February 2004.[2] Specifically, Brazil requests that the United States address the following questions:

(A) How many farms that planted upland cotton had fewer upland cotton planted acres than upland cotton base acres, or equal numbers of each? We refer to these as "Category A" farms. What was the total of their upland cotton base acreage? What was the total of their upland cotton planted acreage?

(1) How many farms that have upland cotton base acres did not plant any upland cotton? What was the total upland cotton base acreage on these farms? Brazil refers to these as "Category A-1" farms.[3]

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[1] Brazil understands that information on marketing year 2006 may be preliminary or incomplete.

[2] Panel Report, Annex L, item 22. The Panel's request for information is contained in the Communication from the Panel on 3 February 2004. The full Communication (Panel Report, Annex L, item 22) is attached in Annex I of this document.

[3] For Category A Farms, the Panel requested "farms [that] had fewer upland cotton planted acres than upland cotton base acres." (*See Panel Report, Annex L, item 22, p. 2*).[3] The United States interpreted this request as covering all farms that had upland cotton base and planted less than their full upland cotton base to upland cotton or that planted no upland cotton at all. (*The full response by the United States is attached in Annex II*). In its updated request, Brazil would like the United States to separate (i) farms that had upland cotton base acres and planted *fewer* upland cotton planted acres than upland cotton base acres and (ii) farms that had upland cotton base acres but planted *no* upland cotton. *(See also Panel Report, Annex L, item 26, para. 5*)

(B) How many farms had more upland cotton planted acres than upland cotton base acres? We refer to these as "Category B" farms. What was the total of their base acreage for each covered commodity, including upland cotton? What was the total of their planted acreage for each covered commodity, including upland cotton? Please also provide the following information concerning these farms:

(1) How many Category B farms had equal numbers of acres planted to all covered commodities and base acres for all covered commodities? We refer to these as "Category B-1" farms. What was the total of the base acreage of Category B-1 farms for each covered commodity, including upland cotton? What was the total of the planted acreage of Category B-1 farms for each covered commodity, including upland cotton?

(2) How many Category B farms had fewer acres planted to all covered commodities than base acres for all covered commodities? We refer to these as "Category B-2" farms. How much was the total acreage of Category B-2 farms planted to all covered commodities less than their base acreage for all covered commodities? What was the total of the base acreage of Category B-2 farms for each covered commodity, including upland cotton? What was the total of the planted acreage of Category B-2 farms for each covered commodity, including upland cotton?

(3) How many Category B farms had more acres planted to all covered commodities than base acres for all covered commodities? We refer to these as "Category B-3" farms. How much did the total acreage of Category B-3 farms planted to all covered commodities exceed their base acreage for all covered commodities? What was the total of the base acreage of Category B-3 farms for each covered commodity, including upland cotton? What was the total of the planted acreage of Category B-3 farms for each covered commodity, including upland cotton?

(C) How many farms had upland cotton planted acres but no upland cotton base acres? We refer to these as "Category C" farms. What was the total of the base acreage of Category C farms for each covered commodity? What was the total of the planted acreage of Category C farms for each covered commodity, including upland cotton?

(D) In addition, for the marketing years 2003 through 2006, please reply to the above questions with respect to all crops on cropland covered by the acreage reports, not simply commodities covered by the programs.

Brazil requests that the United States continue to provide the requested information on both state level and federal level (*i.e.*, totals). Further, as noted above, Brazil requests that the United States provide aggregate payment unit data by crop for each group of farms.

For the United States' convenience, Brazil attaches the Panel's communication dated 3 March 2004, which contains the Panel's "Supplementary Request for Information Pursuant to Article 13 of the DSU," in Annex I. Brazil further attaches, in Annex II, an excerpt of the U.S. response to the Panel's data request, dated 3 March 2004.

Information on the General Sales Manager 102 (GSM 102), General Sales Manager 103 (GSM 103) and Supplier Credit Guarantee (SCGP) Programs

4. In a press release dated 5 July 2005, USDA announced that the Bush Administration was sending to Congress proposed statutory changes to remove the one-percent cap on fees for guarantees issued under the GSM 102 and SCGP programs (the one-percent fee cap is required by 7 U.S.C. § 5641(b)(1)), and terminate the Intermediate Export Guarantee Program (GSM-103).[4] In a paper dated 17 February 2006 and titled "WTO Litigation and Negotiation: Potential Implications for Cotton", at page 2, Carol Goodloe, Senior Economist in USDA's Office of the Chief Economist, suggested that the proposal to repeal the fee cap and to eliminate the GSM-103 program was not "included" in budget reconciliation legislation because of "Senate rules".[5]

With respect to this issue, Brazil has the following questions:

(a) Was the 2005 Administration proposal not "included" in budget reconciliation legislation because of "Senate rules"? If yes, please explain the nature of the Senate rules. If not, please explain why the proposal was not "included" in budget reconciliation legislation.

(b) Please provide a copy of any subsequent legislative proposals concerning repeal of the fee cap or termination of GSM-103 program provided by the Executive Branch to the US Congress. What is the legislative vehicle and timeline for consideration and adoption of these proposals?

(c) Does the United States expect that the Congress will vote on an FY 2007 budget reconciliation bill in calendar year 2006? Please explain.

5. Please explain why the United States stopped issuing ECGs under the SCGP program as of 1 October 2005.

6. On 23 January 2006, USDA invited public comment on "options to reform" SCGP. Those comments were due by 23 February 2006. What form will the results of USDA's reform inquiry take, and when will those results be released? When does USDA intend to re-commence issuance of guarantees under the SCGP program?

7. Please prepare a table showing correspondence between the so-called "scheduled" products listed in Table ES:1 of document G/AG/N/USA/53 and the list of products eligible for guarantees under the GSM 102 and the SCGP programs.

8. Please provide the calculation underlying the "subsidy rates for credit guarantee programs" stated on page 21 to the Notes to Financial Statements of the CCC for fiscal years 2004 and 2005 (available at http://www.usda.gov/oig/rptsauditsccc.htm). Please provide these calculations also for fiscal years 2002 and 2003.

9. Please provide the calculation underlying the "original subsidy rate" and "current reestimated rate" columns in Table 8 of the Federal Credit Supplement to the Fiscal Year 2007 Budget of the United State Government (available at http://www.whitehouse.gov/omb/budget/fy2007/), with respect to the CCC Export Loan Guarantee Programs.

[4] *See* http://www.usda.gov/wps/portal/!ut/p/_s.7_0_A/7_0_1OB?contentidonly=true&contentid=2005/07/0242.xml.

[5] *See* http://www.usda.gov/oce/forum/2006%20Speeches/PDF%20speech%20docs/Goodloe2806.pdf.

10. In the original panel proceedings in WT/DS267, the United States provided, as Exhibit US-150, two memoranda, dated 8 April 2002 and 25 March 2003, titled "Annual Review of Fees for USDA Credit Programs". Please provide any memoranda or similar documents constituting annual reviews for subsequent years.

11. Please list and describe all criteria taken into account by CCC in setting the fee schedule for the GSM 102 and SCGP programs, and in determining the applicable fee for a guarantee for a particular transaction.

12. In determining the applicable fee for a GSM 102 or SCGP guarantee for a particular transaction, is the interest rate spread charged by the market to banks or borrowers in the foreign country involved examined, to identify changing market conditions? If the answer is in the affirmative, please provide documentary proof that demonstrates how this factor is taken into account.

13. What return does CCC require on capital employed, both across all of its programs and, more specifically, for the GSM 102 and SCGP programs?

14. Please indicate at what interval fee schedules for the GSM 102 and SCGP programs are reviewed. Please provide CCC regulations or procedures listing the elements to be taken into account during a review of the fee schedules.

15. Please provide data regarding the value of guaranteed transactions, by tenor and by country (rather than by CCC regional groupings), separately for GSM 102, GSM 103 and SCGP, by year for each of fiscal years 2000-2006.

16. For fiscal year 2006, please separate announced allocations for GSM 102 into individual country allocations, rather than CCC regional group allocations.

17. Please provide data regarding fees collected, by country (rather than by CCC regional groupings), separately for ECGs issued under GSM 102, GSM 103 and SCGP, by year for each of fiscal years 2000-2006.

18. For each country eligible for export credit guarantees through the GSM 102 and the SCGP programs, please provide the sovereign-risk rating and the private risk-rating established through the Interagency Country Risk Assessment System (ICRAS), as well as any ICRAS papers or analyses justifying those ratings.

19. Brazil understands that ICRAS has established eleven sovereign and nine nonsovereign risk categories for use by U.S. government agencies and programs providing cross-border loans, guarantees or insurance. Does CCC classify GSM-approved foreign banks, as well as foreign borrowers under the GSM 102 and SCGP programs, according to these same eleven sovereign and nine nonsovereign risk categories?

20. If the answer to the previous question is in the negative, please indicate the number of risk categories into which CCC classifies guarantees for the GSM 102 and SCGP programs, and explain: (i) how those risk categories are established; and (ii) how those risk categories correspond to the ICRAS categories.

21. Whether CCC uses the ICRAS risk categories or its own risk categories, please:

(a) provide a correspondence table and documentary support showing the correspondence between the CCC risk categories and the ratings (*e.g.*, BB, BBB, BBB-, etc.) in the Moody's or Standard and Poor's rating systems;

(b) for fiscal years 2000-2006, indicate the value of guaranteed transactions in each CCC risk category for GSM 102 guarantees issued in each of those years;

(c) for fiscal years 2000-2006, indicate the value of guaranteed transactions in each CCC risk category for SCGP guarantees issued in each of those years;

(d) for fiscal years 2005 and 2006, indicate the value of guaranteed transactions in each CCC risk category for the portfolio of GSM 102 guarantees outstanding on the last day of each fiscal year;

(e) for fiscal years 2005 and 2006, indicate the value of guaranteed transactions in each CCC risk category for the portfolio of SCGP guarantees outstanding on the last day of each fiscal year.

22. In each of fiscal years 2000-2006, please list the percentage of importers/purchasers in export transactions for which an SCGP guarantee is provided that are government-owned or -controlled, or quasi-government-owned or -controlled.

23. Please describe the profile of a typical importer/purchaser in export transactions for which an SCGP guarantee is provided, in terms of loan size, importer/purchaser's asset size, and importer/purchaser's credit rating.

24. Please describe how loss or default rates on SCGP guarantees vary for different importer/purchaser profiles (again, in terms of loan size, importer/purchaser's asset size, and importer/purchaser's credit rating).

25. For the cohort of SCGP guarantees issued in each of fiscal years 2000-2006, please provide a chart that divides the cohort according to the value of the transactions guaranteed. Please use increments of $1000.

26. For the cohort of SCGP guarantees issued in each of fiscal years 2000-2006, please provide a chart that divides the cohort according to the credit rating of the borrower/purchaser.

27. For the cohort of SCGP guarantees issued in each of fiscal years 2000-2006, please provide a chart that divides the cohort according to the value of the transactions guaranteed, and, further, indicates loss or default rates for each increment of transaction value.

28. For the cohort of SCGP guarantees issued in each of fiscal years 2000-2006, please provide a chart that divides the cohort according to the credit rating of the borrower/purchaser, and, further, indicates loss or default rates for each category of credit rating.

29. For the cohort of GSM 102 guarantees issued in each of fiscal years 2000-2006, please provide a chart that divides the cohort according to the value of the transactions guaranteed. Please use increments of $1000.

30. For the cohort of GSM 102 guarantees issued in each of fiscal years 2000-2006, please provide charts that divide the cohort according to the credit rating of the foreign bank, and of the borrower/purchaser.

31. For the cohort of GSM 102 guarantees issued in each of fiscal years 2000-2006, please provide a chart that divides the cohort according to the value of the transactions guaranteed, and, further, indicates loss or default rates for each increment of transaction value.

32. For the cohort of GSM 102 guarantees issued in each of fiscal years 2000-2006, please provide charts that divide the cohort according to the credit rating of the foreign bank, and of the borrower/purchaser, and, further, indicates loss or default rates for each category of credit rating.

33. Please provide data and documentary support addressing default rates for the GSM 102 and SCGP programs (both separately and together) for each fiscal year during the period 2000-2006.

34. How does CCC arrive at the default and loss estimates presumably used to determine fees for GSM 102 and SCGP guarantees?

35. For each country eligible for export credit guarantees through the GSM 102 and the SCGP programs, please provide the Office of Management and Budget's (OMB) default estimate. (OMB's default estimate methodology is discussed on page 79 of the "Analytical Perspectives" document associated with the U.S. 2007 budget, available at http://www.whitehouse.gov/omb/budget/fy2007/).

36. How does the OMB default estimate affect the fee schedule for the GSM 102 and SCGP programs? What, if any, discretion does CCC enjoy to depart from the OMB default estimate in setting fees for the GSM 102 and SCGP programs?

37. How does CCC fund accumulated losses?

38. What was the total amount of outstanding principal and interest guaranteed through GSM 102, GSM 103 and SCGP on 1 July 2005? Please provide data separately for each of the three programs. With respect to this data:

(a) What proportion of the outstanding principal and interest was associated with exports of unscheduled products, and what proportion was associated with exports of scheduled products?

(b) Of the proportion associated with scheduled products, what proportion was associated with exports of rice?

39. Page 30 of the "Notes to Financial Statements" included with the CCC's Financial Statements for Fiscal Years 2005 and 2004 (available at http://www.usda.gov/oig/rptsauditsccc.htm) lists the value of guaranteed transactions outstanding on 1 September 2005, divided by maturity date. Please provide a similar chart with data as of 1 July 2005.

40. Does the CCC require that a party (*e.g.*, the exporter) to an export transaction for which an SCGP guarantee is requested seek and provide to CCC credit references for the importer/purchaser? Does the CCC itself seek such credit references? If answered in the affirmative, please provide the relevant regulations or procedures setting out this requirement.

41. Does CCC require information regarding the credit rating of an importer/purchaser in an export transaction for which and SCGP guarantee is requested? If answered in the affirmative, please provide the relevant regulations or procedures setting out this requirement.

42. CCC maintains a list of foreign bank obligors approved for participation in the GSM 102 program. The list is available at http://www.fas.usda.gov/excredits/foreignbanks.html. Does CCC inquire into the credit rating for these banks? If so, please provide the credit rating for the banks currently approved.

43. Are there statutory or regulatory limits on the level of exposure (in terms of the value of transactions, or any other variable) CCC can maintain, under the SCGP program, with respect to any

given importer? If answered in the affirmative, please provide regulations or procedures setting out the limits.

44. Are importers included on the default lists of the American Cotton Exporters Association (ACEA) or the World Cotton Exporters Association (WCEA) allowed to participate in transactions involving GSM 102 or SCGP guarantees?[6]

45. Please provide a copy of any agreement governing the relationship between the U.S. government and CoBank, with respect to CoBank's role as a lender under the GSM 102 program.

46. ExpectMore.gov has undertaken an assessment of the "Agricultural Export Credit Guarantee Programs" subject to these consultations. The assessment (program code 10002020), is available at http://www.whitehouse.gov/omb/expectmore/detail.10002020.2005.html. Please provide the following documents, identified as "Evidence" in the assessment (each of which is highlighted in the attached copy of the assessment):

- FAS Credit Guarantee Program Analysis;
- FAS GSM to Exports Powerpoint;
- FAS Portfolio Analysis (annual) (please provide for FY 1999 to the present, or if maintained on a calendar or marketing year basis, then for calendar or marketing years 1999 to the present);
- Contingent Liability by Country Risk Grade Powerpoint;
- FAS Decision Memo, 4/12/04 department wide meeting with OMB
- CCC Exposure Report (monthly) (please provide for all months from FY 1999 to the present);
- FAS Risk Assessment Handbook;
- Geographic and Commodity Analysis (quarterly) (please provide for all quarters from FY 1999 to the present);
- Commercial Export Credit Report (quarterly) (please provide for all quarters from FY 1999 to the present).

[Annex 1 and Annex 2 to this document omitted.]

[6] These lists are maintained at http://www.acsa-cotton.org/Default_Lists/ACEA_Default_List/body_acea_default_list.asp (for ACEA) and http://www.acsa-cotton.org/Default_Lists/WCEA_Default_List/body_wcea_default_list.asp (for WCEA).

ANNEX D-2

RESPONSES OF BRAZIL TO THE PANEL'S QUESTIONS ON THE DSU ARTICLE 13 ISSUE

(19 January 2007)

<u>Question 1</u> (to Brazil)

Does Brazil deem that the questions posed in Part B[1] of Annex 1 of its request submitted on 1 November 2005 ("1 November request" hereafter) are now unnecessary?

1. Brazil continues to believe that the information, documents and data requested in Part B of Annex 1 of its request submitted on 1 November 2005 ("1 November Request") will assist the compliance Panel in making "an objective assessment of the matter before it," within the meaning of Article 11 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU").

2. Brazil notes that the documents requested in questions 17-23 of Annex 1 to Brazil's 1 November Request were cited by the U.S. Department of Agriculture's Foreign Agriculture Service in a self-assessment of the export credit guarantee ("ECG") programs. This self-assessment was provided to the compliance Panel as Exhibit Bra-588.

3. In previous discussions, the United States noted uncertainty regarding the definition of the term "default rate," as used in questions 13 and 14 of Annex 1 to Brazil's 1 November Request. To clarify, Brazil uses the term as it is used by the Commodity Credit Corporation ("CCC") in its financial statements. Specifically, on page 28 of the Notes to the CCC's fiscal year 2006 and 2005 financial statements, provided to the compliance Panel as Exhibit Bra-585, CCC details "defaults" for the ECG programs, phrased in percentage terms (and therefore as *rates* of default).[2]

<u>Question 2</u> (to Brazil)

Is Brazil asking the United States to respond to all of the questions posed in Part A of its 1 November request?

4. Brazil asks that the compliance Panel request the United States to provide data responsive to all questions in Part A of Brazil's 1 November Request. The information provided by the United States in the table in Section VI.A.(c) of its First Written Submission[3] demonstrates that the United States has already collected and compiled the data necessary to respond to most, if not all, of Part A of Annex I of Brazil's 1 November Request.

5. Brazil recalls that its 1 November Request, like the request by the original panel, distinguishes between three categories of U.S. upland cotton farms: A, B and C.

[1] Concerning Export Guarantee Programs.

[2] These rates are only offered in the aggregate, and not for individual ECG programs or as related to the credit ratings of obligors; Brazil has asked for further detail in its questions.

[3] U.S. First Written Submission, para. 224.

6. With respect to Category A farms[4], *i.e.*, upland cotton farms that "underplant" their base acreage, Brazil notes that the table in Section VI.A.(c) of the U.S. First Written Submission[5] provides incomplete information. While the United States provides information responsive to the question: "What was the total of their upland cotton planted acreage?"[6], the United States does not provide information responsive to the following question: "What was the total of their upland cotton base acreage?" Further, the United States provides no information for farms that have upland cotton bases acres but no planted acres (Category A-1 farms[7]). These omissions make it impossible for Brazil to update Tables A-1 and A-3 of the original panel's report.[8] Finally, the United States provides no information on the actual *number of farms* that fall into these categories.

7. With respect to Category B farms, *i.e.*, farms that "overplant" their upland cotton base acreage[9], and with respect to Category C farms, *i.e.*, upland cotton farms that have no upland cotton base acreage[10], Brazil notes that the United States also provides information that is partially responsive to the questions proposed by Brazil. In particular, the table in Section VI.A.(c) of the U.S. First Written Submission[11] provides information on the total number of upland cotton base and upland cotton planted acres on these farms. This information, along with the limited information provided with respect to Category A farms, enables Brazil to update Tables A-2, A-4 and A-5 of the original panel's report.[12] However, the United States does not provide information on the base and planted acreage of other covered commodities on these farms. This makes it impossible for Brazil to update Table A-6 of the original panel's report.[13] The United States also provides no information on the actual *number of farms* in these categories.

8. Finally, the United States does not provide information on direct and counter-cyclical payment units for each program crop and each category of farm.

9. In sum, the U.S. First Written Submission answered some of the questions in Part A of Annex I to Brazil's 1 November Request. This partial response demonstrates that the United States has collected and compiled most, if not all, of the data necessary to fully respond to Brazil's 1 November Request. Brazil, therefore, requests that the compliance Panel ask the United States to fully respond to Brazil's 1 November Request.

10. Specifically, Brazil identifies the questions that it considers remain unanswered based on the data submitted by the United States as part of its First Written Submission. For each of these questions, Brazil asks that the compliance Panel request the United States to provide annual data covering the period MY 2002-2005:

(a) How many Category A farms were there in the period? How many base acres were on Category A farms?

(b) How many Category A-1 farms were there in the period? How many base acres were on Category A-1 farms?

[4] *See* Part A of Question 1(A) of Annex I of Brazil's 1 November 2006 Request.
[5] U.S. First Written Submission, para. 224.
[6] *See* Row 1 of the United States table at paragraph 224 of the U.S. First Written Submission.
[7] *See* Part A, Question 1(A)(1) of Annex I of Brazil's 1 November 2006 Request.
[8] *See* Panel Report, *U.S. – Upland Cotton*, paras. 7.636 and 7.639.
[9] *See* Part A, Question 1(B) of Annex I of Brazil's 1 November 2006 Request.
[10] *See* Part A, Question 1(C) of Annex I of Brazil's 1 November 2006 Request.
[11] U.S. First Written Submission, para. 224.
[12] *See* Panel Report, *U.S. – Upland Cotton*, paras. 7.636, 7.639 and 7.641.
[13] *See* Panel Report, *U.S. – Upland Cotton*, para. 7.642.

(c) How many Category B farms had equal numbers of acres planted to all covered commodities and base acres for all covered commodities? Brazil refers to these as "Category B-1" farms. What was the total of the base acreage of Category B-1 farms for each covered commodity, including upland cotton? What was the total of the planted acreage of Category B-1 farms for each covered commodity, including upland cotton?

(d) How many Category B farms had fewer acres planted to all covered commodities than base acres for all covered commodities? Brazil refers to these as "Category B-2" farms. How much was the total acreage of Category B-2 farms planted to all covered commodities less than their base acreage for all covered commodities? What was the total of the base acreage of Category B-2 farms for each covered commodity, including upland cotton? What was the total of the planted acreage of Category B-2 farms for each covered commodity, including upland cotton?

(e) How many Category B farms had more acres planted to all covered commodities than base acres for all covered commodities? Brazil refers to these as "Category B-3" farms. How much did the total acreage of Category B-3 farms planted to all covered commodities exceed their base acreage for all covered commodities? What was the total of the base acreage of Category B-3 farms for each covered commodity, including upland cotton? What was the total of the planted acreage of Category B-3 farms for each covered commodity, including upland cotton?

(f) How many Category C farms were there in the period? What was the total of the base acreage of Category C farms for each covered commodity? What was the total of the planted acreage of Category C farms for each covered commodity, including upland cotton?

(g) What were the average counter-cyclical payment yields for each program crop on each category of farm?

ANNEX D-3

RESPONSES OF THE UNITED STATES TO THE PANEL'S QUESTIONS ON THE DSU ARTICLE 13 ISSUE

(19 January 2007)

The United States is in receipt of the Panel's communication dated January 17, 2007, in which it poses questions to the parties regarding Brazil's November 1, 2006, request that the Panel collect more than 35 different data items or documents pursuant to Article 13 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"). My authorities have instructed me to provide the following responses:

Question 3 (to the United States)

If the United States is of the view that the Panel should not pose to the United States any or all of the questions in Part A of Brazil's 1 November request, please cite the reasons for that view.

Question 4 (to the United States)

If the United States is of the view that the United States cannot respond to any or all of the questions (or any part thereof) in Part A of Brazil's 1 November request, please explain that view, bearing in mind the fact that the United States did provide the data to the original Panel.

1. The Panel notes in its communication that, in its rebuttal submission, Brazil reiterated its request that the Panel collect certain data and documents from the United States pursuant to Article 13.1 of the DSU.[1] Brazil complains in that submission that the Panel does not have before it certain data collected by the original panel at Brazil's urging regarding farms that hold base acres under the counter-cyclical program and those farms' planted acres for cotton and other program crops.[2] However, Brazil's assertion is factually incorrect as the United States submitted the relevant data as an exhibit to its first written submission.

2. In Exhibit US-64, the United States submitted precisely the same data in precisely the same format as that submitted in response to the original panel's Article 13 request.[3] Moreover, the United States explained in Annex I to its first written submission how these data are relevant to the claims and arguments at hand. Specifically, the data fatally undermine the analysis of Brazil regarding the effects of the counter-cyclical payment program.[4] Brazil has attempted to attribute an entirely exaggerated effect to the counter-cyclical program by speculating, *inter alia*, that restrictions on payments when fruits and vegetables are planted on acreage in excess of a farm's non-base acres serve to funnel planting decisions towards upland cotton because fruits and vegetables are allegedly "the most relevant alternative in some major cotton areas."[5] However, the empirical data requested by

[1] January 17, 2007 Communication from the Panel.
[2] *See* Brazil Rebuttal Submission, para. 164.
[3] *See* Response of the United States to the Panel's February 3, 2004, Data Request, As Clarified on February 16, 2004 (providing 8 data files via CD-ROM) (March 3, 2004).
[4] U.S. First Written Submission, Annex I, paras. 36-37.
[5] Brazil First Written Submission, Annex I, para. 63.

Brazil and presented in Exhibit US-64 demonstrate that Brazil's argument is pure speculation and contradicted by the facts.[6]

3. The United States also notes that the Panel should reject Brazil's argument for how the data in Exhibit US-64 should be used; namely, to allocate counter-cyclical payments for both cotton base acres and non-cotton base acres to upland cotton production using its self-titled "Brazil methodology."[7] This argument misrepresents the panel and Appellate Body's analyses in the original proceeding and ignores the resulting recommendations and rulings of the DSB. First, this "Brazil methodology" was *not* applied in the context of the panel's assessment of significant price suppression, as Brazil has implied, and therefore neither the Panel's finding of serious prejudice, nor the resulting DSB recommendations and rulings, extended to counter-cyclical payments for non-cotton base acres.[8] Rather, as is clear from a review of Brazil's citations[9], it was only addressed in the context of the original panel's analysis of "support to a specific commodity" under Article 13(b) of the *Agreement on Agriculture* (the "Peace Clause" analysis). And, even in that context it was specifically *rejected*. In fact, while Brazil touts the original panel's characterization of this methodology as "appropriate,"[10] that panel did not rely on the methodology in its Peace Clause analysis.[11] Moreover, Brazil fails to mention that when it raised the methodology on appeal, the Appellate Body specifically indicated that the methodology was unacceptable:

> [W]e see little in the Panel's finding or on the record that would allow us to discern a link between the support-conferring measures with respect to non-cotton historical base acres and current production of upland cotton. *We do not, therefore, accept the methodology submitted by Brazil* that included, in the Article 13(b)(ii) calculation, payments with respect to both cotton and non-cotton base acres flowing to current production of upland cotton.[12]

4. Thus, because "support-conferring measures with respect to non-cotton historical base acres" were *not* included in the support found to exceed the limitation in the Peace Clause proviso, such measures were exempt, by virtue of the Peace Clause, from actions, including Brazil's serious prejudice claims. Therefore, there could have been no, and there were no, DSB recommendations and

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[6] Specifically, the ratio of upland cotton base acres to planted acres on such farms was low (for example, only 32.7 percent in California), showing that there is no basis for the funneling effect claimed by Brazil. Further, only about *one third* of the acres planted to cotton in the historical "base" period were still planted to cotton in MY 2005. Moreover, in those areas in which fruits and vegetables are a viable alternative to cotton, substantial acreage was planted to fruits and vegetables on farms with upland cotton base acreage (for example, 600,000 acres in California and more than 1 million acres nationwide). This too demonstrates that farmers do not feel compelled to plant cotton rather than fruits and vegetables on these farms. As the United States will explain in its forthcoming rebuttal submission, Brazil has no answer to these U.S. arguments.

[7] This is the methodology under which Brazil attempts to further exaggerate the amount of counter-cyclical payments by including payments made in respect of base acres for other programs crops simply because they were made on farms on which the number of acres planted to cotton exceeded the number of upland cotton base acres held by the farm operator. Brazil Rebuttal Submission, para. 171.

[8] *See, e.g.,* Brazil's November 1, 2006 request, paras. 9-13. Indeed, it is surprising that Brazil makes this argument given that it vehemently opposed *any* precise calculation of the subsidy in the context of the significant price suppression analysis (arguing that it was sufficient for the original panel to simply to find that the payments under the Step 2, marketing loan, and counter-cyclical payment programs were allegedly, respectively, "very large"). *See, e.g., United States – Upland Cotton (AB)*, paras. 98-99.

[9] Most of Brazil's citations in its November 1 request are to the following paragraphs: 7.608-7.633 and 7.641-7.647. These refer to the section of the original panel report entitled "Conclusion regarding Article 13(b)" and to an "Attachment to Section VII:D" (which is itself entitled "Domestic Support Measures and Article 13 of the *Agreement on Agriculture*").

[10] *See, e.g.,* Brazil Rebuttal Submission, para. 172.

[11] *United States – Upland Cotton (Panel),* para. 7.580.

[12] *United States – Upland Cotton (AB),* para. 380.

rulings with respect to such measures, and counter-cyclical payments for non-cotton base acres are not "measures taken to comply" within the meaning of DSU Article 21.5.

5. In sum, Brazil's renewed request in its rebuttal submission that the Panel collect the data items listed in Part A of Annex 1 of Brazil's November 1 request is moot since the United States has already provided the data for the period relevant to Brazil's present serious prejudice claims. Moreover, Brazil's arguments about the relevance of this information are incorrect and misleading; to the extent they are relevant, the data support the U.S. view. In light of the foregoing, the United States respectfully requests the Panel to reject the renewed request.

6. As the Panel has invited each of the parties to comment on any of the questions posed to the other party, the United States also provides the following brief comment relating to Question 1 directed to Brazil:

Question 1 (to Brazil)

Does Brazil deem that the questions posed in Part B of Annex 1 of its request submitted on 1 November 2005 ("1 November request" hereafter) are now unnecessary?

7. To date, Brazil has failed to provide *any* reason in its November 1 request, its first submission, or its rebuttal submission why the Panel should collect the more than 25 items listed in Part B of Annex 1 of its November 1 request. Nor has Brazil provided the type of item-by-item explanation that is needed for *the Panel* to determine whether these items are indeed "necessary and appropriate" within the meaning of Article 13 of the DSU for the Panel's objective assessment of the evidence and arguments submitted by the parties. Under these circumstances, there is no basis to grant Brazil's request.

ANNEX D-4

COMMENTS OF BRAZIL ON THE ORAL STATEMENTS OF THE UNITED STATES AT THE MEETING WITH THE PANEL

(9 March 2007)

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LIST OF ABBREVIATIONS

DSU	Understanding on Rules and Procedures Governing the Settlement of Disputes
FAPRI	Food and Agricultural Policy Research Institute
FSRI Act	Farm Security and Rural Investment Act of 2002
ICAC	International Cotton Advisory Committee
MY	Marketing Year
SCM Agreement	*Agreement on Subsidies and Countervailing Measures*
U.S.	United States
USDA	U.S. Department of Agriculture
WTO	World Trade Organization

LIST OF EXHIBITS

U.S. Export Sales Data, accessed at www.fas.usda.gov/export-sales/h1404.htm	Exhibit Bra-663
Monthly Export Sales	Exhibit Bra-664
Analysis of Planting Decisions Based on Expected Returns and Cash Costs	Exhibit Bra-665
Actual Costs and Returns Analysis Based on Cash Costs	Exhibit Bra-666
Expected Costs and Returns Using Variable Costs	Exhibit Bra-667
Actual Costs and Returns Using Variable Costs	Exhibit Bra-668
"Adoption of Genetically Engineered Crops in the U.S.: Cotton Varieties," Economic Research Service, U.S. Department of Agriculture, accessed March 2007 at http://www.ers.usda.gov/data/biotechcrops/ExtentofAdoptionTable2.htm	Exhibit Bra-669

TABLE OF CASES

Short Title	Full Case Title and Citation
Brazil – Aircraft (21.5)	Appellate Body Report, *Brazil – Export Financing Program for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/AB/RW, adopted 4 August 2000, DSR 2000:VIII, 4067.
U.S. – FSC (21.5)	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW, adopted 29 January 2002, DSR 2002:I, 55.
U.S. – FSC (21.5 II)	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Second Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW2, adopted 14 March 2006.
U.S. – Softwood Lumber IV	Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, adopted 17 February 2004, DSR 2004:II, 571.

1. INTRODUCTION

1. Brazil thanks the compliance Panel for the opportunity to comment on the United States' Opening and Closing Statement at the Panel Meeting. In this submission, Brazil comments on selected issues and arguments raised by the United States. Brazil also refers the compliance Panel to its own Closing Statement at the Panel Meeting, in which Brazil responded to the majority of new U.S. arguments.

2. Specifically, in its Closing Statement, Brazil made, *inter alia*, the following points in response to U.S. adverse effects-related arguments:

- Mandatory and price-contingent marketing loan and counter-cyclical subsidies granted subsequent to the original panel's reference period are properly before this compliance Panel.[1]

- Brazil's argument that there is a rapid transmission of prices in an integrated world market is consistent with the fact that farmers outside the United States react more slowly to higher prices from the elimination of U.S. subsidies.[2]

- The fact that the average acre planted to upland cotton covered its production costs with market returns in MY 2003 was an aberration.[3]

- Brazil has demonstrated that the world market price-suppressing effects from marketing loan and counter-cyclical subsidies are "significant."[4]

3. Additionally, in its Closing Statement, Brazil made the following points in response to the U.S. export credit guarantee-related ("ECG") arguments:

- The amended GSM 102 program does not meet its long-term costs and losses, under item (j) of the Illustrative List. The U.S. government continues, every year, to project that GSM 102 ECGs issued in that year will result in losses.[5]

- Even if the GSM 102 program meets its long-term operating costs and losses, within the meaning of item (j), this does not, under the proper interpretation of footnote 5 to the SCM Agreement, "demonstrate[] dispositively" that GSM 102 ECGs are not export subsidies.[6]

- Even if the GSM 102 program meets its long-term operating costs and losses, the United States has failed to achieve "full withdrawal" of the prohibited subsidy, instead merely replacing it with another prohibited subsidy. Specifically, under the amended fee schedule, GSM 102 ECGs are export-contingent contributions that confer "benefits".[7]

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[1] Brazil's Closing Statement, paras. 2-4.
[2] Brazil's Closing Statement, paras. 5-8.
[3] Brazil's Closing Statement, paras. 15-16.
[4] Brazil's Closing Statement, paras. 17-20.
[5] Brazil's Closing Statement, paras. 21-22.
[6] Brazil's Closing Statement, para. 24, *quoting* U.S. Oral Statement, heading III.A.1.
[7] Brazil's Closing Statement, paras. 25-27, *quoting* Appellate Body Report, *U.S. – FSC (21.5 II)*, para. 83.

- Article 14(c) of the SCM Agreement sets forth only "guidelines" that the Appellate Body, at the United States' urging, has concluded must not be followed rigidly, even in countervailing measure disputes to which the provision expressly applies.[8]

- By continuing to pay claims on certain ECGs outstanding on 1 July 2005, the United States has failed to "withdraw the subsidy", under the interpretation of that phrase made by the Appellate Body.[9]

4. Brazil will not revisit these points, but will instead address a number of additional adverse effects-related issues raised in the United States' Opening and Closing Statements. In this submission, Brazil does not offer any additional comments on ECG-related issues raised in the United States' Opening and Closing Statements.

2. LOWER U.S. EXPORTS IN MY 2006 ARE DRIVEN BY LOWER WORLD DEMAND, NOT THE ELIMINATION OF THE STEP 2 PROGRAM

5. The United States continues to argue that the elimination of the Step 2 program caused the decrease in U.S. upland cotton exports in MY 2006.[10] As explained in Brazil's Closing Statement, this is inaccurate.[11]

6. The United States has provided weekly February export data to show that the repeal of the Step 2 program has resulted in a decline in exports. By comparing MY 2006 to MY 2005, the United States claims that "U.S. exports are *down 30 per cent*".[12] However, the United States fails to mention that exports surged prior to the repeal of the Step 2 program. Data shows that prior to the elimination of Step 2 subsidies, sales were at their second highest level for the MY 2002-2007 period.[13] Considering the average of the two months prior to the repeal of Step 2 subsidies (June-July 2006) and the two subsequent months (August-September 2006), reveals that exports fell by 85 per cent. In other words, they were 7 times less.[14] Brazil also notes that during the two months prior to the elimination of Step 2 subsidies, U.S. exports were close to double their average over the previous five- marketing years (MY 2000-2004).[15] One consequence of these massive sales in MY 2005 is a subsequent decline in exports in MY 2006. This is consistent with the attempt by rational exporters to cash in the last available Step 2 payments.

7. During the first weeks of calendar year 2007, *i.e.*, half-way through MY 2006, data on U.S. exports continues to show lower sales. The United States attributes this to the elimination of Step 2. A close analysis of world trade however provides a different explanation. In fact, all major cotton exporters, with the exception of India, have seen their exports decline in MY 2006.[16] The primary reason for this decline is weak international demand. As Brazil has repeatedly shown by providing market reports, China, the biggest importer, is using up "a large supply of cotton imported prior to the

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[8] Brazil's Closing Statement, paras. 28-29, *citing* Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 92.

[9] Brazil's Closing Statement, para. 30, *citing* Appellate Body Report, *U.S. – FSC (21.5)*, paras. 2, 223-231, and Appellate Body Report, *Brazil – Aircraft (21.5)*, para. 45.

[10] Brazil notes that the United States fails to provide the source for some of its data (*See, e.g.*, U.S. Oral Statement, para. 11) or does not provide the link to its data (*See, e.g.*, U.S. Oral Statement, para. 10.).

[11] Brazil's Closing Statement, para. 11.

[12] U.S. Oral Statement, para. 10.

[13] Exhibit Bra-663 (U.S. Export Sales Data, accessed at www.fas.usda.gov/export-sales/h1404.htm).

[14] Exhibit Bra-664 (Monthly Export Sales).

[15] Exhibit Bra-664 (Monthly Export Sales).

[16] Exhibit Bra-652 (International Cotton Advisory Committee Review, Volume 60, Number 3 January-February 2007, accessed February 2007, p. 4).

expiration of the Step 2 program."[17] Increasing Indian exports have added to export declines in the United States and other exporting countries.[18] These undisputed facts largely explain the decline in the U.S. share of Chinese imports and in the U.S. share of world exports.[19]

8. Moreover, the reduction in U.S. exports must be viewed in perspective. Brazil notes that USDA (and ICAC) currently project U.S. exports in MY 2006 to be the *second highest in history* and comparable to MY 2004 levels.[20] In addition, projections for MY 2007 and 2008 show an expected annual increase of almost 10 percent compared to MY 2006 and 2007, respectively.[21]

9. Thus, the present decline in U.S. share of exports is not a result of Step 2 elimination but a result of overall declining world trade.

3. BRAZIL HAS NOT CHANGED ITS POSITION REGARDING THE CAUSE OF SIGNIFICANT PRICE SUPPRESSION

10. The United States claims that Brazil has shifted position from asserting that exports cause price suppression, to asserting that stocks and production cause price suppression. Moreover, the United States asserts that it is "too late … to be altering fundamental factors" and that Brazil submits "no evidence or argument to substantiate its new assertion."[22] These U.S. claims are false.

11. Brazil has not changed its position. Production, stocks and exports are interlinked – all constitute supply; any supply not consumed domestically must eventually be exported.[23] Indeed, this is a question of basic economics. Whether U.S. supply – generated by U.S. subsidies – ends up temporarily in a warehouse, or is exported immediately, this excess supply suppresses world market prices. In his Oral Statement during the Panel Meeting, Andrew Macdonald confirmed this relationship.[24]

12. In its Oral Statement, the United States noted that domestic U.S. mill use for MY 2006 is decreasing.[25] This lack of domestic demand for U.S. supply also contributes to the accumulation of stocks of subsidy-generated U.S. upland cotton that will eventually be exported. Again, whether U.S. supply resulting from subsidized production is exported immediately, or ends up temporarily as stocks and is exported later, it affects, and in fact suppresses, world market prices for upland cotton.

4. AN ANALYSIS OF UPLAND COTTON VARIABLE COSTS AND RETURNS SUPPORTS BRAZIL'S SERIOUS PREJUDICE CLAIMS

13. Next, Brazil addresses U.S. arguments regarding the "expected" and "actual" total costs and return charts presented in Brazil's Oral Statement. These charts visually illustrate two effects of upland cotton marketing loan and counter-cyclical subsidies.[26] First, the charts show that marketing loan and counter-cyclical subsidies are essential for upland cotton farmers to be able to cover their

[17] Exhibit Bra-662 (Elton Robinson, "High certificated cotton stocks slow trade, weigh on prices," Delta Farm Press, 1 December 2006, accessed February 2007 at http://deltafarmpress.com/mag/farming_high_certificated_cotton/).
[18] Exhibit Bra-652 (International Cotton Advisory Committee Review, Volume 60, Number 3 January-February 2007, accessed February 2007, p. 4).
[19] U.S. Oral Statement, paras. 10-11.
[20] Exhibit Bra-651 (Cotton and Wool Outlook, USDA, 12 February 2007, p. 4, accessed February 2007 at http://usda.mannlib.cornell.edu/usda/current/CWS/CWS-02-12-2007.pdf).
[21] Exhibit Bra-635 (2002-2007 USDA Agricultural Baseline Projections, p. 46).
[22] U.S. Closing Statement, para. 15.
[23] Brazil's Closing Statement, paras. 9-14.
[24] *See* Brazil's Oral Statement, paras. 147, 160-162.
[25] U.S. Oral Statement, para. 11.
[26] Brazil's Oral Statement, paras. 63-78.

costs of production and stay in the business of growing upland cotton. Market revenue by itself is almost never sufficient, nor is it expected to be sufficient, to cover *total* costs. Further, expected and actual market revenue is below or just above average *variable* costs in a number of years, suggesting that many upland cotton farmers would exit cotton faming without marketing loan and counter-cyclical subsidies even in the short term. Similar evidence on the gap between U.S. upland cotton producers production costs and market returns has been presented in Brazil's First Written Submission[27], Rebuttal Submission[28] and Oral Statement.[29]

14. Second, the charts in Brazil's Oral Statement show that upland cotton farmers would exit upland cotton production by switching to the production of alternative crops but for the effect of marketing loan and counter-cyclical subsidies. Absent those subsidies, expected returns from growing corn or soybeans in almost every year make it more attractive to grow one of these alternative crops. This evidence responds to U.S. criticisms that Brail has not properly examined the relative attractiveness of competing crops at the time of planting.[30]

15. In its Oral Statement, the United States asserted that variable costs and market returns are the determinative factors driving farmers' year-to-year planting decisions.[31] Yet, during the second day of the Panel Meeting and in its Closing Statement, the United States admitted that certain fixed costs, including those that are "cash costs,"[32] are also pertinent to planting decisions.[33] Indeed, the second U.S. chart in the "U.S. Exhibit of February, 28 2007," entitled "Costs of producing cotton," includes variable and fixed costs that constitute cash costs. It excludes land, own-labour and capital recovery costs. However, these non-cash costs[34] account for almost 30 percent of the total cost of producing cotton.[35]

16. Brazil also notes that the first chart in the "U.S. Exhibit of February, 28 2007" is based on *actual* costs and *actual* market returns as realized in marketing year 2005. Brazil is puzzled that the United States presents a chart of *actual* returns minus cash costs, when, in the words of the United States, a farmer "cannot rewind time and make different production decisions based on how things actually turn out."[36] In other words, it is costs and *expected* returns at the time of planting that provide one useful means to assess the impact of marketing loan and counter-cyclical subsidies. This is the approach that Brazil has followed in figures 1-4 of its Oral Statement,

17. In any event, farmers can only survive by seeking to maximize their market and subsidy returns over *total* costs, including cash and imputed costs, when making planting decisions. Nevertheless, comparing total costs, variable costs or even cash costs to expected market returns leads

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[27] Section 7.11 of Brazil's First Written Submission, paras. 156-164.

[28] Section 2.3.6 of Brazil's Rebuttal Submission, paras. 245-289.

[29] Section 2.4 of Brazil's Oral Statement, paras. 54-91.

[30] *See* U.S. First Written Submission para. 255. *See also* U.S. Rebuttal Submission, paras. 269, 275, 300-301.

[31] U.S. Oral Statement, paras. 12 and 73.

[32] According to *The Commodity Costs and Returns Estimation Handbook* "cash costs are costs that require a cash payment at the time the transaction occurs or during a specified reported period such as a week or month." *See* Exhibit Bra-649 ("Conceptual Issues in Cost and Return Estimates," Chapter 2 of Commodity Costs and Returns Estimation Handbook, a report of the AAEA Task Force on Commodity Costs and Returns).

[33] *See* U.S. Exhibit of February 28, 2007. In this exhibit, the United States compares cash costs and actual market returns of growing upland cotton, corn and soybeans in MY 2005. According to the United States, cash costs include operating costs, hired labour, taxes, insurance and general overhead. *See also* U.S. Closing Statement, para. 17.

[34] Brazil notes that land is only a non-cash cost to the extent it is owned by the farm operator. Rented land is a cash cost.

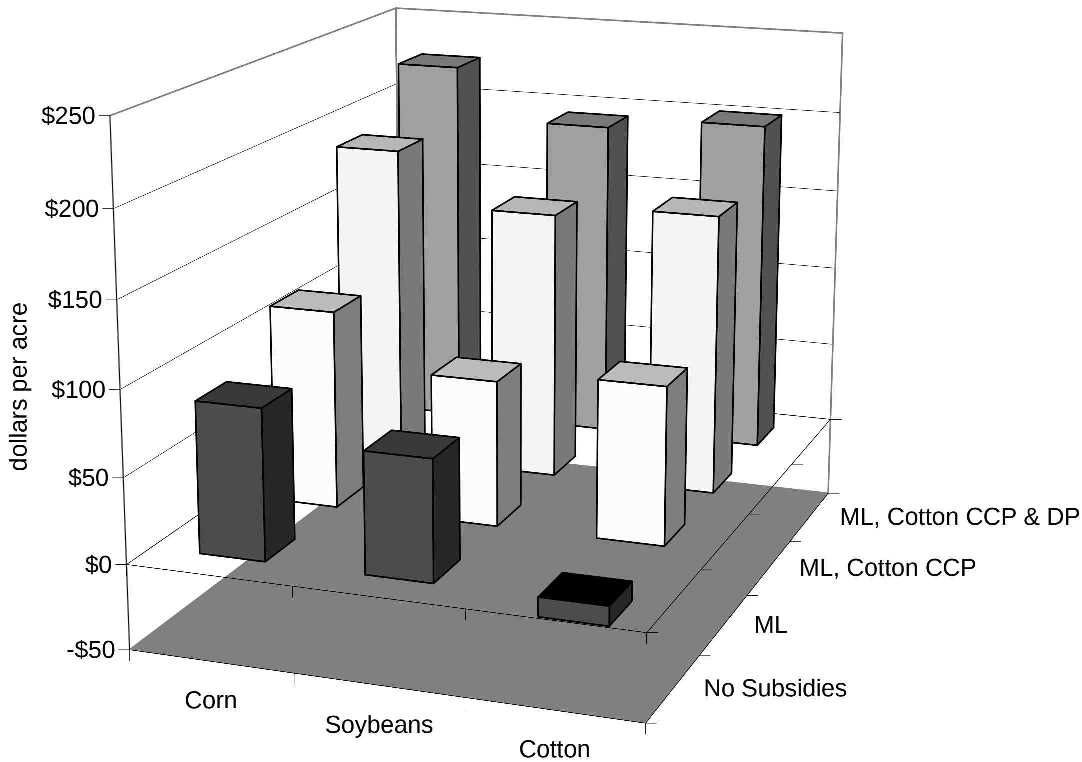
[35] Exhibit Bra-648 (Actual Costs and Returns Analysis).

[36] U.S. Oral Statement, paras. 4 and 65.

to the same basic conclusion: planting upland cotton without marketing loan and counter-cyclical payments would be economically irrational.

18. This irrationality is seen even when examining "cash costs," as identified by the United States in the U.S. Exhibit presented on 28 February 2007, compared to *expected* as well as *actual* revenue. Based on the relevant USDA and FAPRI data found in the attached exhibits, Figures 7 through 12, below, are based on *cash* costs, but conceptually mirror figures 1 through 6, respectively, of Brazil's Oral Statement, which were based on *total* cost.

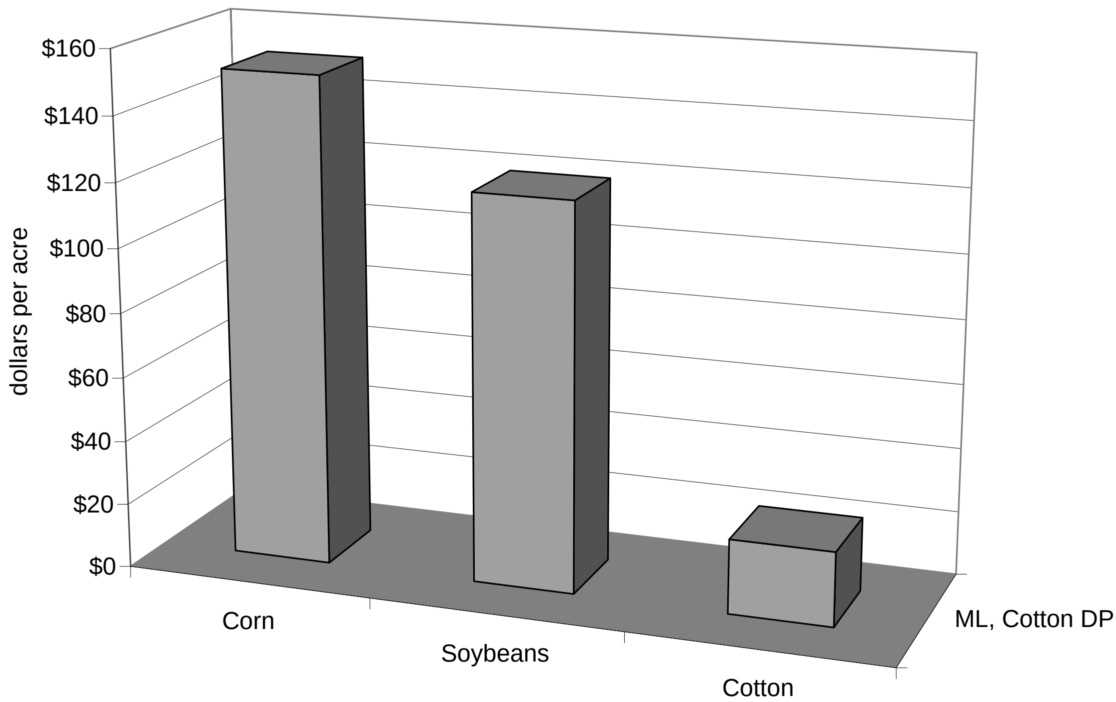
Figure 7 – Expected Returns in Excess of the Cash Costs of Growing Cotton, Corn or Soybeans on a Base Acre of Cotton in MY 2005[37]



19. Figure 7 demonstrates that in MY 2005 the average acre planted to upland cotton did not expect to be able to cover its cash costs with market revenue. Producing corn and soybeans, on the other hand, was expected to yield market returns well in excess of cash costs (*see* first row in red). However, when expected marketing loan subsidies are factored into farmers' expectations, the expected returns in excess of cash costs are nearly equalized for all three crops (*see* second row in yellow).

[37] Exhibit Bra-665 (Analysis of Planting Decisions Based on Expected Returns and Cash Costs).

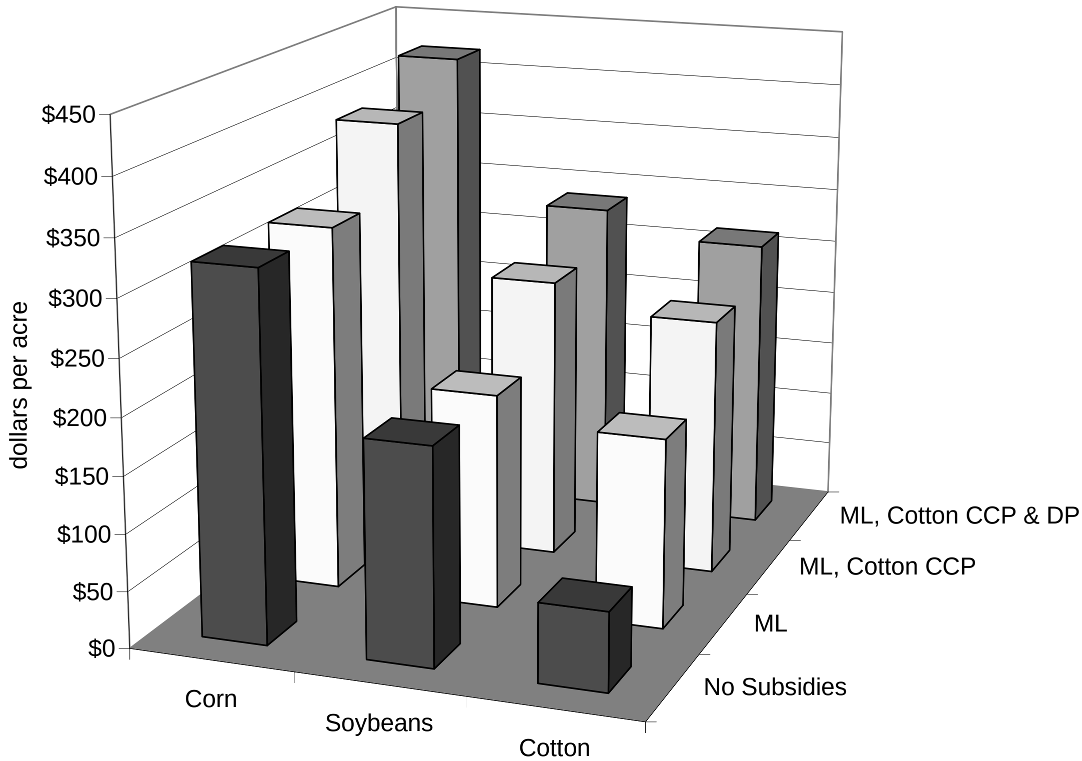
Figure 8 – Expected Returns in Excess of the Cash Costs in MY 2005 with No Cotton Marketing Loan or CCP Subsidies[38]



20. As depicted in figure 8, if upland cotton marketing loan and counter-cyclical subsidies did not exist in MY 2005, expected returns in excess of cash costs for soybeans and corn would have been much higher than for upland cotton, suggesting that many farmers would have switched to the production of alternative crops.

[38] Exhibit Bra-665 (Analysis of Planting Decisions Based on Expected Returns and Cash Costs).

Figure 9- Expected Returns in Excess of the Cash Costs of Growing Cotton, Corn or Soybeans on a Base Acre of Cotton in MY 2007[39]



21. The first row of figure 9 shows that market returns in excess of cash costs are expected in February 2007 to be nearly five times higher for corn than for cotton and nearly three times higher for soybeans than for upland cotton in MY 2007. Considering only market returns, it would be very surprising if upland cotton acreage declined by *only* 14 percent in MY 2007, as predicted by the National Cotton Council.[40] However, when marketing loan subsidies are factored into farmers' expectations, returns for upland cotton are expected to be almost as high as those for soybeans and just 40 percent less than returns for corn.[41] Viewed in this context, it makes sense that only 14 percent of upland cotton acres switched to alternative crops.

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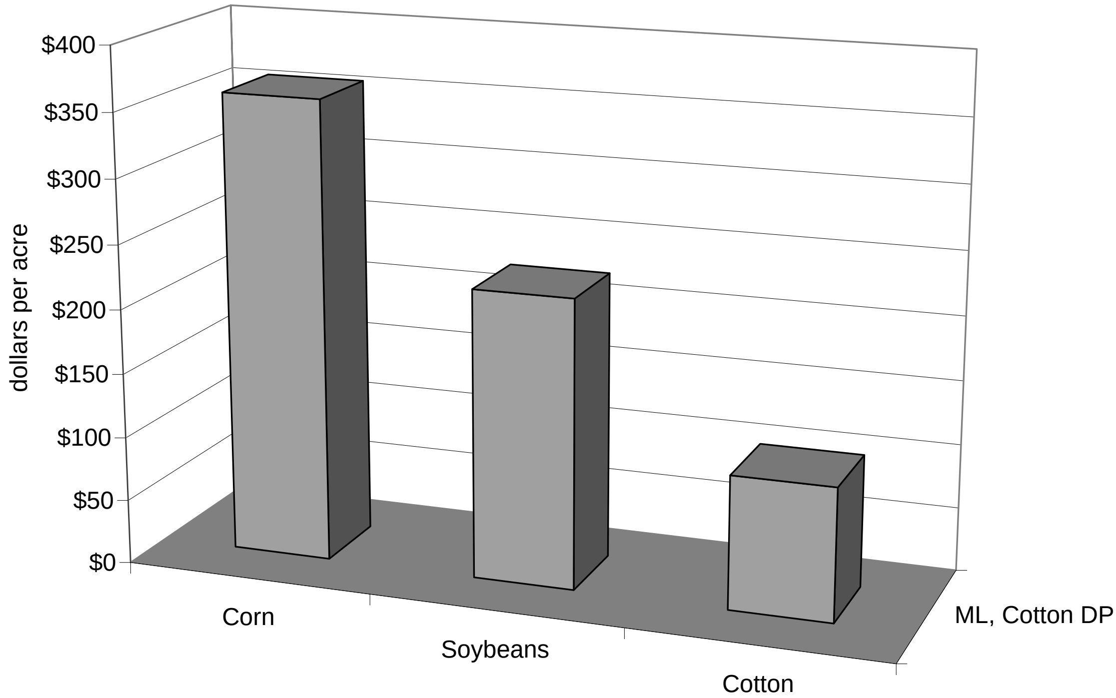
[39] Exhibit Bra-665 (Analysis of Planting Decisions Based on Expected Returns and Cash Costs).
[40] Exhibit Bra-646 (Planting Intentions Survey, National Cotton Council).
[41] Exhibit Bra-665 (Analysis of Planting Decisions Based on Expected Returns and Cash Costs).

Figure 10 – Expected Returns in Excess of the Cash Costs in MY 2007 with No Cotton Marketing Loan and CCP Subsidies[42]

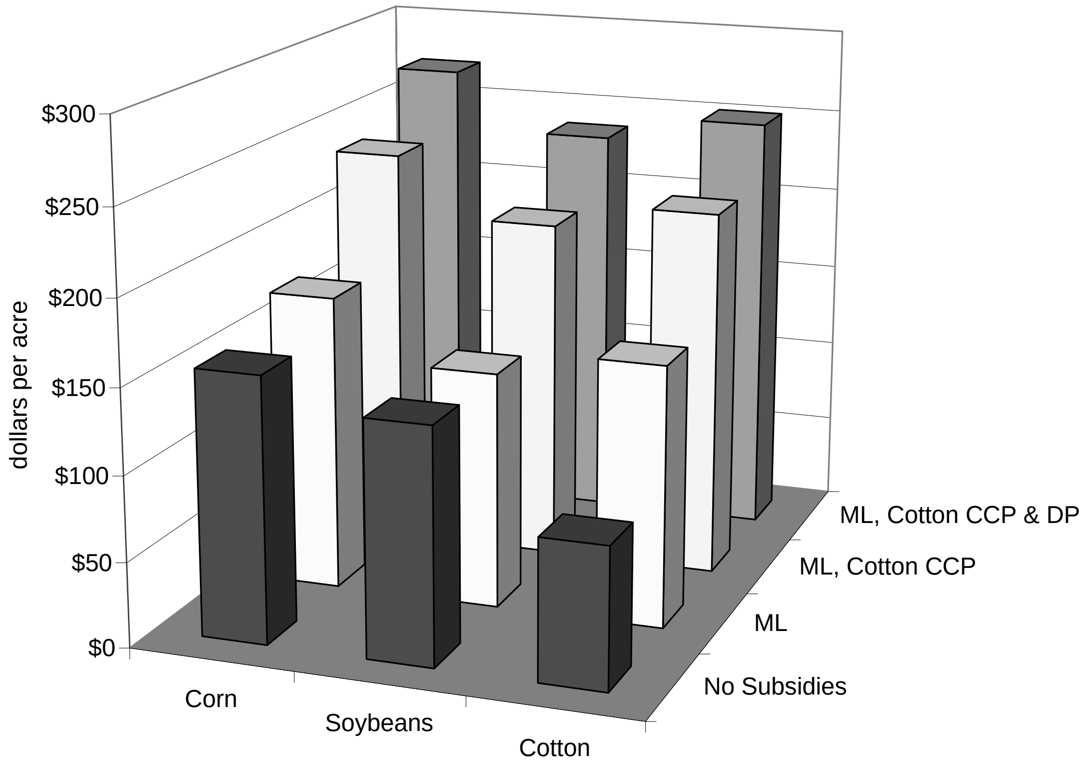


22. Figure 10 summarizes the planting decision for an acre of upland cotton base in February 2007 in the absence of upland cotton marketing loan and counter-cyclical subsidies. It again suggests that more than 14 percent of upland cotton acreage would switch to alternative crops in the absence of these subsidies.

23. As were figures 5 and 6 in Brazil's Oral Statement, the following figures 11 and 12 are based on actual market returns:

[42] Exhibit Bra-665 (Analysis of Planting Decisions Based on Expected Returns and Cash Costs).

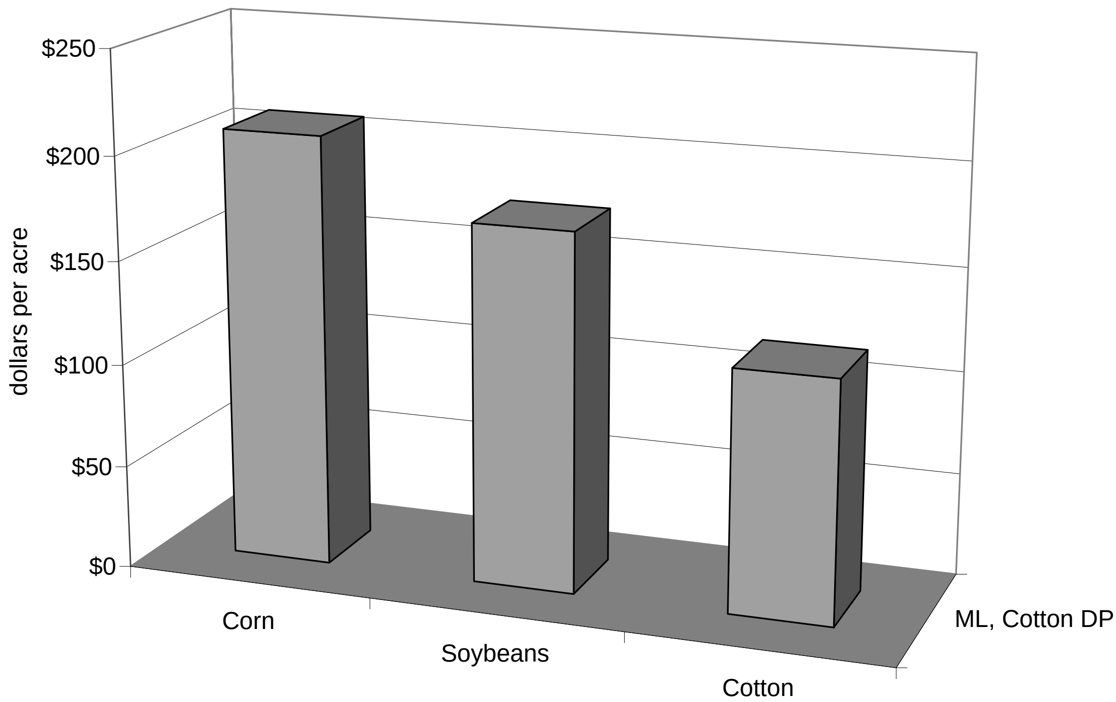
Figure 11 – Average <u>Actual Returns</u> in Excess of the Average <u>Cash Costs</u> Associated with Planting Cotton, Corn or Soybeans on an Cotton Base Acre in MY 2002-2006[43]



24. Figure 11 illustrates what actually happened between MY 2002 and 2006. The chart shows that actual market returns in excess of cash costs for upland cotton were far less than those for corn and soybeans. However, when upland cotton marketing loan subsidies are taken into account, returns in excess of cash costs were higher for upland cotton than for soybeans, and only slightly lower than for corn.

[43] Exhibit Bra-666 (<u>Actual</u> Costs and Returns Analysis Based on <u>Cash</u> Costs).

Figure 12 – Average Actual Returns in Excess of the Average Cash Costs with No Cotton Marketing Loan or CCP Subsidies in MY 2002-2006[44]



25. Figure 12 illustrates that absent upland cotton marketing loan and counter-cyclical payments, growing corn or soybeans on an upland cotton base acre would have been more profitable. Similar to Brazil's figure 6 presented as part of its Oral Statement, and based on total costs, these charts based in cash costs continue to show that planting soybeans and corn on upland cotton base acres would be attractive without price-contingent upland cotton subsidies.

26. This evidence shows that the effect of marketing loan and counter-cyclical subsidies is to provide strong financial incentives to maintain upland cotton acreage – even in the unlikely event that farmers only consider variable or cash costs when making planting decisions. *But for* the marketing loan and counter-cyclical payments for upland cotton, it would be far more profitable for upland cotton farmers, on average, to plant corn or soybeans. Thus, as Brazil indicated during the Panel Meeting, the usefulness of the comparisons based on *total* costs presented in figures 1-6 as part of its Oral Statement is not diminished by the use of cash costs in figures 7-12 above. Removing non-cash costs[45] changes the level of expected or actual market returns minus costs, but does *not* change the relative attractiveness of producing corn or soybeans – as compared to upland cotton – on a base acre of upland cotton.

[44] Exhibit Bra-666 (Actual Costs and Returns Analysis Based on Cash Costs).

[45] According to *The Commodity Costs and Returns Estimation Handbook* "noncash costs are those in which the timing of the physical use of resources and the cash payments differs." *See* Exhibit Bra-649 ("Conceptual Issues in Cost and Return Estimates," Chapter 2 of Commodity Costs and Returns Estimation Handbook, a report of the AAEA Task Force on Commodity Costs and Returns).

27. Analyzing actual and expected returns in excess of *variable* (as opposed to only *cash*) costs[46] yields a similar result. Removing fixed costs changes the level of returns minus costs, but not the relative attractiveness of growing cotton, corn or soybeans on a base acre of upland cotton. Exhibit Bra-667 provides a complete comparison of expected returns in excess of variable costs in MY 2002-2007. Exhibit Bra-668 provides a comparison of actual returns in excess of variable costs.[47]

28. The United States presented a number of other misleading arguments about U.S. upland cotton costs and returns in its Opening Statement. The United States argued that an examination of costs and returns in MY 2003 demonstrates that 92 percent of upland cotton farmers are able to cover their variable and total costs of production.[48] As Brazil explained in its Opening Statement[49], Closing Statement[50] and in response to oral questions from the compliance Panel, this assertion is misleading, and to some extent simply incorrect.

29. First, it is important to understand that the allegedly "new" cost information broken down by costs groups[51] (*i.e.*, low-, mid- and high-cost producers) is based on the same underlying survey data presented in Brazil's First Written Submission and used by Brazil in subsequent submissions and statements.[52] It is not "new," but instead an elaboration of USDA data that Brazil has relied upon throughout this proceeding. In fact, the "new" grouping of farms into those that are low-cost, mid-cost and high-cost is somewhat arbitrary. Brazil has long maintained that upland cotton producers' costs are not uniform.[53] It is entirely unremarkable that some farmers have a lower cost structure than others.

30. However, the critical flaw in the United States reliance on the "new" cost information is that it pertains to MY 2003, a year in which cotton prices were the highest they have been in the past ten years. Concluding that upland cotton farmers are generally able to cover their costs with market revenue based on market returns in MY 2003 is misleading and incorrect. In the past eight years, MY 2003 is the only year in which the average acre planted to upland cotton was able to cover its total costs of production.

31. The United States also claims that a fundamental shift occurred in the production costs of U.S. upland cotton farmers. One reason cited by the United States is the adoption of genetically engineered ("GE") cotton seeds. However, an examination of the rate of adoption of GE varieties shows that this argument, once again, is incorrect.

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[46] Variable costs include operating, land and labour costs. *See, inter alia*, Brazil's Rebuttal Submission, Sections 2.3 and 6.2.

[47] Brazil notes that the excel files in Exhibits Bra-634, 648, 665, 666, 667 and 668 easily permit an alteration of the "cost" to which market and subsidy returns are compared. The cells in the row entitled "No subsidies" in the first three worksheets can be changed to reflect different cost concepts. The charts in the later worksheets of the excel file will automatically update to reflect the new cost concept.

[48] U.S. Oral Statement, paras. 11 and 72.

[49] Brazil's Oral Statement, para. 84.

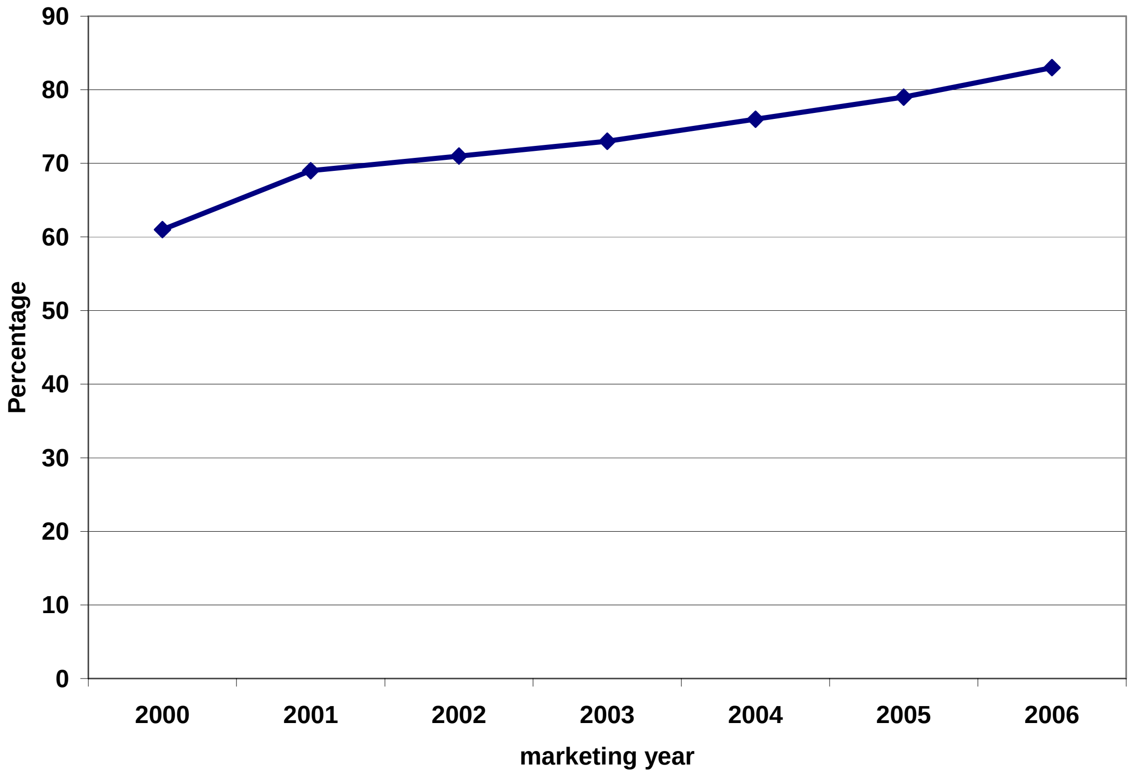
[50] Brazil's Closing Statement, paras. 15-16.

[51] Exhibit U.S.-93 (WTO Confidential).

[52] *See* Section 7.11 of Brazil's First Written Submission; Section 2.3.6 of Brazil's Rebuttal Submission; and Section 2.4 of Brazil's Oral Statement.

[53] *See, e.g.*, Brazil's Rebuttal Submission, paras. 267-272; Brazil's Oral Statement, para. 85.

Figure 13 – U.S. Adoption of GE Cotton Varieties[54]



32. The chart based on USDA data shows that the adoption of GE varieties increased from 71 percent in 2002 to 79 percent MY 2005, hardly a dramatic shift. Further, while GE varieties undoubtedly raise yields (and thus lower per-acre costs), they also increase the cost of seed, as seen in USDA's new cost survey of MY 2003. In any event, all of these developments are already reflected in the USDA's costs and return data relied upon by Brazil and the United States.

33. Moreover, the United States implies that the average profit made by upland cotton farmers in MY 2003 and the small loss in MY 2004 is the beginning of a dramatic new trend. It is not. High prices in MY 2003 allowed upland cotton farmers to cover their total costs for the first time in six years. Record high yields and a relatively high harvest price (despite lower prices in the subsequent marketing year) enabled upland cotton farmers to almost cover their costs in MY 2004. Yet, in MY 2005, despite another year of abnormally high yields, the average gap between total costs and market returns widened to $80 per acre. With lower yields and stagnant prices in MY 2006, the gap is expected to grow even wider.[55] Further, projections of future costs and market prices by USDA and FAPRI suggest that the gap between total costs and returns will continue indefinitely.[56]

34. In sum, the upland cotton cost and returns analysis presented by Brazil demonstrates that marketing loan and counter-cyclical subsidies have played a decisive role in U.S. upland cotton producers' ability to grow upland cotton profitably.

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[54] Exhibit Bra-669 ("Adoption of Genetically Engineered Crops in the U.S.: Cotton Varieties," Economic Research Service, U.S. Department of Agriculture, accessed March 2007 at http://www.ers.usda.gov/data/biotechcrops/ExtentofAdoptionTable2.htm).

[55] Exhibit Bra-648 (Actual Costs and Returns Analysis).

[56] *See, e.g.*, Brazil's First Written Submission, Figure 28 at para. 292.

5. COMMENTS BY DANIEL SUMNER

35. In this Section, Brazil presents the comments of Professor Sumner on the U.S. critique of his analysis, presented by Dr. Glauber:

36. In several documents, including the statement of Dr. Glauber[57], the United States lists what it identifies as "key problem with Brazil's new model." This same list appears in the U.S. Rebuttal Submission[58] and in U.S. responses to questions of the compliance Panel.[59] I have dealt with each of the issues listed by the United States in earlier documents. Some of the issues were discussed further at the Panel Meeting. My comments below summarize the main points with reference to floor discussion at the Panel Meeting and to earlier documents.

37. I respond to the claims of the United States in the order in which they appear in the U.S. Opening Statement.[60]

5.1. U.S. criticism: "lacks cross-commodity impacts and cross-price elasticities, potentially leading to biased price effects"[61]

38. The United States is simply wrong on this point. My model fully accounts for cross-commodity feedbacks to the cotton supply function that are relevant to assessing the impact of the removal of U.S. subsidy programs. It does so based on the U.S. supply elasticity parameter that I apply. Of course, my model does not explicitly address the effect of removing cotton subsidies on, for example, corn or hay acreage, because reporting those effects is not relevant to this proceeding. To include explicit cross-commodity impacts and cross-price elasticities in the model would only be justified if one has a policy interest in these other commodities. Yet, the impact of removing cotton subsidies on corn or hay acreage in the United States is not at issue before this compliance Panel.

39. The United States argues that leaving out these cross-commodity impacts and elasticities could "potentially" lead to bias. However, the only way that leaving out these extraneous equations could lead to "bias" with respect to the price effects for cotton is if the model used failed to incorporate feedbacks from induced changes in other crop prices on upland cotton supply. However, my model uses a supply elasticity that fully accounts for the feedback effects. This point was explicitly and clearly raised and discussed in my Annex I analysis.[62] I also discussed the issue more fully and provided citations in my rebuttal comments.[63] Finally, I reviewed these previous discussions in my supplemental statement submitted as Exhibit Bra-659.

40. While it is easy to make models more complicated, complications for their own sake are just a sign of poor modeling and a lack of understanding of the reason that models are created in the first place. The continued repetition of this claim by the United States, with no acknowledgment or engagement on the issue should not mislead the compliance Panel. The use of general equilibrium supply elasticities, such as the one I apply to my model, is well-known and well-established among modelers. There is no ambiguity on this point.

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[57] U.S. Oral Statement, Statement of Dr. Glauber, para. 3.

[58] U.S. Rebuttal Submission, Annex I, para. 4.

[59] U.S. Response to Questions of the Panel, Parts D-E, 27 February 2007, para. 35.

[60] U.S. Oral Statement, Statement of Dr. Glauber, para. 3.

[61] U.S. Oral Statement, Statement of Dr. Glauber, para. 3.

[62] "Analysis of Effects of U.S. Upland Cotton Subsidies on Upland Cotton Prices and Quantities by Daniel A. Sumner," Annex I, Brazil's First Written Submission, para. 17.

[63] "Response to the Submission of the United States titled 'Annex I: A Review of the Simulation Analysis Presented by Dr. Sumner,'" Brazil's Rebuttal Submission, Annex I, paras. 14-17.

5.2. U.S. criticism: "is static with no explicit relationship for changes in cotton stock levels and no stock's equations"[64]

41. Once again, the United States asserts that the model should have been made more complicated simply for the sake of complications. The United States does not indicate why a "dynamic" model with respect to cotton stocks would be useful in this case. Certainly there are cotton stock fluctuations from month-to-month and year-to-year, just as there are weather events and consumer trends in textile demand. The existence of stock fluctuations does not imply that such changes in stocks would be induced by the kind of policy changes under consideration here.

42. While, one could create a complicated model designed to account for these extraneous events or trends, such a model would not improve our ability to understand the effect of U.S. cotton subsidies. Indeed, introducing unnecessary complications serves only to make a model unwieldy and is likely to introduce unknown biases because it becomes impossible to trace clearly the effects of policy change.

43. In its reparameterization of my model, the United States simply uses a very large price elasticity of demand for cotton in the short run. This is a mistake. Stocks respond in the short run to unanticipated, temporary fluctuations in price, as firms liquidate stocks when prices are high in order to rebuild stocks when prices are low. Modeling endogenous stockholding may be valuable for some applications, but not for modeling policy changes that are fully anticipated and expected to be permanent.

44. Furthermore, as I explain more fully in the supplemental statement submitted as Exhibit Bra-659, the econometric exercise used to create the so-called stocks demand elasticity referred to by the United States is based on data from small year-to-year fluctuations in cotton stocks and cotton prices. The policy experiment we are considering here is far outside the range of the data used to create the estimates used by the United States. More importantly, the policy experiment we are considering here is conceptually different from the kinds of price fluctuations used to generate stock changes in the statistical exercise relied on by the United States.

5.3. U.S. criticism: "contains foreign supply elasticities that are different from FAPRI that underestimate the response of foreign producers to changes in world prices"[65]

45. I have devoted many pages to explaining the reasons for the parameter choices that are most appropriate for application in my model to estimate the effects of removing U.S. cotton subsidies on cotton market prices and quantities. An initial discussion appeared in my original Annex I analysis[66] and I included more discussion in my supplemental statement in Exhibit Bra-659. FAPRI estimates of this parameter tend to overestimate the degree of supply response to world market price changes that would be generated by a reduction in or elimination of U.S. cotton subsidies.

46. Anticipated and permanent removal of U.S. cotton subsidies would cause a substantial initial decline in U.S. cotton acreage and production. The reduced production and exports from the United States would cause higher world market prices for cotton. Foreign producers would respond to that higher world market price gradually and in a muted fashion. There are several reasons for this gradual and muted response: (i) the degree of price increase would not be known with certainty; (ii) the price received by many growers would fail to fully reflect the price change in the world market; and (iii) many growers have a limited ability to expand cotton acreage in the short run.

[64] U.S. Oral Statement, Statement of Dr. Glauber, para. 3.

[65] U.S. Oral Statement, Statement of Dr. Glauber, para. 3.

[66] "Analysis of Effects of U.S. Upland Cotton Subsidies on Upland Cotton Prices and Quantities by Daniel A. Sumner," Annex I, Brazil's First Written Submission, paras. 20-24.

I explain these points more fully in my original Annex I analysis[67] and in subsequent documentation.[68] The United States may disagree but has provided no reasoning or evidence, other than the claim that FAPRI uses a different parameter value. That does not constitute a "key problem" with my model.

5.4. U.S. criticism: "treats production flexibility payments and direct payments differently even though they operate in the same way"[69]

47. This is a puzzling claim. Production flexibility payments applied during the period MY 1996 to 2001, and were replaced by direct payments under the provisions of the FSRI Act of 2002. Both payment programs enter the cotton supply function as a partially coupled source of revenue. The only difference in the treatment of the two programs is that I use a smaller coupling factor for production flexibility payments than I use for direct payments.

48. Throughout my analysis, going back to my analysis presented to the original panel in 2003, I explained carefully why direct payments provide larger production incentives than did production flexibility payments. I used a coupling factor of 0.15 for production flexibility payments and a coupling factor of 0.25 for direct payments. The main reason for the higher coupling factor for direct payments is that the FSRI Act of 2002 allowed producers to update their payment base for direct payments. This update of base acres has two effects. First, it tied the direct payments more closely to the actual acreage used for cotton production. Second, it enhanced growers' perceptions of the likelihood of future base acre updates, which is a major contributor to the production incentives inherent in so-called decoupled payments. I deal with this issue more fully in my 2003 article in the *Australian Journal of Agricultural and Resource Economics*.[70]

49. For the purposes of this proceeding, it is also worth reminding ourselves that production flexibility payments were discontinued in 2001 and, therefore, play little, if any, role in the results of my analysis that are relevant for the compliance Panel's assessment.

5.5. U.S. criticism: "incorporates step 2 payments directly into the producer retinal function as fully coupled payment"[71]

50. This is not a problem in my model and raising this issue suggests that the United States fails to understand some basic microeconomic principles.

51. As I explain in my Annex I analysis[72], basic microeconomic analysis confirms that taxes or subsidies applied to buyers or sellers may be analyzed as either consumer subsidies or producer subsidies at the convenience of the modeler without affecting the results of the analysis. A vertical shift down in the effective price paid by buyers (as in the case of Step 2 subsidies) may be equivalently modeled as a vertical increase of the same magnitude in the supply price received by sellers. The impacts on prices and quantities are identical no matter which way the subsidy is

[67] "Analysis of Effects of U.S. Upland Cotton Subsidies on Upland Cotton Prices and Quantities by Daniel A. Sumner," Annex I, Brazil's First Written Submission, paras. 27-31.

[68] "Response to the Submission of the United States titled 'Annex I: A Review of the Simulation Analysis Presented by Dr. Sumner,'" Brazil's Rebuttal Submission, Annex I, paras. 20-24.

[69] U.S. Oral Statement, Statement of Dr. Glauber, para. 3.

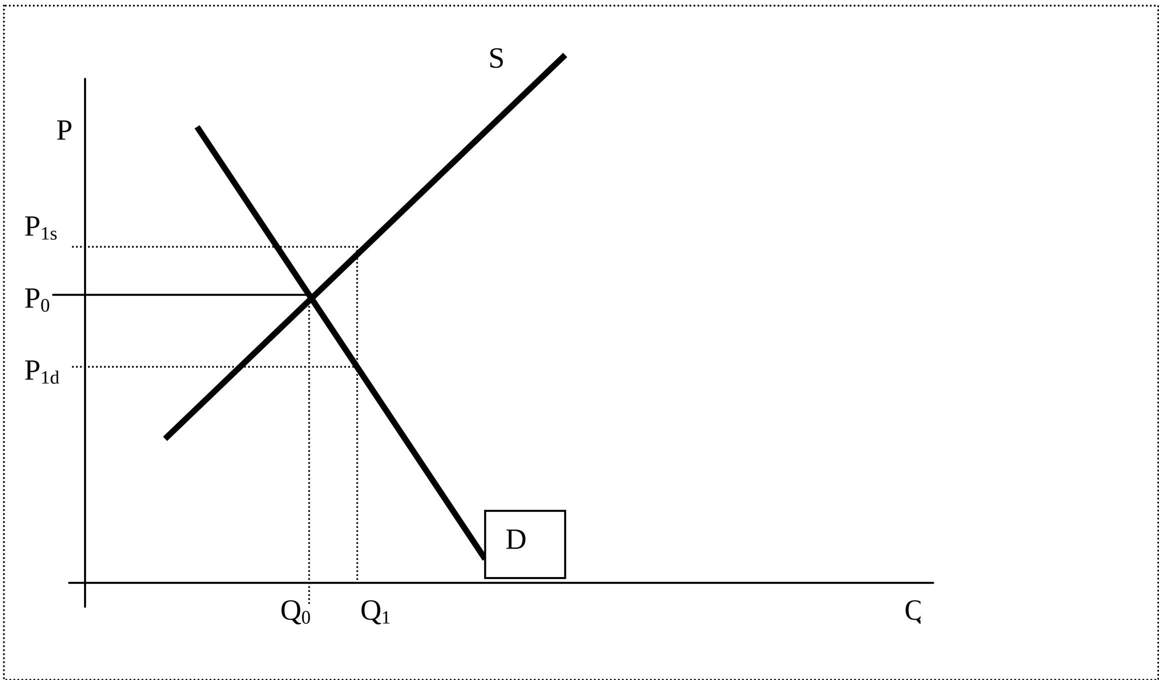
[70] Sumner, Daniel. "Implications of the US Farm Bill of 2002 for Agricultural Trade and Negotiations." *The Australian Journal of Agricultural and Resources Economics*, Volume 47, Number 1, March 2003, pp. 99-122.

[71] U.S. Oral Statement, Statement of Dr. Glauber, para. 3.

[72] "Analysis of Effects of U.S. Upland Cotton Subsidies on Upland Cotton Prices and Quantities by Daniel A. Sumner," Annex I, Brazil's First Written Submission, paras. 54-56.

incorporated in the analysis. This is a standard exercise on the incidence of taxation (negative subsidy) for undergraduate students in microeconomics.[73]

Figure 14 – Simple Graphical Demonstration of the Equivalence of a Production or Demand Subsidy



52. In Figure 14, a demand subsidy is shown as a lower effective price paid by buyers in the amount of $P_0 - P_{1d}$. This lower effective price (which includes the subsidy) elicits a higher quantity demanded Q_1. In order to encourage that amount of additional production, the market price must rise to P_{1s} (the new price received by producers). Thus, the demand subsidy causes the market price received by producers to rise to P_{1s}, while the price paid by buyers falls to P_{1d}. The amount of the subsidy is $P_{1s} - P_{1d}$. Alternatively, if a subsidy of this amount is paid to producers, the quantity supplied would rise to Q_1, the net price received by producers (inclusive of the subsidy) would be P_{1s} and the price paid by buyers would be P_{1d}. The equilibrium results are identical to those that would be obtained if the subsidy were initially provided to buyers. The net result in terms of price and quantity effects of the subsidy depends on the magnitude of the per-unit subsidy and the supply and demand slopes, or elasticities.

53. This conceptual framework is directly applied to my modeling of the Step 2 program. The results of my analysis would be identical whether the subsidy enters the model on the demand side or the supply side. Thus, the United States has not identified a "key problem." Rather, it has identified a natural modeling approach that I used to make the analysis transparent and straightforward.

54. Finally, I note that the United States' arguments do not affect my results from removing marketing loan and counter-cyclical subsidies only, which are the most relevant simulation results for the compliance Panel's assessment.

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[73] *See* Robert S. Pindyck. and Daniel L. Rubinfeld, *Microeconomics*, fifth edition Prentice Hall, 2001, pages 313-320. See also exercise 13, page 323.

5.6. U.S. criticism: "appears to ignore statutory parameters, for example by including countercyclical payment rates in each of the various price expectations that sometimes exceed statutory maximum. The maximum countercyclical payment paid on 85 percent of pace and program yields cannot exceed 13.7 three cents. Yet Dr. Sumner incorporates a value as high as 19.10 cents, which is 39 percent greater than the maximum allowed rate"[74]

55. The United States is also in error on this point. As I explained briefly in my oral remarks[75], the United States failed to read with care the second Appendix of my Annex I analysis, where my approach to modeling counter-cyclical payments is discussed in detail. In particular, Table A.4, on page 45 of my Annex I analysis, explicitly and clearly shows the projected counter-cyclical payment rate per unit of *output*.[76] The statutory maximum applies to counter-cyclical program payments per unit of *program base*. Hence, there is no conflict. My projected counter-cyclical payment rate per unit of *output* is independent from the statutory limit placed on the counter-cyclical payment rate per unit of *program base*. In particular, because counter-cyclical payment base exceeds production, we expect the counter-cyclical payment rate per unit of output to be larger than the counter-cyclical payment rate per unit of base.

5.7. Conclusion

56. In sum, during the Panel Meeting, the United States has again criticized my model, but not identified any real problems. Its repeated criticism result from a number of obvious U.S. errors that I addressed above. In some cases, the United States also simply repeats criticisms with no acknowledgment of my earlier responses thereto.

6. CONCLUSION

57. Brazil looks forward to answering the forthcoming questions posed by the Panel.

[74] U.S. Oral Statement, Statement of Dr. Glauber, para. 3.
[75] Brazil's Oral Statement, para. 120.
[76] "Analysis of Effects of U.S. Upland Cotton Subsidies on Upland Cotton Prices and Quantities by Daniel A. Sumner," Annex I, Brazil's First Written Submission.

ANNEX D-5

COMMENTS OF THE UNITED STATES ON THE ORAL STATEMENTS OF BRAZIL AT THE MEETING WITH THE PANEL

(9 March 2007)

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Canada – Aircraft II	Panel Report, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R, adopted 19 February 2002
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I. INTRODUCTION

1. The United States appreciates the opportunity provided by the Panel to comment on Brazil's "oral" presentation at the meeting with the Panel. In that meeting, Brazil not only presented 77 pages of arguments and evidence orally over the course of approximately four and a half hours – unilaterally consuming almost the entire first day of the meeting with the Panel – but it also submitted 42 new "exhibits" (and 9 resubmitted exhibits) containing information that Brazil did *not* present orally but simply attached to its oral statement.

2. The "exhibits" included with Brazil's oral statement include a third written submission produced by Brazil allegedly to address issues "which there was not time to discuss in [Brazil's economists'] brief statement before the Panel."[1] Leaving aside the irony of describing a four and a half hour oral presentation – of which a substantial portion was taken up by Brazil's economist – as "brief," Brazil's written submission was made in breach of the Panel's working procedures. The working procedures provide for two written submissions, a first written submission and a rebuttal submission, both of which are to be submitted "[b]efore the substantive meeting of the Panel with the parties to the dispute."[2] The working procedures do not contemplate any third written submission either in or after the meeting of the Panel with the parties. While the Panel's working procedures do contemplate – indeed, require – that the parties submit a written product either at or shortly after the meeting with the Panel, the procedures are very clear as to what that written product must be. Specifically, parties must submit "a written version *of their oral statement*" presented to the Panel and the other parties during the meeting.[3] The Panel's working procedures neither contemplate nor permit the submission of arguments and evidence which were *not* part of any oral statement ("which there was [allegedly] not time to discuss in" an oral presentation that otherwise spanned almost an entire day).[4] Given that the third written submission in BRA-659 is not permitted under the Panel's working procedures, the United States respectfully requests that the Panel reject that submission.

3. The United States also notes that much of the new evidence and arguments presented by Brazil in its oral statement was known and available to Brazil well before the date of the Panel meeting. Yet Brazil appears to have chosen to withhold it until the meeting with the Panel when little time remained to subject it to scrutiny. Upon review of this new evidence and argument, it is apparent why Brazil would be anxious to avoid any meaningful assessment thereof.[5] Although voluminous, this evidence and argument offer little support for Brazil's claims. In fact, much of the data newly submitted by Brazil confirms the U.S. arguments that the United States has complied with its obligations to implement the DSB's recommendations and rulings.

II. THE EXPORT CREDIT GUARANTEE PROGRAMS MEET THE TESTS IN THE SCM AGREEMENT FOR NOT BEING EXPORT SUBSIDIES

4. In the case of the export credit guarantees, the fact remains that:

- the United States has provided no GSM 103 guarantees since 1 July 2005;

[1] *See* Supplementary Statement of Daniel Sumner, para. 1 (Exhibit BRA-659).

[2] *See* United States – Subsidies on Upland Cotton (DS267), Working Procedures for the Panel, para. 4 (8 November 2006).

[3] *See* United States – Subsidies on Upland Cotton (DS267), Working Procedures for the Panel, para. 4 (8 November 2006).

[4] *See* Supplementary Statement of Daniel Sumner, para. 1 (Exhibit BRA-659).

[5] In this regard, the United States recalls Brazil's efforts at the Panel meeting and thereafter to preclude or limit any opportunity for the United States to respond in writing to Brazil's "oral" presentation.

- the United States has provided no Supplier Credit Guarantee Program (or "SCGP") guarantees since 1 October 2005 and there are, presently, no longer any guarantees even "outstanding" under that program;

- following carefully the guidance provided by the original panel, the United States imposed a new fee schedule with respect to GSM-102 guarantees under which higher fees are assessed for obligations in higher-risk countries;

- the United States reclassified into an ineligible risk category twenty-two countries posing a higher risk of default that had been eligible for GSM-102 guarantees before 1 July 2005;

- as a result of the changes in the fee schedule, fees have increased 46 percent on average over fiscal year 2004, the last year in which the old fee schedule applied;

- all of the U.S. changes, together, increased the premiums and decreased the likelihood of incurring substantial operating costs and losses over the long-term of the portfolio of programs examined by the original panel; and

- according to the U.S. budget data, premiums under the three U.S. export credit guarantee programs were more than adequate to cover their long-term operating costs and losses even before the United States took steps to implement the DSB's recommendations and rulings and are even more assured of doing so in the future given all of the changes made by the United States.

5. The substantial evidence before the Panel thus shows that the United States is not providing any export subsidies within the meaning of item (j) in Annex I of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement"). Under the proper interpretation of the *SCM Agreement*, the assessment of whether or not export credit guarantees constitute prohibited export subsidies can – indeed should – begin and end with that assessment under item (j).

6. Nothing in Brazil's oral presentation – nor in any of its submissions prior to that – undermine the evidence of profitability before the Panel or the fact that the U.S. export credit guarantee programs are entirely consistent with item (j) of the Illustrative List.[6] Rather, Brazil seeks to invent new obligations not provided for in the *SCM Agreement*, in particular, by asserting a separate standard for "export subsidy" under the general definitional elements of Articles 1.1 and 3.1(a). Even leaving aside that Brazil's approach is unsupported by the text, that approach fails even on its own terms.

A. <u>There Is No Difference Between the Amount Paid On Loans Subject to a GSM-102 Guarantee and Other Comparable Commercial Loans</u>

7. The substantial evidence before the Panel, thus, shows that the United States is not providing any export subsidies within the meaning of item (j). In the view of the United States, under a proper

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[6] The United States does not address here Brazil's arguments attempting to undermine the substantial evidence showing that the U.S. export credit guarantee programs have historically been profitable even without the recent changes made to implement the recommendations and rulings of the DSB. Nor does the United States address Brazil's arguments about export credit guarantees issued prior to 1 July 2005 and rescheduled debt. Brazil's oral presentation contain nothing new in respect of those arguments and the United States has them in its submissions already before the Panel. The U.S. arguments can be found in the U.S. first written submission at paragraphs 71-104, the U.S. Rebuttal Submission at paragraphs 84-133, and the U.S. oral statement at paragraphs 16-49.

interpretation of *SCM Agreement*, the assessment of whether or not export credit guarantees constitute prohibited export subsidies begins and ends with that assessment under item (j).

8. Nothing in Brazil's oral presentation – nor in any of its prior submissions – undermine the evidence of profitability before the Panel or the fact that the United States export credit guarantee programs are entirely consistent with item (j) of the Illustrative List. Rather, Brazil seeks to invent new obligations not provided for in the *SCM Agreement*, in particular, by asserting a separate standard for "export subsidy" under the general definitional elements of Articles 1.1 and 3.1(a). Even leaving aside that Brazil's approach is unsupported by the text, that approach fails even on its own terms.

B. Brazil Fails to Show That There Is a Difference Between the Amount Paid on Loans Subject to a GSM-102 Guarantee and Other Comparable Commercial Loans, and Fails to Rebut the U.S. Evidence in this Regard

9. Article 14 of the *SCM Agreement* sets out the conditions under which a "benefit" may be considered to be "conferred" for countervailing duty purposes and defines how to measure "benefit" in such a case. While Article 14 does not apply directly in the case of actions under Part II of the *SCM Agreement*, it interprets and applies the definition of "benefit" set out in Article 1.1. Thus, the Appellate Body has relied upon Article 14 as important contextual guidance in interpreting "benefit."[7] Indeed, its was Brazil that originally invoked Article 14 to justify its prohibited export subsidy arguments against the export credit guarantees in the present proceeding.[8]

10. Paragraph (c) of Article 14 provides that a government-provided loan guarantee confers a benefit for countervailing duty purposes *only* where there is "a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee." The "benefit" is measured as "the difference between these two amounts adjusted for any differences in fees."

11. Even by this standard, however, Brazil fails to show that the U.S. GSM-102 guarantees constitute prohibited export subsidies. In fact, Brazil does not submit a single piece of evidence to show – with respect to *any* loans subject to a GSM-102 guarantee – that there is "a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee."

12. Moreover, Brazil has failed to rebut the U.S. evidence showing that commercial lenders regularly involved in both the GSM-102 program and other lending in the foreign agricultural sector, in fact, do provide – and have provided – unsecured financing to foreign banks that are CCC-approved obligors on terms the annualized cost of which was less than that available under the GSM-102 program.[9] In fact, Mr. Sundaram, the consultant retained by Brazil for purposes of this proceeding, acknowledged that the examples the United States provided, as supplied by [[ ]], show "lower annualized costs than under GSM-102."[10]

13. While Mr. Sundaram went on to criticize the U.S. examples, his criticism is without basis. According to Mr. Sundaram, the "average life" is allegedly insufficient to capture some hypothesized riskiness that is greater in a three-year term GSM transaction than in a two year bullet payment.[11] However, in each of the examples provided by the United States, the short-term and long-term ratings

[7] *Canada – Aircraft (AB)*, para. 155.

[8] Brazil First Written Submission, paras. 371-375

[9] U.S. First Written Submission, paras. 119-130 and Exhibit US-22; U.S. Rebuttal Submission, paras. 145-170.

[10] Brazil Oral Statement, para. 214

[11] Brazil Oral Statement, para. 219

for each of the banks are comparable.[12] Indeed, Mr. Sundaram acknowledged that the Panamanian and Mexican banks are both "investment grade."[13] Thus, the theoretical difficulty that Brazil tries to create is inapplicable to those comparisons as a matter of fact. Despite Brazil's allegations to the contrary[14], the comparisons offered by the United States are fully "apples-to-apples" comparisons.

14. Moreover, Brazil appears to ignore the pricing of risk inherent in the transactions. While it emphasizes that "fully one-third of the principal remains at risk after two years"[15] in a GSM-guaranteed transaction, Brazil fails to acknowledge that *fully one-third of the principal has been paid* after *one* year in the same transaction. In contrast, the entire bullet payment remains outstanding for the first two years. As a matter of commercial logic, the risk inherent in an obligor's capacity to service debt increases with the amount of debt outstanding. The repayment term of the GSM transaction compels an early payment of principal reducing the outstanding debt.[16]

15. Finally, the United States notes Brazil's assertion that "the examples provided by the United States do not appear to prove anything about the ability of GSM-102's target foreign obligors [allegedly non-investment grade] to secure foreign credit."[17] However, this assertion serves to undermine what has been Brazil's own – entirely unfounded – argument in this proceeding; namely, that the United States allegedly "targets" and services only non-investment grade foreign obligors. The United States welcomes Brazil's acknowledgment that GSM credit guarantees are offered in *many* markets where other financing is readily obtained, including in Mexico and Panama – two of the countries involved in the examples provided by the United States. And the U.S. examples are not the only ones involving investment grade participants in the GSM program; scores of CCC-approved foreign bank obligors enjoy an investment grade rating.[18] Brazil's sweeping assertions that GSM-102 guarantees are provided only where there is no financing available to foreign obligors is undermined not only by the particular examples provided by the United States, but also by this evidence of the large number of investment-grade participants.

C. There is No Basis to Ignore All of Textual Provisions Dealing With Export Credit Guarantees and Loan Guarantees and to Use Instead a "Severable Benefit" Approach Specifically Precluded Under the *SCM Agreement* With Respect to Such Measures

16. Unable to make its case under *any* provision of the *SCM Agreement* dealing either with export credit guarantees or loan guarantees, Brazil essentially asks the Panel to ignore the *SCM Agreement* altogether and to create and impose obligations not found anywhere in the text. Towards this end, Brazil argues that other panels have disregarded the text as well. Brazil's arguments are simply not tenable.

17. Brazil asserts, for example, that the panel in *EC-DRAMs* "agreed that a government guarantee confers a 'benefit' *per se* if without the guarantee, commercial lending would not have been available. Where commercial lending would not have been available without the government guarantee, the panel in *EC-DRAMs* did not require the type of quantitative assessment on which the United States here insists."[19] As a threshold matter, however, that panel did not – indeed, could not – "undo" the disciplines agreed upon in Article 14(c) of the *SCM Agreement*. To the contrary, the *EC-DRAMs*

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[12] U.S. Rebuttal Submission, para. 150.
[13] Brazil Oral Statement, para. 223.
[14] Brazil Oral Statement, para. 222.
[15] Brazil Oral Statement, para. 221.
[16] In fact, GSM-102 guarantees often require semi-annual payments of principal.
[17] Brazil Oral Statement, para. 223. Brazil appears to make the same incorrect and irrelevant point in paragraph 177 of its oral statement.
[18] U.S. First Written Submission, para. 110.
[19] Brazil Oral Statement, para. 194.

panel expressly *acknowledged* the proper approach for the determination of "benefit" in the context of a government guaranteed loan in Article 14(c) of the *SCM Agreement*: "[I]t appears that the examination is to focus on the difference between the amount paid on a loan guaranteed by the government, compared to the amount that would have to be paid on a comparable commercial loan, absent the government guarantee."[20] The panel's ultimate finding – that the EC could properly find a "benefit" where there was no "evidence on the record . . . to contradict the EC's conclusion that, absent the government guarantee, the banks would not have been willing to agree to the [financing] at all"[21] – is entirely consistent with the standard in Article 14(c) of the *SCM Agreement*. But the facts of that dispute are not the same as the facts before this Panel. As the United States has shown, this is *not* a situation where "absent the government guarantee" banks "would not have been willing to agree to . . . [financing] at all."

18. Brazil also cites the panel report in *Canada-Aircraft II* for the proposition that "even in assessing 'benefit' under Article 14(c), the legal standard boiled down to an assessment whether fees for the government guarantee were consistent with fees for commercial guarantees."[22] There, too, however, the panel expressly acknowledged that the appropriate standard was set out in Article 14(c) of the *SCM Agreement*. The panel found that under the circumstances of that dispute, it was "safe to assume" that it the fees charged for the loan guarantee were not "market based," the test in Article 14(c) would be met. Moreover, even while it asserted that it was "safe" to make such an assumption, the panel actually *required* Brazil, as the complaining party, to provide "arguments or information regarding what the [airline] might have had to pay on a *comparable commercial loan* absent the *IQ* loan guarantee."[23] The panel noted that:

> Brazil has made no arguments to the effect that 'there is a difference between the amount that the [Mesa Air Group] pays on a loan guaranteed by [IQ] and the amount that the [Mesa Air Group] would pay on a comparable commercial loan absent the [IQ] guarantee', adjusted for any difference in fees. In particular, although Brazil does not deny that loan guarantees are available on a commercial basis, Brazil has failed to adduce any arguments or information regarding what Mesa Air Group might have had to pay on a comparable commercial loan absent the IQ loan guarantee.[24]

19. On the basis of *that* failure on the part of Brazil – as well as Brazil's failure to "make any other argument to the effect that IQ's fee for its loan guarantee to Mesa Air Group is not market based" – the panel "reject[ed] Brazil's claim that the IQ loan guarantee to Mesa Air Group confers a 'benefit.'"[25]

20. Brazil has, thus, failed to provide any basis for the panel to disregard all of the textual provisions relating to export credit guarantees and loan guarantees and to use, instead, its "severable benefit" approach. As the United States explained in the meeting with the Panel, Brazil's approach fundamentally undermines the drafters' acknowledgment, expressed in Article 14(c), that the provision of a loan guarantee is fundamentally different from the provision of other government services. While a comparison of fees for a government service against the fees charged in the market for a comparable service is the proper approach in the case of other government services – as provided in Article 14(d) – Article 14(c) specifically *precludes* such an approach for loan guarantees. Instead, it recognizes that a loan guarantee is made for the sole purpose of *supporting a loan transaction*; the guarantee becomes an integral part of that transaction and has no value beyond it. An assessment of the total costs of the transaction is necessary to assess whether a "benefit" is actually conferred by the

[20] *EC-DRAMs*, para. 7.190.
[21] *EC-DRAMs*, para. 7.190.
[22] Rebuttal Submission of Brazil, para. 410.
[23] *Canada-Aircraft II,* para. 7.399 (emphasis added).
[24] *Canada-Aircraft II,* para. 7.399.
[25] *Canada-Aircraft II,* para. 7.399.

guarantee. A simple comparison of the fee charged for the issuance of one loan guarantee to the fee charged for another may provide an incomplete and distorted picture in this regard.

D. <u>Brazil's Argument That GSM-102 Guarantees Necessarily Provide a Benefit Because They Constitute a "Unique Financial Instrument" Is Legally and Factually Unfounded</u>

21. In its oral presentation, Brazil once again asserts that the GSM-102 export credit guarantee is "a unique financial instrument without any parallel at market."[26] In Brazil's view, "that is the beginning and end of the analysis" and demonstrates that the GSM-102 program confers benefits *per se*.[27] Brazil has not shown any textual basis for this kind of *per se* test.

22. Indeed, the United States wonders if Brazil has thought through fully the consequences of its argument. If the *SCM Agreement* were found to actually contain the standard advocated by Brazil, one would have expected *Brazil – Aircraft (Article 21.5 II)* to have been decided differently. There, Canada challenged certain "PROEX" interest rate equalization payments made "in support of export credits extended to the purchaser, and not to the producer, of Brazilian regional aircraft."[28] The panel noted that, in those circumstances, Canada could make a *prima facie* showing of "benefit" if it established that "PROEX III payments allow the purchasers of a product to obtain export credits on terms more favourable than those available to them in the market, this will, at a minimum, represent a prima facie case that the payments confer a benefit on the producers of that product as well, as it lowers the cost of the product to their purchasers and thus makes their product more attractive relative to competing products."[29] The panel did not consider whether PROEX payments were a "unique financial instrument." Brazil did not argue there, as it has attempted to do here, that "the beginning and end of the analysis" was the question of whether PROEX III payments were "a unique financial instrument without any parallel at market."[30] Indeed, that question could presumably have been answered fairly easily, because unlike PROEX, commercial actors are not in the business of making payments for nothing.

23. In any event, the United States has provided examples of other international financial institutions – such as such as the European Bank for Reconstruction and Development ("EBRD"), the International Finance Corporation ("IFC"), and the Inter-American Development Bank ("IDB") – that provide similar guarantees to the GSM-102. While Brazil attempts to dismiss these examples by arguing that these entities cannot, by definition, provide commercial products, Brazil's argument is without merit.[31] As the principal basis for this argument, Brazil continues to focus on the ability of such entities to "borrow from government treasuries," asserting that "as a result, public entities tend to enjoy a lower cost of funds than their market-based counterparts."[32] Brazil further suggests that these entities cannot provide commercial products because they "enjoy a guarantee flowing from the full faith and credit of governments."[33]

24. However, Brazil has not shown that the entities identified by the United States rely on such borrowing for their operations or that they enjoy such guarantees from governments. The IFC, for example, receives no sovereign guarantee.[34] Furthermore, the IFC indicates that "the major source of IFC's borrowings is the international capital markets. Under the Articles of Agreement, the

[26] Oral Statement of Brazil, para. 174.
[27] Oral Statement of Brazil, para. 174.
[28] *Brazil – Aircraft (Article 21.5 II)*, para. 5.28, n. 42.
[29] *Brazil – Aircraft (Article 21.5 II)*, para. 5.28, n. 42.
[30] Oral Statement of Brazil, para. 174.
[31] Brazil Oral Statement, para. 187.
[32] Brazil Oral Statement, para. 188.
[33] Brazil Oral Statement, para. 188.
[34] U.S. Rebuttal Submission, para. 166.

Corporation may borrow in the public markets of a member country only with approvals from that member and also the member in whose currency is denominated."[35] Further, "market borrowings are generally swapped into floating-rate obligations denominated in US dollars."[36] EBRD issues medium and long-term debt obligations on the market.[37]

25. Moreover, the ability of an entity to borrow from a government does not necessarily preclude an entity from providing *products* on commercial terms.[38] For example, the panel recognized in *Korea – Commercial Vessels* that:

> The fact that KEXIM may receive subsidized government funding does not mean that it will inevitably provide subsidized financing to its customers. It is possible that KEXIM might charge market rates and increase its profit margin instead."[39]

26. Brazil also asserts that a former U.S. official – specifically, a former Secretary of the U.S. Treasury – has recognized that international financial institutions cannot offer commercial products.[40] However, Brazil's own exhibit shows that the statement referenced by Brazil did *not* relate to any of the international financial institutions noted above, but, rather, to state-owned or controlled "market window" institutions of individual OECD members that restrict financing to national exporters. International financial institutions such as IFC, IDB, and EBRD are fundamentally different entities. They do not operate at the behest of any single government. Indeed, Brazil itself has noted that the IDB is owned by 47 member countries[41]; EBRD by 60 governments[42]; and IFC by 178 member countries.[43] Rather, they operate commercially without benefitting any particular government or citizen constituency. Brazil has provided no legitimate basis for asserting that such financial institutions can never provide commercial products.

27. In short, Brazil fails to show *either* that its "unique financial instrument" test is required under the *SCM Agreement* or that the measures it challenges are in fact "unique financial instruments."

E. Brazil's Argument Would Effectively Render Most, If Not All, Export Credit Guarantees Prohibited Export Subsidies

28. Brazil's ultimate argument appears to be that export credit guarantees are prohibited export subsidies unless there is a purely private bank (like a Citibank, for example) already providing the same export credit guarantees and, even in that case, the guarantees are prohibited subsidies unless the *fees* charged by the private bank for the export credit guarantees are lower than the *fees* charged by the government entity. These assertions are without basis in the *SCM Agreement* and, given the nature of the market for export credit guarantees, would effectively render *all* export credit guarantees provided by any Member anywhere in the world to be prohibited subsidies.

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[35] Exhibit US-79, p. 13.
[36] Exhibit US-79, p. 13.
[37] Exhibit US-77, p.10.
[38] U.S. Rebuttal Submission, para. 156.
[39] *Korea – Commercial Vessels*, para. 7.84.
[40] Brazil Oral Statement, para. 186 and Exhibit Bra-654.
[41] Rebuttal Submission of Brazil, para. 442.
[42] Rebuttal Submission of Brazil, para. 441.
[43] Rebuttal Submission of Brazil, para. 440. Brazil also criticizes the United States for finding "significance in that fact that public entities like the EBRD, IDB and IFC are 'profitable'."Brazil Oral Statement, para. 189. The United States, however, was merely responding to the significance that *Brazil* had ascribed to its assertion that such institutions are incapable of providing commercial products because they are "not a private sector actor motivated by profit." Rebuttal Submission of Brazil, para. 441.

29. As Brazil is well aware, export credit guarantees and other similar loan guarantees are now and have always been instruments provided predominantly – if not exclusively – by governments and international financial institutions, as opposed to purely private banking institutions. It is hardly surprising then that Members would have agreed to a standard for "prohibited export subsidy" in item (j) that imposes disciplines based on the net costs of a program.[44] Nor is it surprising that, in the context of countervailing duty investigations, Members would have agreed to a standard that looks to the effect of a guarantee on the underlying loan. Brazil's efforts to have the Panel ignore the text itself – what Members actually agreed to given the particular nature of the measure and the market – and to impose instead a fee-based comparison to some theoretical purely private bank is untenable.

30. This would effectively render most if not all export credit guarantees to be prohibited export subsidies, in contravention of the express intent of the drafters in item (j) and Article 14(c) of the *SCM Agreement*. Furthermore, Brazil's approach is contradicted by Article 10.2 of the *Agreement on Agriculture*. If the test for being a prohibited export subsidy were as simple as Brazil claims, then there would have been no need for the negotiators of the WTO agreements to have specifically called for the development of international disciplines on export credit guarantees. Indeed, by calling for the development of additional disciplines on export credit guarantees, Article 10.2 of the *Agreement on Agriculture* supports the fact that at present the analysis can – indeed should – begin and end with the disciplines currently in item (j).

31. The ramifications of such an impermissible interpretation are significant. The compliance panel will recall India provides similar services through the Export Credit Guarantee Corporation of India, Ltd. Further examples include the following:

- The Export Finance and Insurance Corporation of Australia, which offers export credit insurance (also subject to item(j)) "when the private market lacks capacity or willingness, filling the market gap."[45] EFIC operates "primarily in that part of the market that is not served by the private market."[46]

- Euler Hermes, the provider of export credit guarantees for the Federal Republic of Germany, provides such products "to support German enterprises to open difficult markets."[47]

- The Korea Export Insurance Corporation – an official export credit agency of Korea – provides "agro-fishery" export insurance that "compensates the losses arising from export transactions and overseas investments that *cannot be handled by the general insurance systems*."[48]

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[44] The United States notes in this regard that in the Illustrative List to the Tokyo Round Subsidies Code, item (j) provided that premium rates could not be "*manifestly* inadequate operating costs and losses of the programs." (Emphasis added). In the Uruguay Round, the negotiators deleted the word "manifestly" from item (j). It is difficult to accept that the negotiators would have gone to the trouble of modifying the standard in item (j) if, as argued by Brazil, that standard could readily be ignored in favour of a different standard.

[45] Export Finance and Insurance Corporation (Australia) - Mission and Objectives; http://www.efic.gov.au/static/efi/corporateinfo/mission.htm (Exhibit US-131).

[46] Export Finance and Insurance Corporation (Australia) - Mission and Objectives; http://www.efic.gov.au/static/efi/corporateinfo/mission.htm (Exhibit US-131).

[47] AuslandsGeschaftsAbsicherung der Budesrepublik Deutschland, Federal Export Credit Guarantees, Basics: Main Features of Export Credit Cover; http://www.agaportal.de/en/aga/grundzuege/grundzuege_exportkredit.html (Exhibit US-132).

[48] Korea Export Insurance Corporation, preface (emphasis added); http://www.keic.or.kr/homepage2/english/main.html. (Exhibit US-133); *see also* East-West Debt: "about the Korea Export Insurance Corporation" http://www.eastwest.be/east_west/keic.htm (Exhibit US-133).

- Banco Nacional de Comercio Exterior of Mexico, a bank "owned by the Mexican government, offers "export credit insurance to cover Mexican firms against default of credit sales to foreign [] customers."[49]

32. Are each of these Members, as well as scores of other Members, breaching their WTO obligations simply because purely private banks do not now, and have not historically, operated in this particular segment of the market? Brazil has utterly failed to show anything in the text of the *SCM Agreement* indicating that Members agreed upon such an absurd result.

33. The text confirms, instead, that the standards reflected in item (j) provide the exclusive test for whether export credit guarantees provide prohibited export subsidies. As discussed above, in the U.S. submissions, and in the meeting with the Panel, the U.S. budget data show – definitively – that premiums collected under the U.S. export credit guarantee program are more than adequate to cover the long-term operating costs and losses of the programs. In short, the United States is fully in compliance with the standard in item (j).

III. BRAZIL HAS FAILED TO ESTABLISH ITS CLAIMS REGARDING THE STEP 2, MARKETING LOAN, AND COUNTER-CYCLICAL PAYMENT PROGRAMS AND ALL PAYMENTS THEREUNDER

34. Brazil's "oral" presentation also fails to remedy the fact that Brazil has provided virtually *no empirical evidence* to support its claims that (a) termination of the Step 2 program "will likely have *no impact* on the level of U.S. production or exports" and "*little positive impact* on the world price for cotton in the long term;"[50] or (b) that "the effect" of U.S. marketing loan and counter-cyclical payment programs is "present" significant price suppression within the meaning of Article 5(c) and 6.3(c) of the *SCM Agreement*.

A. Brazil's Arguments About the Effects of the Step 2 Program and World Market Price Effects Continue to Shift

35. Although Brazil has argued throughout the original panel proceedings and in this proceeding that allegedly high levels of U.S. exports are the cause of significantly suppressed world market prices[51], Brazil attempts now to change its basic theory of significant price suppression. Indeed, it does so after having attempted to simply dismiss the evidence of declining U.S. exports as a temporary phenomenon that was simply a function of U.S. producers "cleaning out the stocks in their warehouses" prior to the termination of the Step 2 program.[52] In the face of the substantial countervailing evidence, Brazil has been forced to seek a new theory to fit the facts. In its "oral" presentation, Brazil now argues that it is increasing U.S. stocks of upland cotton – not the export of U.S. cotton – that is suppressing world market prices.

36. Brazil has submitted no evidence – or even fully laid out the arguments – to support its 11th hour theory of significant price suppression. And Brazil cannot simply transpose its earlier arguments regarding the effects of exports. While stocks of any commodity are an important factor influencing the world supply and demand balance and, therefore, prices, there is no basis – and Brazil has not provided any – for suggesting that an increase in stocks can have the same impact on world

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[49] Bancomext 2005 Annual Report, pp. 2, 26; http://www.bancomext.com/Bancomext/publicasecciones/secciones/7304/AnnualReportBancomext2005.pdf (Exhibit US-134).

[50] Brazil First Written Submission, para. 206 (quoting Brazil First Written Submission, Annex II, paras. 41-43).

[51] *See, e.g.*, Brazil First Written Submission, para. 2.

[52] Brazil Rebuttal Submission, para. 82.

market prices as actual exports. When stocks are held – *i.e.*, are removed from trade on the world market – any possible impact on prices is necessarily substantially less than if they were being traded.

37. Moreover, the price impact of existing U.S. stocks is necessarily greater *within* the United States than it is in the world market. And, consistent with this, U.S. prices have been lower than normal in relation to the A index almost throughout the entire 2006 marketing year.[53] Between August 2001 and July 2005, the A Index averaged 4.69 cents above the nearby NY futures. Since August 2006, the "A" has averaged between 5 and 10 cents above NY futures.[54] As a result of this and other market signals, U.S. producers are reducing plantings. Returns to cotton producers are below expectations and plantings in the United States are expected to decline 14 percent or more in 2007.[55] In short, the evidence concerning the effects of stocks on U.S. prices and the corresponding response of U.S. farmers is *not* consistent with Brazil's new theory that U.S. stocks are suppressing world market prices.

38. This conclusion is reinforced when one considers other factors in the world market. For example, *total* world stocks are expected to decline in 2006 from 2005 levels.[56] Moreover, the world stocks-to-use ratio for cotton has declined for the second year in a row, meaning that the world is using more cotton than is being produced.[57] This is consistent with the fact that world market prices are rising and are expected to continue to do so. While Brazil asserts these prices should be even higher, it has offered no evidence – other than unfounded allegations by its hired economist – to support that assertion.

39. Similarly, the behaviour of other market participants – including Brazil – does not evidence any perception of significant price suppression as a result of U.S. stocks. To the contrary, Brazil and India are expected to increase production in 2007, with recent reports from Brazil anticipating a near-record crop in 2007.[58] By planting and producing more cotton in 2007, India's and Brazil's farmers would appear to be receiving positive signals from current world prices. U.S. production, meanwhile, decreased in 2006, exports are declining in 2006, and U.S. planting is expected to decline substantially in 2007. Again, these are not facts indicative of significant price suppression as a result of U.S. stocks.

40. Thus, Brazil's last minute theory that U.S. *stocks* – not exports – are causing significant price suppression is unsupported by evidence.

B. Brazil's Arguments About the Alleged Effects of the Marketing Loan and Counter-Cyclical Payment Programs Are Misleading, and the Evidence Brazil Submits Actually Confirms the U.S. Position Regarding the Marketing Loan and Counter-Cyclical Payment Program

41. Brazil's "oral" statement seeks to respond to the U.S. observation that Brazil has failed to provide an evidentiary basis for its claims that the marketing loan and counter-cyclical payment programs are presently causing significant price suppression. Brazil asserts that certain allegedly

[53] Daily A-Index and NY Futures Price Data (Exhibit US-135).

[54] Daily A-Index and NY Futures Price Data (Exhibit US-135).

[55] National Cotton Council 2007 Acreage Survey available at http://www.cotton.org/econ/reports/intentions.cfm.

[56] USDA Foreign Agricultural Service, Cotton: World Markets and Trade, February 2007 (available at http://www.fas.usda.gov/currwmt.asp).

[57] USDA Foreign Agricultural Service, Cotton: World Markets and Trade, February 2007 (available at http://www.fas.usda.gov/currwmt.asp).

[58] ICAC Cotton This Month (1 March 2007) (Exhibit US -136).

"key" pieces of evidence support its claims of a breach of Articles 5(c) and 6.3(c) of the *SCM Agreement*.[59] None of this evidence withstands scrutiny, however.

1. None of the Evidence Submitted By Brazil Regarding the Nature, Magnitude and Effects of the Marketing Loan and Counter-Cyclical Payments Indicates That the Payments Are Having Significant Price Suppressive Effects

42. ***Counter-cyclical Payments:*** Brazil's "oral" presentation contains no empirical evidence to support Brazil's claims that counter-cyclical payments are having significant production- or export-inducing effects, or that they are significantly suppressing world market prices. Indeed, Brazil's "empirical evidence" appears to consist of little more than the naked assertion that counter-cyclical payments "restrict planting flexibility," "reduce the risk associated with producing the base crop" "increase the ability of farmers to invest in production-enhancing equipment" and "smooth revenue flow. . . and ease access to credit."[60] While all these things may well be true to some extent, Brazil has not explained why they support a finding that the payments cause significant price suppression. Indeed, almost all of these consequences asserted by Brazil also can be attributed to direct payments and, indeed, to *any* payment to a producer of a crop. The *exact* same planting flexibility restrictions apply in the case of both direct and counter-cyclical payments. Moreover, *any* payment to producers will "increase the ability of farmers to invest in production-enhancing equipment," "smooth revenue flow. . . and ease access to credit."[61] However, those factors did not support any finding of significant price suppression with respect to direct payments in the original proceeding. And, in indeed, the negotiators of the WTO agreement expressly found that Members could provide a whole range of payments to agricultural producers, all of which presumably would have the general effects Brazil attributes to counter-cyclical payments, and yet still have "no, or at most minimal, trade-distorting effects or effects on production."[62]

43. Indeed, from a structural standpoint, Brazil recognizes that the "crucial difference" between the direct and counter-cyclical payments is that the farmer is assured of receiving the former each year but not the latter, because counter-cyclical payments are provided only if the season-average farm price ends up being below the threshold set out in the statute.[63] As the United States has explained in response to questions from the Panel, some analysts have examined whether this difference results in any substantial differences in the *effects* of the two programs, and they have concluded that it likely *does not*.[64] For example, Westcott *et. al.* determined that the link to prices may, in some circumstances, result in indirect production effects stemming primarily from lowered risk of price volatility. However, they concluded that the degree of any such production effects is likely to be minimal and mitigated by a number of factors including that:

(a) where prices are expected to be above maximum threshold – counter-cyclical payments behave just like the fixed direct payments[65];

(b) "cross-commodity effect[s] suggest[] that CCPs may provide a general reduction in revenue risks rather than a crop-specific effect. Net returns among alternative crops would remain the primary consideration underlying production choices;"[66]

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[59] Brazil Oral Statement, para. 25.
[60] Brazil Oral Statement, para. 41.
[61] Brazil Oral Statement, para. 41.
[62] *See* Annex 2 of the *Agreement on Agriculture*.
[63] Brazil Oral Statement, para. 50.
[64] *See* U.S. Answers to Parts D-E of the First Set of Panel Questions, para. 27 (6 March 2007).
[65] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 203 (Exhibit US-35).

(c) "while a number of studies indicate that farmers are risk averse (Chavas and Holt, 1990, 1996, for example), other risk reduction instruments already exist to manage risks. Thus, with revenue risk reduction now provided by CCPs as part of farm programs, farmers may adjust their use of these other farm and nonfarm risk management strategies;"[67] and

(d) "a large portion of output in the U.S. agricultural sector is produced by a small share of large producers. . . . Evidence that risk aversion decreases as income rises (Chavas and Holt, 1990, 1996) suggests that risk aversion may also tend to decline as the size of farms increases. Thus, with larger farms that account for most production being less averse to facing risk, this lowers potential production effects of CCPs due to risk reduction. And while smaller farms may be more risk averse in their farm enterprise, off-farm income may reduce the overall level of household income risk."[68]

44. Studies looking to the actual effects of counter-cyclical payments confirm their minimal impacts on planted acreage and production. For example, as the United States has explained, a 2007 study by Lin & Dismukes found that "[t]he effect of CCPs on producers' planting decisions . . . appears to be *very negligible* – an increase in the acreage of major field crops of less than 1% ... ."[69] The United States has submitted this and other studies examining the empirical evidence regarding the actual effects of counter-cyclical payments on corn, wheat, and soybean producers in recent years, including MY 2005, the marketing year on which Brazil has placed special emphasis. The United States also has provided studies taking a more qualitative assessment of the question at hand.[70] These studies support a finding that counter-cyclical payments have – at best – minimal effects on plantings and production (and, thus, are likely to have negligible effects on world market prices).

45. In its unsolicited third written submission – BRA-659 – Brazil asks the Panel simply to disregard all of these studies.[71] For the reasons discussed above, Brazil's submission was made in breach of the Panel's working procedures and is not properly part of the record before the Panel. Nonetheless, the United States would make the following points as to why the arguments made by Brazil therein are unavailing. Brazil complains that the studies do not relate specifically to counter-cyclical payments made in respect of upland cotton. However, as the United States has explained, there is no reason why that should preclude the Panel from considering the studies as being highly relevant.[72] Indeed, Brazil has not submitted any evidence – save for the unsupported assertions of its

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[66] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 204 (Exhibit US-35).

[67] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 204 (Exhibit US-35).

[68] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 204 (Exhibit US-35).

[69] Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter-cyclical Payments' Production Impacts," *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 83 (Exhibit US-85) (emphasis added).

[70] U.S. Rebuttal Submission, para. 226-252.

[71] Supplementary Statement of Daniel Sumner, paras. 18-38.

[72] Brazil also makes the inexplicable argument that a number of the studies submitted by the United States are not relevant because they allegedly do "not examine whether CCPs are decoupled from production. Rather, [they] examine whether CCPs increase acreage." Supplementary Statement of Daniel Sumner, para. 21. Brazil applies this criticism, for example, to the 2007 study by Lin & Dismukes finding "very negligible" increases in the acreage of major field crops. Brazil appears to be confused about its own claims and arguments in this proceeding. As the United States understands it, Brazil's claim here is that marketing loan and counter-cyclical payments are presently significantly suppressing world market prices. Brazil's theory to support this claim has been that these payments affect the planting decision, causing U.S. producers to plant more than they otherwise would and that this ultimately leads to oversupply and suppressed world market prices. It is remarkable, therefore, that Brazil would attempt to *dismiss* studies because they look at effects of payments on

hired economist – to show that the effects would be substantially different in the case of upland cotton, especially given that *no base acre holder has to produce anything, let alone the base crop, in order to receive any payments under the program*. More importantly, Brazil appears to forget that *it is Brazil that bears the burden of proving its claims in this proceeding*. Indeed, while Brazil insists that only cotton-specific studies may be considered as relevant, Brazil has not itself provided *a single* study that examines the actual effects of counter-cyclical payments made specifically in respect of upland cotton production. Moreover, what studies Brazil has provided do not detract from the substantial evidence showing that – as a matter of fact – counter-cyclical payments have minimal acreage and production effects.[73] Therefore, Brazil's allegations of significant planting effects are just that – allegations. They are supported neither by the empirical evidence nor any studies conducted in light of such evidence.

46. Brazil has no answer either to the studies finding that a substantial part of counter-cyclical payments are capitalized into land values and land rents. Although Brazil argues that the Panel should simply disregard this evidence, Brazil has not explained why the following conclusion of the OECD is not valid and entirely relevant to the question at hand:

> Empirical work suggests that PFC and MLA payments had a significant effect on land values and rental rates. Given the importance of the rental market for land in the United States, it appears that *there was a relatively high "pass-through" of the additional income generated by the payments to landowners, many of whom are not the actual operators of the land*. It appears that the payments primarily had the effect of increasing the value of the principal fixed asset in agriculture—land.[74]

47. Indeed, the United States recalls that Brazil has argued that the more certainty there is about whether payments will be received, the more likely they are to be capitalized into land values and

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acreage and suggest that what is relevant is some undefined inquiry into whether payments are "coupled" to production (an inquiry, incidentally, that has no basis in the text of Articles 5(c) and 6.3(c)).

[73] Indeed, the study that Brazil has touted as "more recent and more relevant" than the numerous studies submitted by the United States does not even examine the behaviour of actual farmers – let alone upland cotton farmers. *See* McIntosh, Christopher R, Jason F. Shogren and Erik Dohlman,"Supply Response to Counter-Cyclical Payments and Base Updating under Uncertainty: An Experimental Study,: forthcoming paper in the *American Journal of Agricultural Economics,* November 2006, page 18 (Exhibit BRA-565). Rather, it looks to the results of a laboratory experiment conducted using University students as "laboratory decision-makers." Brazil criticizes the United States for allegedly "attempt[ing] to discredit research findings in economics simply because they derive from controlled experiments." Supplementary Statement of Daniel Sumner, para. 38. According to Brazil, this is "30 years out of date." Supplementary Statement of Daniel Sumner, para. 38. However, Brazil makes no effort to reconcile this view with its own arguments that U.S. studies should be dismissed if they do not examine the precise acreage responses of *upland cotton* farmers. Nor does Brazil address the fundamental limitations noted by authors themselves in respect of the laboratory experiment. *See* McIntosh, Christopher R, Jason F. Shogren and Erik Dohlman,"Supply Response to Counter-Cyclical Payments and Base Updating under Uncertainty: An Experimental Study,: forthcoming paper in the *American Journal of Agricultural Economics*, November 2006, page 18 (Exhibit BRA-565) ("Our design did not address two features of the 2002 Act which could affect the interpretation of our results. First, there are no adjustments made in our bonuses for the fact that direct and counter-cyclical payments are made only on a percentage (85 percent) of base acres. If these adjustments were incorporated, the lump sum bonuses would have been lower, implying our results could overstate the effects of CCPs. Second, we excluded the marketing loan program to focus on the basic CCP structure—target price, market price, and direct rate. Adding the marketing loan program into our design would temper the basic effects of CCPs by providing an additional price support mechanism.")

[74] Abler, David, and David Blandford. A Review Of Empirical Studies Of The Acreage And Production Response To US Production Flexibility Contract Payments Under The Fair Act And Related Payments Under Supplementary Legislation, Directorate For Food, Agriculture And Fisheries Committee For Agriculture, OECD, Paris, AGR/CA/APM(2004)21/FINAL, p.17 (25 March 2005) (Exhibit US-32) (emphasis added).

rents.[75] Given that MLA payments were provided as part of *ad hoc* legislation – unlike counter-cyclical payments which have been established well ahead of time as a part of the FSRI Act of 2002 – farmers were presumably even less likely to have anticipated MLA payments than counter-cyclical payments. Thus, the degree of capitalization into land values and rents is presumably even *greater* than that found in the OECD study for MLA payments. And, as the OECD study concluded:

> If PFC and MLA payments were captured largely by landowners through higher land values and land rents, then the scope for these payments to influence agricultural production would be narrowed. Farmers renting land would not be able to use payments associated with their rented land to cover fixed or variable costs. These farmers would be no more able to secure capital from traditional lenders than in the absence of the payments. They would see no increase in wealth, at least on the land that they rent, ruling out a risk-related wealth effect. Expectations of future payments associated with rented land would not affect decisions by renters because they would not capture these payments. The payments would not affect a renter's decision to remain in or to exit from agriculture, although they could affect a landlord's decision to keep land in agriculture.[76]

48. Brazil's only response to this evidence is that it is "mathematically impossible" that direct and counter-cyclical payments "are capitalized into land rents and captured by the land owner."[77] Brazil has not explained why – if this were so – the OECD could have come to such a fatally flawed conclusion (especially given that the OECD conclusions cited above were actually reached after reviewing a *number* of different studies all examining the pass-through effects of PFC and MLA payments).

49. In fact, the flaw is in the data that Brazil uses to allege its "mathematical impossibility." As the United States explained in its rebuttal submission, instead of examining actual land rents – as Brazil purports to do – Brazil actually considers an *imputed* economic cost to land that the USDA calculates by valuing the alternative uses of the asset (for example, renting it to another producer).[78] To make matters worse, Brazil looks at average imputed rental values for land on farms *with* payment base acres and *without* payments base acres, despite the fact that the former would have a substantially higher rental value precisely *because* of the payments associated with them. Brazil's response that *different* levels of payments are made on different base acres because of differences in historical yields misses the point entirely, and is no justification for comparing farmland linked to payment base with farmland *not* linked to payment base acres as Brazil attempts to do.

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[75] Brazil Rebuttal Submission, para. 146.

[76] Abler, David, and David Blandford. A Review Of Empirical Studies Of The Acreage And Production Response To US Production Flexibility Contract Payments Under The Fair Act And Related Payments Under Supplementary Legislation, Directorate For Food, Agriculture And Fisheries Committee For Agriculture, OECD, Paris, AGR/CA/APM(2004)21/FINAL, p.17 (25 March 2005) (Exhibit US-32).

[77] Brazil Oral Statement, para. 46.

[78] U.S. Rebuttal Submission, para. 259.

50. While it is sparse, it is also instructive to consider the type of evidence that Brazil actually *does* rely upon to support its claims regarding counter-cyclical payments. Brazil invokes as evidence of "present" significant price suppression resulting from counter-cyclical payments, a statement made *in February 2001 – i.e.,* before either the 2002 FSRI Act or the counter-cyclical payments authorized thereunder went into effect – by a National Cotton Council representative about *emergency relief provided under the FAIR Act of 1996* as to whether that relief helped cotton farmers "avoid bankruptcy" in the period MY 1999-2001.[79] This statement – quoted out of context – about emergency relief under the FAIR Act of 1996 including production flexibility contract payments, marketing loss assistance payments, and disaster payments, offers no insight regarding the role of counter-cyclical payments in production decisions or about U.S. farmers' costs and revenues today. Certainly it does nothing to detract from the actual data regarding "present" costs and revenue, which, as discussed below, flatly contradict Brazil's claims that U.S. upland cotton farmers would be bankrupt without the marketing loan and counter-cyclical payment programs. In fact, while this "evidence" makes no substantive contribution to the issues before the Panel, the fact that this is the type and quality of "empirical evidence" upon which Brazil must rely speaks volumes about the lack of an evidentiary basis for Brazil's claims.

51. ***Marketing Loan Payments:*** Brazil's arguments regarding marketing loan payments are no more availing than its arguments about the counter-cyclical payments. Indeed, rather than providing actual evidence regarding the effects of the marketing loan payments, Brazil attempts to simply sidestep the issue by, again, (a) asserting that the matter has already been resolved by the original panel while at the same time (b) mischaracterizing the U.S. arguments to avoid engaging on the real issues at hand. Brazil's approach lacks merit.

52. First, the United States reiterates that the question of whether or not marketing loan payments are causing "present" significant price suppression today was not considered by the original panel. To the contrary, that panel expressly declined to consider the effects of any future payments allegedly "mandated" to be made under the Step 2, marketing loan, and counter-cyclical payment programs. The original panel also declined to consider whether the marketing loan and counter-cyclical payment *programs* would necessarily have adverse effects in the future; a finding that – by Brazil's own admission – would have been *required* for the original panel to have made a finding against the programs as such.[80] Moreover, as Brazil has conceded, the market conditions that existed at the time of the original proceeding are very different from those that prevail at present.[81]

53. Indeed, the market conditions are even more different now than Brazil cares to admit. The Step 2 program is no longer in effect, and since the termination of the program, U.S. exports in

[79] Brazil Oral Statement, para. 43.

[80] For example, in the case of its claims against the challenged programs, *per se*, Brazil asked the Panel "to find that the mandatory provisions of the 2002 FSRI Act and the 2000 ARP Act together with their implementing regulations, as listed above, *cannot be applied in a WTO consistent manner*." Brazil's 9 September 2003 Further Submission, para. 435-436. Explaining what this would mean in the context of this dispute, Brazil argued "[f]irst, the Panel needs to evaluate whether the U.S. subsidies will *necessarily threaten* to cause serious prejudice at price levels below the trigger prices of the U.S. subsidies. Second, the Panel needs to consider whether the U.S. subsidies threaten to cause serious prejudice *even at price levels at which only crop insurance subsidies and direct payments are made*." Brazil's 9 September 2003 Further Submission, para. 426 (emphasis added). The original panel did not conduct the requested evaluation and did not make the requested findings.

[81] *See* Brazil Rebuttal Submission, paras. 235-236 (In an effort to excuse itself from having even to show any *coincidence* of U.S. payments and price suppression, Brazil argued that "the underlying statutory and regulatory bases for U.S. upland cotton subsidies and market conditions provided the original panel with a fairly dynamic environment in which to examine temporal coincidences. The period MY 2001-2005 (principally under the FSRI Act of 2002) was more stable. After MY 2001, it did not involve the same extreme declines in the world market prices for upland cotton or significant additional increases in the U.S. share of world production and exports, compared to the period MY 1998-2002.")

MY 2006 are sharply lower than in recent years. U.S. exports for MY 2006 are *down 30 percent* from the levels observed at the same time last year.[82] Weekly cotton sales are *31 percent below* the 5-year average.[83] And total U.S. export commitments are currently approximately *40 percent below* last year's level and *27 percent* below the 5-year average.[84] Forecasts for the future are similarly gloomy. As the United States explained in the panel meeting, in February, USDA lowered the U.S. cotton export forecast for MY 2006 by nearly 8 per cent, following a 2 percent downward revision in January.[85] These downward revisions are taking place at the same time that USDA estimates record *high* foreign cotton mill use, which means that U.S. share of foreign consumption is expected to drop from 16 percent in MY 2005 to 12 percent in MY 2006. Moreover, U.S. share of world exports is expected to drop from 40 percent in MY 2005 to 36 percent in MY 2006. U.S. domestic mill use for MY 2006 is projected at just 5 million bales, the lowest since MY 1931. The declining demand for U.S. upland cotton is also being reflected in planting and production decisions. The annual survey of planting intentions conducted by the National Cotton Council indicates that U.S. upland cotton plantings are likely to be down an average of 14 percent in MY 2007 from 2006 levels.[86]

54. To the extent that Brazil asserts that the original panel already examined and resolved the question of what effects the marketing loan has under such market circumstances as prevail now, the United States submits that Brazil's argument is wholly without merit.

55. Second, it is astonishing that Brazil yet again asserts that "the United States never explains how marketing loan subsidies could have no effect on producers' decision to plant cotton ... ."[87] Not only has the United States never *alleged* that " marketing loan subsidies could have no effect on producers' decision to plant cotton,"[88] but the United States and Brazil's own economist appear to agree on precisely the conditions under which marketing loan payments might affect producers' decision to plant cotton. Specifically, to determine whether marketing loan payments have effects in any given year, it is necessary to examine the planting decisions made by U.S. producers in light of the conditions as they existed as of the time of planting for each marketing year (i.e., January-March).[89] A producer's expectations at that time about market revenue and/or revenue from government payments, costs and other factors will determine whether cotton or some other crop is planted, or if the land is put to other use. Brazil conceded this point both in this proceeding[90], and in the original proceeding.[91]

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[82] Weekly Export Performance Report for week ending February 15, 2007 (Exhibit US-113).

[83] Weekly Export Performance Report for week ending February 15, 2007 (Exhibit US-113).

[84] Weekly Export Performance Report for week ending February 15, 2007 (Exhibit US-113).

[85] February 2007 World Agricultural Supply and Demand Estimates (WASDE) Report (Exhibit US-114).

[86] National Cotton Council Planting Intentions Survey MY 2007 (Exhibit US-115).

[87] Brazil Oral Statement, para. 35.

[88] This is the second time that the United States has addressed the same mischaracterization of the U.S. position. *See e.g.,* U.S. Rebuttal Submission, para. 268 ("Brazil's rebuttal arguments about the structure, design, and operation of the marketing loan program are, yet again, premised on a mischaracterization of the U.S. arguments. Brazil asserts that 'the United States argues that upland cotton producers do not expect to receive marketing loan payments. . . .The United States argues that marketing loan payments . . . have no effect on planted acreage, no effect on production, no effect on exports, and no effect on the world price of cotton.' Brazil Rebuttal Submission, para.101. This is not what the United States has argued and the United States respectfully refers the Panel to the U.S. first written submission at paragraphs 203-225 where the actual U.S. arguments are set out in detail.")

[89] *See e.g.,* Cotton Percent Planted, 15 Selected States (Exhibit US-44).

[90] *See* Brazil First Written Submission, Annex I, para. 36 ("U.S. cotton producers respond to the *expected* prices and *expected* rates of subsidy that apply at the time planting and other key decisions are made in the production cycle") (emphasis added) and Brazil First Written Submission, Annex I, para. 58 ("[t]he magnitude of the impact on incentives to produce cotton is equal to the *expected* difference between the loan rate, which is known at planting time, and the grower's *expectations* at the time of planting about the AWP for

56. Nonetheless, while Brazil agrees with the United States as to the correct analysis, Brazil continues to present evidence that directly contradicts this analysis. For example, in its "oral" presentation, Brazil alleges that marketing loan payments in MY 2005 were 29 percent higher than in MY 2002 and, according to Brazil, this "*alone* strongly suggests that its effects on U.S. production and exports as well as on world market prices are much greater [than in the period before the original panel]."[92] Yet Brazil concedes that the *effects* of the marketing loan payments are a function of expectations regarding payments, not actual payments received. Indeed, in its modeling exercise purporting to examine the effects of marketing loans, Brazil's economist does not even include actual payments, explaining:

> U.S. producers respond to revenue they expect to receive from market prices and expected government subsidies, where relevant expectations are those that are held around the time that planting and other key production decisions are made. U.S. producers do not know with certainty what actual prices and subsidies will turn out to be as they unfold during the marketing year. *Therefore, as in reality, the model assumes that actual prices or subsidies in a marketing year do not affect cotton growers' behaviour in that marketing year.*[93]

57. It is telling that Brazil repeatedly misstates the U.S. position and continues to offer evidence that is fundamentally at odds with the correct analysis of possible price effects (which it has expressly acknowledged). The fact is that Brazil has not – indeed, cannot – show that U.S. cotton producers' expectations regarding marketing loan payments in have actually led to "present" significant shifts in planting. Indeed, as discussed next, the data submitted by Brazil regarding producers' expected revenues and costs show that producing upland cotton was both economically viable and rational in every year under the FSRI Act, including MY 2006 (the relevant year for purposes of Brazil's "present" serious prejudice claims).

2. *The Cost of Production Analysis Submitted By Brazil Is Fundamentally Flawed and the Proper Assessment of the Data Supports the U.S. Argument That Marketing Loan and Counter-Cyclical Payments Are Not Having Any Significant Price Suppressive Effects*

58. The centerpiece of Brazil's oral presentation regarding serious prejudice is a series of six charts[94] and accompanying discussion that Brazil presents to show the allegedly "economically irrational business of growing cotton in the United States within marketing loan and CCP subsidies."[95] Brazil submits that this evidence establishes that U.S. upland cotton producers would not plant upland cotton and could not survive without marketing loan and counter-cyclical payments. As the United States shows below, however, Brazil's analysis is inconsistent with the economic literature regarding the role of costs in planting decisions, the findings of the Appellate Body regarding the relevance of variable versus total costs, and the approach taken in all econometric models of which the United States is aware that look to costs as a factor in planting decisions (including Brazil's own model in the original proceeding). Indeed, viewed consistently with the principles recognized therein, the data show that (a) upland cotton producers expected and were able to meet their variable costs in every

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cotton that will apply when the grower makes that marketing loan transaction.") (emphasis added). Brazil Further Submission, Annex I, para. 17-18.

[91] *US – Upland Cotton (AB)*, para. 440 ("Brazil counters that farmers decide what to plant based on expected market prices as well as expected payments under the challenged subsidy programs, such that planted acreage responds to both these factors.")

[92] Brazil Oral Statement, para. 31.

[93] Brazil First Written Submission, Annex I, para. 4 (emphasis added).

[94] In fact, there are only three charts, with a second associated chart for each that isolates one of the columns therein.

[95] Brazil Oral Statement, para. 57 and paras. 57-91.

year under the FSRI Act solely with market revenue; (b) that upland cotton was the most attractive crop from a cost/revenue perspective in most years; (c) upland cotton producers met and exceeded even their *total* cash costs in almost every year under the FSRI Act of 2002.

59. What Brazil's analysis lays bare is not the "economically irrational business of growing cotton in the United States within marketing loan and CCP subsidies,"[96] as Brazil alleges, but rather the distortive and unfounded nature of Brazil's cost analysis.

a. Variable costs – not total costs – are the relevant measure in assessing year-to-year planting decisions

60. It is useful to begin with a summary of what Brazil purports to show. Specifically, Brazil asserts that it is providing: (a) a chart showing expected market revenue net of total costs of production for corn, soybeans, and cotton in MY 2005; (b) a chart showing expected market revenue net of total costs of production for corn, soybeans, and cotton in MY 2007; and (c) a chart showing average market revenue net of total costs of production for corn, soybeans, and cotton in MY 2002-2006. Brazil argues that in each of these time periods, U.S. farmers would have lost money *across the board* producing *any* of these crops (or would have expected to do so) "but for" marketing loan and counter-cyclical payments. According to Brazil, this analysis shows that U.S. farmers producing cotton, soybeans, or corn can only survive because of those payments. Brazil further alleges that it is only when those payments are taken into account that *upland cotton* becomes an attractive crop relative to the others. Brazil is wrong.

61. Even before addressing the numerous technical flaws in Brazil's analysis, it is useful to put Brazil's argument in perspective; in particular, the remarkable assertion that U.S. farmers could not produce *soybeans*, *corn*, or *cotton* in the United States in any of the periods examined absent marketing loan and counter-cyclical payments. Indeed, although the United States has almost one billion acres of farmland, and although corn and soybeans were two of the top five top agricultural commodities in MY 2005, Brazil would have the Panel believe that producing those crops and cotton – indeed, perhaps even agriculture itself – is an ""economically irrational business" in the United States. This premise is simply untenable. In fact, it demonstrates precisely the flaws in the analysis presented by Brazil – that ***total costs in each year are <u>not</u> the proper considerations in assessing the viability of farmer's year-to-year planting decisions***.

62. Rather, for a farmer, the relevant costs in deciding what to plant in each year are variable costs of production. Recall the simplified example examined in the first U.S. submission of a farmer deciding in January of a particular year whether to plant all soybeans, some soybeans and some cotton, all cotton, or to allow the land to sit idle. This farmer will consider, *inter alia*, the expected price of cotton at harvest, the expected price of soybeans at harvest, as well as the anticipated costs of growing each crop. In so doing, he does not need to consider fixed asset and overhead costs. He has already incurred those costs; they will not differ based on whether the farmer plants soybeans, cotton, a mix, or nothing. Rather, the farmer will consider projected net revenues taking into account costs for such items as seed, fertilizer, chemicals, and other expenses that are directly related to planting, harvesting, and marketing each crop. The economically rational decision for him will be to plant the crop, or mix of crops, that *both* covers his variable costs *and* maximizes his net revenue. In other words, the farmer will choose the option that gives him the largest margin above variable costs. This will not only allow him to cover his variable expenses but will also give him the most revenue to pay down total costs.

63. That variable costs are the relevant consideration in year-to-year planting decisions is well-accepted in agricultural economics. The United States discussed the extensive literature in this regard

[96] Brazil Oral Statement, para. 57 and paras. 57-91.

in its submissions to the panel in the original proceeding.[97] To supplement that discussion, the United States submits two other studies that confirm that variable costs are the appropriate consideration in assessing year-to-year planting decisions.[98] Considering the evidence submitted earlier in the dispute, the Appellate Body expressly recognized that:

> We agree with the general proposition of the United States that *variable costs may play a role in farmers' decision-making as to whether to plant upland cotton or some alternative crop, and how much of each crop to plant.* From a short-term perspective, variable costs may be *particularly important*.[99]

64. Moreover, the fact that variable costs – not total costs – is the appropriate measure is also evidenced by the fact that there is *no economic model* of which the United States is aware that uses total costs in its supply response equations (that is, to examine the planting decision). Indeed, FAPRI uses variable costs in its modeling framework. And even Brazil's model in the original proceeding – purportedly based on the FAPRI model – used variable costs in the net revenue equation that determined the planting decision of farmers.

65. Thus, there is no basis whatsoever for Brazil's use of total costs to examine planting decisions in any particular year.

b. U.S. farmers expected to meet and exceed variable costs in each year, and in most years upland cotton was the most attractive option

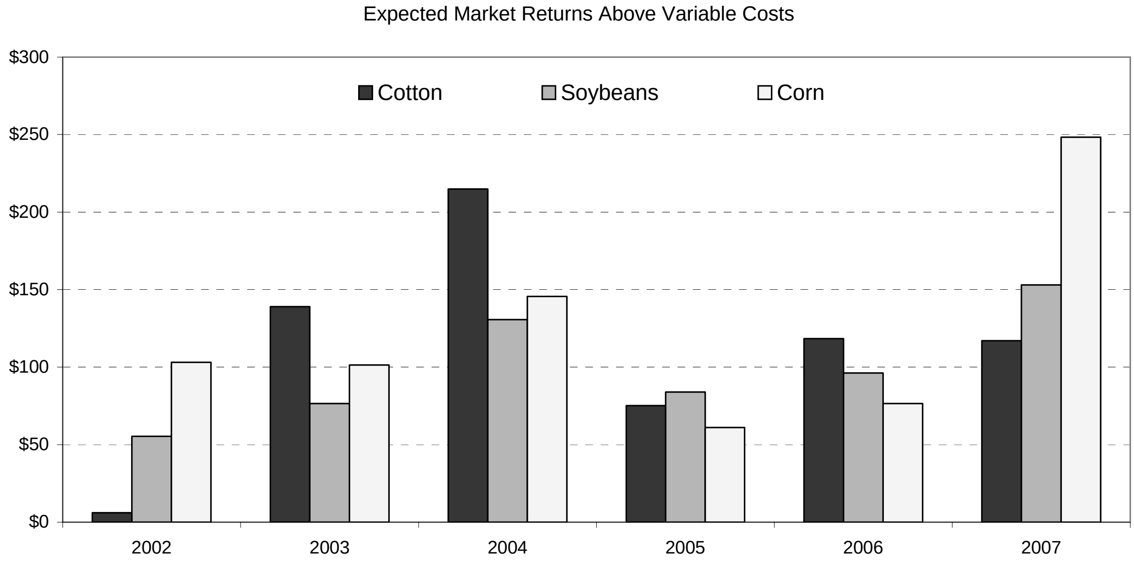
66. When a proper examination is undertaken regarding the expected returns and variable costs, the data show that U.S. farmers expected to cover their variable costs regardless of whether they decided to grown cotton, corn, or soybeans. Brazil has acknowledged that if a "farmer would not be able to cover even variable costs, he or she would not plant anything at all to minimize losses."[100] Conversely, where, as here, the farmer *is* covering his variable costs, it is economically rational for him to plant *something*. The question is then *what* to plant. On that question, the assessment depends on a number of factors including the relative net revenue, considerations of weather, and considerations of other factors affecting yields (such as pests and disease). As shown below, in most years, upland cotton was the most attractive option from the standpoint of costs and revenues.

[97] *See e.g.*, U.S. Further Rebuttal Submission in the Original Proceeding, paras. 117-122 (18 November 2003).

[98] *See* Cecil Davison and Brad Crowder, "Northeast Soybean Acreage Response Using Expected Net Returns" *Northeastern Journal of Agriculture and Resource Economics*, April 1991, pp. 33-41 (Exhibit US-137) and Duncan M. Chembezi and Abner W. Womack, "Regional Acreage Response for U.S. Corn and Wheat: The Effects of Government Programs", *Southern Journal of Agricultural Economics*, July 1992, pp 187-198 (Exhibit US-138).

[99] *US – Upland Cotton (AB)*, para. 453.

[100] Brazil Oral Statement, para. 67.



67. The U.S. analysis above seeks to replicate the revenue expected and variable costs faced by actual U.S. cotton farmers. Each aspect of the calculation is described in Annex I.[101] As discussed therein, the United States has examined relative costs and revenue of growing upland cotton, corn, and soybeans in the 17 U.S. cotton-producing states.[102]

68. The analysis shows that for the entire period MY 2002-2007, U.S. cotton farmers expected to meet or exceed their variable costs of planting cotton, corn, *or* soybeans. Therefore, it was economically rational for those farmers to plant *something*, rather than leaving the land idle. In terms of *what* to plant, upland cotton was the most attractive option – from the standpoint of costs and revenue – in at least three of the years (MY 2003, MY 2004, and MY 2006). In MY 2002, 2005, and 2007, cotton was not the most attractive option. It is instructive to examine more closely shifts in upland cotton acreage in those years because that shows precisely that, contrary to Brazil's assertions, U.S. farmers' planting decisions correspond to market signals.

69. In MY 2002, upland cotton was least attractive of the three options, and U.S. planted acreage declined correspondingly from 15.5 million acres in MY 2001 to 13.7 million acres in MY 2002.

70. In MY 2005, soybeans appeared to be the most attractive crop, followed by cotton. In this circumstance, the expectation was that cotton acreage would fall slightly. In fact, however, it increased slightly – by approximately 600,000 acres. What explains this increase? Brazil has attempted repeatedly to attribute this to the alleged effects of marketing loans and counter-cyclical payments. However, the data point fairly precisely to the reason for the slight increase in cotton acreage in MY 2005 – a shift away from soybean acreage due to concerns about an outbreak of Asian soybean rust at the end of MY 2004. Soybean rust, a recurrent problem for soybean producers in much of the southern hemisphere, was first detected in the United States in the Fall of 2004, late enough in the season that it posed no threat to that year's soybean crop. After overwintering in the South, soybean rust posed a new, uncertain, and potentially large threat at the beginning of the 2005

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[101] The back-up data is also provided in Exhibit US-139.

[102] In other states, cotton does is not a competitor crop and, therefore, corn and soybean costs from those states would distort the picture.

U.S. soybean season.[103] Soybean rust has been detected in eight states in the Delta and Southeast regions since late 2004.[104] It was in these regions that the shift from soybean acreage to upland cotton acreage occurred in MY 2005. Of the 600,000 acre increase from MY 2004 to MY 2005, almost the entire shift occurred in the Delta region, where an *increase* in 530,000 acres of cotton was offset precisely by a *decrease* of 530,000 acres of soybeans. Thus, it was soybean rust, and not marketing loan or counter-cyclical payments, that was responsible for increased acreage in MY 2005.

Changes in planted acreage, 2004 to 2005

State/ Region	Cotton		Soybeans	
	Change in acres	*% change*	*Change in acres*	*% change*
DELTA	530	15.6	-530	-4.4
Arkansas	140	15.4	-170	-5.3
Louisiana	110	22.0	-220	-20.0
Mississippi	110	10.0	-60	-3.6
Missouri	60	15.8	0	0
Tennessee	110	20.6	-80	-6.6
SOUTHEAST	74	2.5	-330	-10.6
Alabama	0	0	-60	-28.6
Florida	-3	-3.3	-10	-52.6
Georgia	-70	-5.4	-100	-35.7
North Carolina	85	11.6	-40	-2.6
South Carolina	51	23.7	-110	-20.3
Virginia	11	13.4	-110	-1.9
SOUTHWEST	94	1.5	75	2.2
Kansas	-11	-12.9	100	3.6
Oklahoma	50	2.2	5	1.6
Texas	100	1.7	-30	-10.3

Source: *Crop Production,* October 2006, Agricultural Statistics Board, NASS, USDA.

71. In MY 2007, corn is expected to provide greater net revenue than either cotton or soybeans. Cotton acreage is shifting consistent with these, and other, market signals. As the United States noted in the meeting with the Panel, the annual survey of planting intentions conducted by the National Cotton Council indicates that U.S. upland cotton plantings are likely to be down an average of 14 percent in MY 2007 from 2006 levels.[105] While Brazil attempts to dismiss this data – arguing that acreage shifts should be *even* higher – it provides no basis for this assertion. Indeed, a 14 percent shift in acreage would be substantial, amounting to more than a 2 million acre drop in planted acreage and

[103] The Value of Plant Disease Early-Warning Systems: A Case Study of USDA's Soybean Rust Coordinated Framework/ERR-18. Econ. Res. Ser., USDA., pg. 1. http://www.ers.usda.gov/publications/err18/err18.pdf

[104] As of October 3, 2006, National Soybean Rust Commentary, South Carolina officials reported a new county with soybean rust, Saluda County. Soybean rust was found in Washington and Sampson Counties in North Carolina on soybeans. Currently rust has been found infecting this year's soybeans in 68 different counties in eight states: AL, FL, GA, LA, MS, SC, TX, and NC. Including reports on kudzu, there are a total of 88 counties in eight states with rust this year, including 7 in Alabama; 15 in Florida; 18 in Louisiana and South Carolina; 13 in Georgia; 3 in Texas; 2 in Mississippi; and 12 in North Carolina. http://www.sbrusa.net/

[105] National Cotton Council Planting Intentions Survey MY 2007 (Exhibit US-115).

– applying MY 2006 yields – a 3.7 million bale decline in production.[106] Brazil has not explained why this Panel should ignore this important evidence.

72. In any event, what the data show is quite different from what Brazil has asserted about the allegedly "economically irrational business of growing cotton in the United States within marketing loan and CCP subsidies."[107] Even without considering those payments, it is clear that U.S. farmers can – and do – meet their variable costs of production. Moreover, under the circumstances, upland cotton is often the most economically rational choice among the available competing crops. Where it has not been, declines in acreage have ordinarily resulted.

c. U.S. farmers actually met and exceeded variable costs and even total cash costs in most years under the FSRI Act of 2002

73. Finally, the United States recalls that total costs may be a relevant consideration in more long-term decisions such as whether or not to exit farming altogether (*i.e.*, not year-to-year planting decisions).[108] However, Brazil's consideration of total costs of growing upland cotton suffers from a number of flaws.

74. First, Brazil considers total costs of growing upland cotton as the *only* consideration for a farmer in deciding whether to continue to exit farming altogether. This is not accurate. Indeed, as the economic literature confirms, whole-farm costs and revenues – including off-farm revenue and revenue from other sources – are also important considerations in making those kinds of decisions.[109] Brazil's attempts to show that U.S. producers would have exited upland cotton production in the long-term solely on the basis of a comparison of costs and revenues for cotton are, thus, not sound. Brazil has never been able to submit any literature, study, report, or empirical evidence to contradict the evidence submitted by the United States regarding the consideration of whole-farm costs and revenues. Nor has Brazil provided any evidence that takes into account whole-farm costs and revenues, and that shows that, absent the marketing loan and counter-cyclical payment programs, U.S. upland cotton producers would have exited upland cotton farming.

75. Second, Brazil includes in its assessment imputed opportunity costs. These are not actual expenditures, but instead are an economic concept used to capture the alternative uses of the land, unpaid family labour and capital; for example, how much a farmer would pay himself for his own labour. These are not like year-to-year cash costs without which a farmer would be unable to continue on in business. It is only through the inclusion of such imputed costs that Brazil seeks to show returns less than total costs.

76. **The fact is that even if one includes additional fixed cash costs, which are not part of variable costs, the outcome remains much the same as for variable costs; that is, in most years the market revenues from cotton cover variable plus fixed cash costs.** As shown below, in most years, U.S. farmers are able to meet and exceed their *total* cash costs. Therefore, Brazil's claims of

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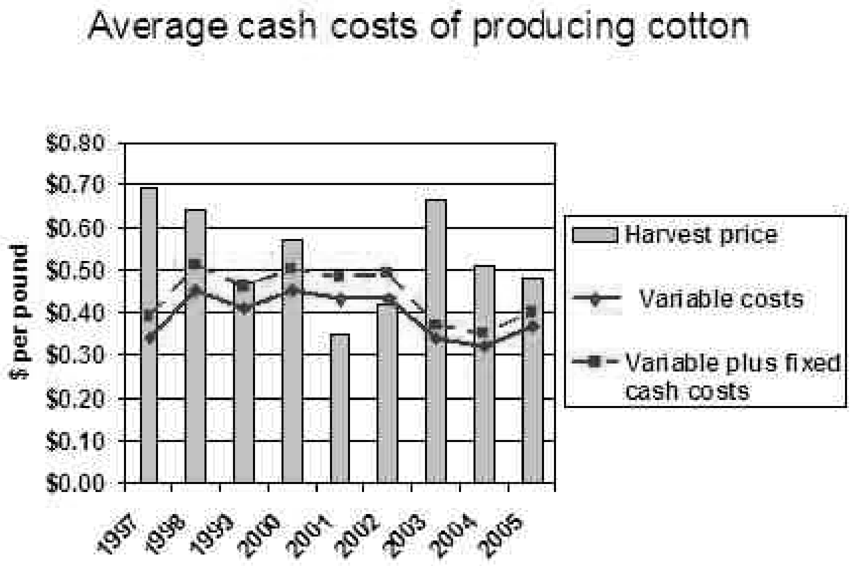
[106] February 2007 World Agricultural Supply and Demand Estimates (WASDE) Report (Exhibit US-114).

[107] Brazil Oral Statement, para. 57 and paras. 57-91.

[108] U.S. First Written Submission, paras. 295-297.

[109] *See e.g.*, Hoppe, Robert A. and Korb, Penni. Understanding U.S. Farm Exits. Economic Research Report 21. June 2006, p. 20 (Exhibit US-46) ("Off-farm work has become important to farm operators. About one-third of farmers have worked off the farm at least 200 days per year—essentially full-time—since 1978. Off-farm work could hypothetically affect exits in two ways. First, off-farm work may be the first step in an exit from farming, which would be reflected in higher exits for farms the operators of which work off-farm. Second, off-farm work might lower the probability of exit by providing farm operator households with another source of income.")

widespread bankruptcies in the absence of marketing loan and counter-cyclical payments are not realistic.[110]



77. Moreover, Brazil has claimed on several occasions that a large cost-revenue gap exists for U.S. cotton producers, such that except for U.S. subsidies, farmers would not plant cotton. Examining the cost data properly for the period 2000-2005, instead of the cumulative $663 *deficit* per acre asserted by Brazil, the cumulative returns over the same period were a *positive* return of $161 per acre. Moreover, for MY 2000-2006, instead of the $837 *deficit* per acre alleged by Brazil, the cumulative net returns were a positive $133 per acre.

d. Conclusion

78. Notwithstanding Brazil attempts to skew the cost data, that data show clearly that U.S. producers actually meet – and, in fact, exceed – their variable costs of producing upland cotton. Moreover, in most years, a relative consideration of variable costs and expected returns shows upland cotton to be the most attractive among competing crops. Where it is not, U.S. farmers behave in exactly the way they would be expected to behave given the particular market signals – they pull back on production except where other considerations (for example, concerns regarding weather, pests or disease) suggest a different approach.

3. The Sumner II Model Is Oversimplified and Relies on Arbitrary Parameters and Assumptions That Have No Basis in the Economic Literature

79. The third piece of allegedly "key evidence" referenced by Brazil in support of its claims of present significant price suppression are the results of the Sumner II model that Brazil commissioned for purposes of this proceeding. As the United States has explained, that model suffers from substantial flaws, both in its structure and operation and in the parameters and assumptions used therein.[111] As a result, the model is overly simplified and produces grossly biased results.

[110] The United States notes that this chart and the back-up spreadsheets were submitted to the Panel and Brazil during the meeting with the Panel. *See* Exhibit US-124.

[111] *See e.g.*, U.S. First Written Submission, Annex I and U.S. Rebuttal Submission, Annex I.

80. Indeed, despite Brazil's efforts to explain it away, Dr. Sumner's own critical assessment of the model – made outside this proceeding – stands. "The simple model" laid out in the 2005 CATO paper – which is virtually identical to the one Brazil has presented in this proceeding – "does not represent the depth of analysis that would be appropriate to support a trade remedy proceeding or a serious prejudice claim before a WTO panel."[112] As Dr. Sumner acknowledged, much of the fault lies with the oversimplifications in the model itself, which "abstract from many complexities that would be important to get more precise estimates."[113] Unfortunately, Dr. Sumner substantially compounded these flaws through his deliberate selection of modeling assumptions and parameters that exaggerate any possible effects of the counter-cyclical and marketing loan programs. As the United States demonstrated at the meeting with the Panel and as shown in the table below, between the original panel proceeding and this Article 21.5 panel proceeding, Dr. Sumner *changed every single elasticity estimate in his modeling exercise, except one* (U.S. mill demand elasticity). And, in *each one of these cases*, he substituted an elasticity that would produce even greater impacts on production and prices than would even the elasticities used for purposes of the original modeling exercise.[114]

Supply and Demand Elasticities Used in Sumner I and II

Parameter	Effects of change to Sumner II elasticity (impact on world price due to removal of marketing loans and counter-cyclical payments)	Sumner I(FAPRI)	Sumner II(CATO)
U.S. cotton supply elasticity	INCREASED IMPACT	0.361 - 0.466	0.80
ROW cotton supply elasticity	INCREASED IMPACT	0.30	0.20
US mill demand elasticity	no change	-0.20	-0.20
US stocks demand elasticity	INCREASED IMPACT	-1.40*	no
ROW mill demand elasticity	INCREASED IMPACT	-0.25	-0.20
ROW stocks demand elasticity	INCREASED IMPACT	-0.463*	no

* Parameter estimate not presented in original Sumner model; estimates drawn from FAPRI model documentation discussed in Annex I to the US Rebutal Submission, paras 23-25. (Exhibit US-56, Exhibit US-109, Exhibit US-65)

81. In Brazil's "oral" presentation, it offers no justification for the flaws in the Sumner II model's structure or its arbitrary and unfounded elasticity assumptions. Nonetheless, the United States addresses below a few of the key aspects of Brazil's "oral" presentation regarding its modeling exercise.

82. First, the United States notes that Brazil continues to attempt to discredit the FAPRI model that it relied upon in the original proceeding (and that Brazil goes as far as to assert *the original panel* relied upon).[115] Now, for example, Brazil derides the years of research embodied in the FAPRI framework and parameters by characterizing it as "piece-mill development." This is presumably intended to establish the superiority of Brazil's model, which was developed by Dr. Sumner alone

[112] Daniel A. Sumner. "Boxed In: Conflicts Between U.S. Farm Policies and WTO Obligations." Center for Trade Policy Studies, The Cato Institute, December 2005. (Exhibit US-108)

[113] Daniel A. Sumner. "Boxed In: Conflicts Between U.S. Farm Policies and WTO Obligations." Center for Trade Policy Studies, The Cato Institute, December 2005. (Exhibit US-108)

[114] Of course, many of the elasticities in the model used for purposes of the original proceeding were already overstated.

[115] *See e.g.,* Brazil Rebuttal Submission, para. 292. Brazil neglects to mention, however, that the original panel expressly stated that "[w]e have taken note of the outcomes of the simulations submitted by Brazil1, and the parties' exchanges of views thereon. We have not relied upon the quantitative results of the modelling exercise – in terms of estimating any numerical value for the effects of the United States subsidies, nor, indirectly, in our examination of the causal link required under Articles 5 and 6.3(c) of the *SCM Agreement*."

after the original panel proceeding and which has never been subjected to any peer review or examination. Brazil's criticisms are remarkable given that – in an effort to have the original panel accept its allegedly FAPRI-based model in the original proceeding – Brazil specifically lauded the fact that FAPRI "continually update[d] [its] analytical capabilities and . . . market intelligence."[116] Thus, the fact that Brazil's new Sumner II model has not been subjected to the same kind of peer review and development renders it less – not more – reliable than the FAPRI framework.

83. Second, Brazil now claims that FAPRI parameters are inappropriate for analyzing the "permanent" removal of payments such as the marketing loan and counter-cyclical payments.[117] However, in the original proceeding Brazil asserted that "FAPRI is the most influential organization in the United States analyzing farm policy and its effects on U.S. and world commodity markets, i.e., that has the highest reputation and experience *in answering the kind of "but for" questions faced by this Panel*,"[118] Indeed, as Brazil expressly acknowledged in the original proceeding:

> The FAPRI model has been widely used for policy analysis in the United States and elsewhere for almost 20 years. U.S. commodity groups, including the U.S. cotton industry, have regularly used the FAPRI model to analyze farm commodity program options. The FAPRI model is also the key model used by the U.S. Congress in considering farm program options. For almost two decades the U.S. Congress has provided special appropriations to support the continued use and development of the FAPRI model. In both the 1996 and the 2002 Farm Bill processes, the FAPRI model provided the most influential projections of likely program impacts. FAPRI received the USDA highest honour for its analysis of certain proposals leading to the adoption of the 2002 FSRI Act.[119]

84. FAPRI has used their modeling system to analyze the removal of domestic subsidies under trade liberalization scenarios and the reduction of farm subsidies under various farm bill scenarios, including the "permanent" removal of payments. Indeed, in attempting to argue that elimination of the Step 2 program has had no effects on exports or prices, Brazil itself submitted and repeatedly cites to a FAPRI assessment of the effects of eliminating that program.[120] FAPRI economists did not find it necessary to change their model or modeling parameters to address that question (involving a total and permanent removal of payments). And Brazil did not complain that the FAPRI assessment of eliminating the Step 2 program was "biased downwards." To the contrary, in that context, Brazil *wants* the Panel to accept that FAPRI allegedly shows "relatively modest effects from the removal of the Step 2 subsidy." Brazil argues that the Panel should *rely* on FAPRI's analysis of that scenario in assessing the effects of eliminating the Step 2 program. Yet Brazil asserts that the same FAPRI analysis is somehow inappropriate for analyzing the counterfactual situation without marketing loan and counter-cyclical payments.[121] Brazil's arguments in this regard are internally inconsistent and lack credibility.

85. Third, the United States notes that Brazil has applied a long-run elasticity for U.S. supply response while imposing very conservative short-run elasticities for international supply and demand response. If the analysis is to be performed in the long run – and the United States considers that it must for the reasons explained at the meeting with the Panel – then long-run elasticities must be

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[116] Answers of Brazil to Questions from the Panel After 2nd Meeting, para 21 (22 December 2003).

[117] Brazil Oral Statement, para. 103.

[118] Answers of Brazil to Questions from the Panel After 2nd Meeting, para 24 (22 December 2003) (emphasis added).

[119] Brazil Further Submission, para. 214 (9 September 2003).

[120] *See* Brazil First Written Submission, para. 203 (addressing FAPRI, "Impacts of Commodity and Conservation Reserve Program Provisions in House and Senate Reconciliation Bills," FAPRI-UMC Report #15-05, December 2005(Exhibit Bra-484).)

[121] Brazil Oral Statement, para. 103.

assumed throughout the model. In that time, foreign cotton producers will make full adjustments and respond as well. Similarly, over the long-term, U.S. and foreign mill demand become more responsive to permanent price changes. There is no basis whatsoever for the kind of mix-and-match approach that Brazil has adopted in an effort to exaggerate any possible effects of the marketing loan and counter-cyclical payments.

86. Fourth, another key source of bias in Dr. Sumner's analysis is the fact that it does not incorporate, either explicitly or implicitly, any stock behaviour.[122] Yet, stock adjustments may have important effects on overall price movements in the short-run. As future prices increase relative to current prices, warehouses will tend to carry more inventory, choosing to sell their cotton in future periods when prices are higher. Likewise, if current prices are high relative to futures prices, sellers find it more attractive to market their cotton rather than holding it for sale in the future. In this way, stocks act to buffer prices. If prices fall, potential sellers will sell less and hold more in stock, thus bolstering prices. If prices rise, inventory holders will sell stocks, thus dampening prices. Ignoring stockholding behaviour in the kind of predominantly short-run assessment that Brazil attempts to conduct exacerbates any possible effects of removal of marketing loans and counter-cyclical payments on world price.

87. Fifth, the United States contests Brazil's efforts to explain away the fact that it uses counter-cyclical payments rates that are in excess of the statutory maximum. According to Dr. Sumner, this results from calculation of counter-cyclical payment rates on a per-pound of production basis[123]: "[The Sumner II model] uses the CCP rate per pound of production for each year. Since cotton production is smaller than cotton base, the CCP rate per pound of production can exceed 13.73 cents per pound when the CCP rate per pound of base remains at the maximum."[124] In other words, Brazil admits that it attempts to attribute to upland cotton production *all* counter-cyclical payments made in respect of upland cotton base acres regardless of whether upland cotton or some other crop was grown. More precisely, Brazil attempts to attribute *cotton* production-inducing effects in respect of payments even when the payments were made on farms that did not produce upland cotton or on farms where other crops were grown, instead of upland cotton, on acres historically planted to cotton. This is an illogical approach that serves no purpose other than to inflate the results of the modeling exercise.

88. In sum, the evidence and arguments before the Panel show that the Sumner II model lacks the rigor or detail to address the complexities of the global fiber market. Moreover, the model's choice of elasticities introduces biased results. Even ignoring the structural issues with the model, the United States has demonstrated that the use of more reasonable, independent elasticities produce dramatically smaller impacts on world price.

IV. CONCLUSION

89. The United States has implemented the DSB's recommendations and rulings in this dispute and that it has done so consistently with its WTO obligations. The United States has eliminated two export credit guarantee programs entirely. And the United States has substantially overhauled the third, lowest-risk program. The United States has also eliminated a third program, the Step 2 program, payments under which were claimed by Brazil to be prohibited export subsidies, among the most distortive of subsidy measures.

90. Moreover, substantial evidence confirms that payments under the marketing loan and counter-cyclical payment programs are not causing present significant price suppression, as Brazil alleges.

[122] The absence of such an analysis is especially remarkable given Brazil's new theory that it is stocks – not exports – that are suppressing world market prices.
[123] Brazil Oral Statement, para. 120.
[124] Brazil Oral Statement, para. 120.

Brazil has not been able to rebut this evidence. Rather, it continues to rely on the heavily biased results of the modeling exercise commissioned for purposes of this dispute. The United States has shown that exercise to be unreliable and, as its author has noted in another context, not "appropriate to support [Brazil's] serious prejudice claim before [this] WTO panel."[125]

91. Finally, the United States again would like to thank the Panel for providing this opportunity to comment on Brazil's "oral" statement. While we recognize that such an opportunity is unusual in WTO panel proceedings, the approach taken by Brazil to the Panel meeting was, itself, unusual. Brazil's approach had the unfortunate consequence of limiting the chance for an oral dialogue with the Panel to a single afternoon. Fortunately, by allowing this opportunity for comment, the Panel has allowed the dialogue to take place, albeit in written form.

[125] Daniel A. Sumner. "Boxed In: Conflicts Between U.S. Farm Policies and WTO Obligations." Center for Trade Policy Studies, The Cato Institute, December 2005. (Exhibit US-108)

ANNEX

CALCULATION OF EXPECTED MARKET NET RETURNS ABOVE VARIABLE COSTS

1. Expected Market Prices:

For upland cotton, soybeans and corn, the expected market price is based on the January-March average of the relevant harvest-time (futures) contract. This is the expected market price most likely to be relied upon by a producer. For 2007, since data are not available for the full month of March, the average reflects January 1 through March 2. The source for those prices is the New York Board of Trade for cotton futures; Chicago Board of Trade for corn and soybeans.

Using the relevant harvest-time contract, the expected market price is derived by subtracting an average basis from the futures price. In the case of cotton, the basis used is $0.05 per pound. For soybeans and corn, a basis of $0.14 is used for each. The basis was taken from analysis by USDA/ERS that projects market prices and counter-cyclical payment rates from futures prices. Models can be found at http://www.ers.usda.gov/Data/PriceForecast/.

For cottonseed, in the absence of a futures market to determine price expectations, expected market prices are set at lagged prices.

2. Expected Yields

For all crops, expected yields are determined based on a linear trend equation applied to USDA/NASS data for actual yields for the period 1995-2006. For upland cotton and cottonseed, the expected yield represents an average yield across the 17 cotton-producing states. For soybeans and corn, average yields across the Cotton Belt are also used, with the exception of data for Missouri and Kansas. Both states are relatively small producers of cotton and large producers of corn and soybeans. However, the majority of corn and soybeans are grown in parts of the states too far north to be suitable for cotton production. Corn and soybean yields in those regions, therefore, are not directly applicable to corn and soybean yields that would be expected in the cotton producing regions of those states.

3. Variable Costs

Data for variable costs are taken from USDA/ERS costs of production data. For each crop, operating costs and hired labor are included as variable costs. For cotton, the costs represent the average across the Cotton Belt. In the case of competing crops, regional data are used to calculate average costs across the cotton-producing states to most closely match the costs faced by U.S. farmers.[1] Projected cotton-belt costs for corn and soybeans are derived from USDA/ERS projections of national costs.

4. Expected Market Net Returns

For 2002 through 2007, expected market returns above variable costs are calculated as follows:

(a) For cotton, variable costs (including USDA-designated costs assigned to ginning that exceed revenue from cottonseed and hired labor) are subtracted from market returns for cotton lint.

(b) For soybeans and corn, variable costs are subtracted from market returns for each of the crops.

[1] The United States does not use national average costs for corn and soybeans since those costs are heavily influenced by the Midwestern United States. Although the majority of corn and soybean production occurs there, it is an area that is not suitable for cotton production. Therefore, the costs for those regions are not the costs ordinarily faced by U.S. cotton farmers.

ANNEX D-6

RESPONSES OF BRAZIL TO THE PANEL'S FIRST SET OF QUESTIONS (SECTIONS A-C)

(26 February 2007)

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Australia – Leather (21.5)	Panel Report, *Australia – Subsidies Provided to Producers and Exporters of Automotive Leather*, WT/DS126/RW, adopted 11 February 2000, DSR 2000:III, 1189.
Australia – Salmon (Article 21.5 – Canada)	Panel Report, *Australia – Measures Affecting Importation of Salmon – Recourse to Article 21.5 of the DSU by Canada*, WT/DS18/RW, adopted 20 March 2000, DSR 2000:IV, 2031.
Canada – Aircraft (21.5)	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/AB/RW, adopted 4 August 2000, DSR 2000:IX, 4299.
Canada – Dairy (21.5)	Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Recourse to Article 21.5 of the DSU by New Zealand and the United States*, WT/DS103/AB/RW, WT/DS113/AB/RW, adopted 18 December 2001, DSR 2001:XIII, 6829.
Chile – PBS (21.5)	Panel Report, *Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products – Recourse to Article 21.5 of the DSU by Argentina*, WT/DS207/RW, circulated to WTO Members 8 December 2006.
EC – Bed Linen (21.5)	Appellate Body Report, *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by India*, WT/DS141/AB/RW, adopted 24 April 2003, DSR 2003:III, 965.
EC – Bed Linen (21.5)	Panel Report, *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by India*, WT/DS141/RW, adopted 24 April 2003, modified by Appellate Body Report, WT/DS141/AB/RW, DSR 2003:IV, 1269.
EC – Selected Customs Matters	Appellate Body Report, *European Communities – Selected Customs Matters*, WT/DS315/AB/R, adopted 11 December 2006.
Mexico – Corn Syrup (21.5)	Appellate Body Report, *Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States – Recourse to Article 21.5 of the DSU by the United States*, WT/DS132/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6675.
U.S. – Certain EC Products (21.5)	Panel Report, *United States – Import Measures on Certain Products from the European Communities*, WT/DS165/R and Add.1, adopted 10 January 2001, modified by Appellate Body Report, WT/DS165/AB/R, DSR 2001:II, 413.
U.S. – FSC	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/AB/R, adopted 20 March 2000, DSR 2000:III, 1619.
U.S. – FSC (21.5 II)	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Second Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW2, adopted 14 March 2006.
U.S. – FSC (21.5 II)	Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Second Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/RW2, adopted 14 March 2006, upheld by Appellate Body Report, WT/DS108/AB/RW2.
U.S. – Shrimp (21.5)	Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse to Article 21.5 of the DSU by Malaysia*, WT/DS58/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6481.
U.S. – Softwood Lumber IV (21.5)	Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada – Recourse by Canada to Article 21.5 of the DSU*, WT/DS257/AB/RW, adopted 20 December 2005.

Short Title	Full Case Title and Citation
U.S. – Softwood Lumber IV (Article 21.5)	Panel Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada – Recourse by Canada to Article 21.5 [of the DSU]*, WT/DS257/RW, adopted 20 December 2005, upheld by Appellate Body Report, WT/DS257/AB/RW.
US – Softwood Lumber V	Appellate Body Report, *United States – Final Dumping Determination on Softwood Lumber from Canada*, WT/DS264/AB/R, adopted 31 August 2004, DSR 2004:V, 1875.
US – Softwood Lumber VI (21.5)	Appellate Body Report, *United States – Investigation of the International Trade Commission in Softwood Lumber from Canada – Recourse to Article 21.5 of the DSU by Canada*, WT/DS277/AB/RW, adopted 9 May 2006.
U.S. – OCTG Sunset Reviews (21.5)	Panel Report, *United States – Sunset Reviews of Anti-Dumping Measures on Oil Country Tubular Goods from Argentina – Recourse to Article 21.5 of the DSU by Argentina*, WT/DS268/RW, circulated to WTO Members 30 November 2006.
US – OCTG Sunset Reviews (Argentina)	Appellate Body Report, *United States – Sunset Reviews of Anti-Dumping Measures on Oil Country Tubular Goods from Argentina*, WT/DS268/AB/R, adopted 17 December 2004, DSR 2004:VII, 3257.
U.S. – Upland Cotton	Appellate Body Report, *United States – Subsidies on Upland Cotton*, WT/DS267/AB/R, adopted 21 March 2005.
U.S. – Upland Cotton	Panel Report, *United States – Subsidies on Upland Cotton*, WT/DS267/R, and Corr.1, adopted 21 March 2005, modified by Appellate Body Report, WT/DS267/AB/R.

A. General questions

Questions to both parties

1. Is Brazil/US of the view that a party to a dispute referred to a panel established under Article 21.5 of the DSU (a party in a compliance panel) can make the same legal argument as it did in the original Panel proceedings?

1. Brazil notes that a party's *arguments* in WTO dispute settlement are distinct from the *claims* identified by the complaining Member in the request for the establishment of a panel.[1] Although there are certain limitations on the *claims* that can be brought by the complainant in Article 21.5 proceedings, the complaining and respondent Members are free to make whatever legal *arguments* they wish.

2. Could each party explain its view on the question of whether, and to what extent, this Panel must rely on the legal and factual analysis underlying the original panel's findings? What are the relevant provisions of the DSU in this regard?

2. According to Article 3.2 of the DSU, dispute settlement is a central element in providing "*security and predictability* to the multilateral trading system". In developing a dispute settlement system that contributes to securing this objective, panels and the Appellate Body have taken care to ensure that disputes involving the same or similar factual and legal questions are resolved in the same way. The Appellate Body has articulated principles in this regard that seek to further the goals of security and predictability.[2]

3. *First*, prior adopted panel and Appellate Body reports create "legitimate expectations" among WTO Members, and should be taken into account by panels when they are relevant to the resolution of a dispute.[3] *Second*, where the issues before a panel are the same as those previously examined by the Appellate Body, it is "not only appropriate," but to "be expected," that the panel would follow the Appellate Body's earlier conclusions.[4]

4. The Appellate Body has also clarified that the objective of "security and predictability" applies with particular force in Article 21.5 proceedings. As Brazil noted in previous submissions, the Appellate Body has stated that "Article 21.5 proceedings do not occur in isolation but are part of a '*continuum of events*.'"[5] The Appellate Body observed that "doubts could arise about the *objective nature* of an Article 21.5 panel's assessment if, on a specific issue, that panel were to *deviate* from the reasoning in the original panel report in the absence of any change in the underlying evidence."[6]

5. In this passage, the Appellate Body linked the need for consistent decision-making by a compliance panel to that panel's duty to make an "objective assessment" of the matter under Article 11 of the DSU. If a compliance panel "deviate[d]" from the original panel's findings on a "specific issue", without a fundamental change in the domestic legal framework and/or facts warranting this deviation, it would suggest that the compliance panel is acting in an arbitrary fashion that does not meet the requirements of an "objective assessment". Accordingly, in the progression of

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[1] *See*, *e.g.*, Appellate Body Report, *EC – Selected Customs Matters*, para. 153.

[2] *See* Appellate Body Report, *US – Softwood Lumber V*, para. 111, where the Appellate Body expressly relied on Article 3.2 of the DSU.

[3] Appellate Body Report, *US – Softwood Lumber V*, para. 111.

[4] Appellate Body Report, *US – OCTG Sunset Reviews (Argentina)*, para. 188.

[5] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 103 (emphasis added) citing Appellate Body Report, *Mexico – Corn Syrup (21.5)*, para. 121. *See* Brazil's First Written Submission, para. 28.

[6] Appellate Body Report, *US – Softwood Lumber VI (21.5)*, para. 103 (emphasis added).

"events" within a single dispute, it is especially important for the compliance panel to respect the findings of the panel and the Appellate Body in the original proceedings.

6. In this compliance dispute, with respect to Brazil's claims of adverse effects, many of the legal questions have already been addressed by the original panel and the Appellate Body. The structure, design and operation of the contested subsidy programs has not altered, nor has the general order of the magnitude of these subsidies. Indeed, the magnitude of the subsidies has *increased*. Further, the evidence relating to the effect of the contested subsidies in the marketplace is also very much the same. In these circumstances, the requirements of "security and predictability," and an "objective assessment", require the compliance Panel to follow the relevant findings of the original panel and the Appellate Body.

7. Although a compliance panel should follow the findings of the original panel and Appellate Body when the factual and legal questions are the same, the questions that arise in compliance proceedings may differ. This is because a compliance panel "is not confined to examining the 'measures taken to comply' from the perspective of the claims, arguments and factual circumstances that related to the measure that was the subject of the original proceedings."[7]

8. With respect to the claims regarding export credit guarantees, the factual and legal questions relating to the existence of a "benefit" under Article 1.1(b) of the *SCM Agreement* were not addressed by the panel in the original proceedings. Thus, there are no findings on these questions that the compliance panel should follow. Brazil notes, however, that prior panel reports address how to assess the "benefit" from loan guarantees[8]; those reports create "legitimate expectations" among WTO Members on this specific issue, and should be taken into account by the compliance panel.[9] The factual and legal questions relating to item (j) of the Illustrative List of Export Subsidies have been thoroughly explored in the original proceedings. To ensure "security and predictability", the compliance panel should follow the earlier findings in its interpretation of item (j) and in its treatment of the evidence.

B. QUESTIONS WITH RESPECT TO BRAZIL'S REQUEST UNDER ARTICLE 13.1 DSU

Questions to the US

3. Is the United States arguing that Brazil must identify the subsidized product for each of the types of subsidies from which it claims serious prejudice? Is the United States arguing that payments which permit planting flexibility are not tied to the production of upland cotton, so that they must be allocated by Brazil across the total value of production of each recipient?

4. Does the United States contest the accuracy of the figures for 2003 – 2005 cited in "Table 6"[10] of Brazil's first submission and "Table 5"[11] of Brazil's rebuttal submission? If so, please provide the accurate figures, or the figures the US deems to be more accurate.

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[7] Appellate Body Report, *Canada – Aircraft (21.5)*, para. 41. *See also* Panel Report, *Chile – PBS (21.5)*, paras. 7.129, 7.136-7.137. The Appellate Body later confirmed that this statement applied in the context of "a *new* claim challenging a *new* component of the measure taken to comply which was not part of the original measure." Appellate Body Report, *EC – Bed Linen (21.5)*, para. 88.

[8] *See* Panel Report, *EC – CVDs on DRAMs*, paras. 7.189, 7.190; Panel Report, *Canada – Aircraft Credits and Guarantees*, para. 7.345.

[9] Appellate Body Report, *US – Softwood Lumber V*, para. 111.

[10] Immediately preceding para. 112 of Brazil's First Written Submission.

[11] Immediately following para. 173 of Brazil's Rebuttal Submission.

Question to Brazil

5. The Panel refers to Brazil's communication dated 22 January 2007 concerning its request in relation to Article 13.1 of the DSU. Is it correct for the Panel to understand that as far as data for 2005 is concerned, data included in Exhibit US-64 satisfies all of the requests Brazil made in Part A of Annex 1 of its 1 November communication?

9. The Panel is correct in understanding that the data included in Exhibit US-64, as far as marketing year 2005 is concerned, satisfies Part A of Brazil's 1 November 2006 request. The data enables Brazil to calculate the amount of counter-cyclical payments allocated to upland cotton under the "Cotton-to-Cotton Methodology" and under "Brazil's Methodology." Brazil presents the results of its calculation as part of its Opening Statement to the compliance Panel.

C. QUESTIONS CONCERNING THE PRELIMINARY OBJECTIONS RAISED BY THE UNITED STATES

1. Preliminary objections of the United States in respect of claims of Brazil regarding export credit guarantees in respect of pig meat and poultry meat

Question to both parties

6. The parties disagree with respect to whether in a proceeding under Article 21.5 of the DSU a party may present a claim that was raised in the original proceeding but on which no finding of WTO-inconsistency was made due to the fact that the Appellate Body was unable to complete the analysis.

a) Could the parties explain the legal basis in the text of Article 21.5 of the DSU and other relevant provisions of the DSU for their position on this question?

b) Could the parties explain whether and how their position on this issue is consistent with prior panel and Appellate Body reports?

A. Introduction

10. Brazil claims that the amended GSM 102 program has been applied to circumvent U.S. export subsidy commitments on pig meat and poultry meat, in contravention of Articles 10.1 and 8 of the *Agreement on Agriculture* (and in consequence, of Articles 3.1(a) and 3.2 of the *SCM Agreement*). In its response to this question, Brazil will demonstrate that under the relevant provisions of the DSU and the jurisprudence, its claims are properly within the scope of these Article 21.5 proceedings. Brazil will address the limits placed by the DSU and prior jurisprudence on both the measures that may be challenged in Article 21.5 proceedings, and the claims that can be raised against those measures. Brazil will then demonstrate that its claims, and the measure subject to those claims, observe those limits.

B. Background

11. The treatment of Brazil's claims in the original proceedings is important to the compliance Panel's assessment of the United States' preliminary objection. In the original proceedings, the measure at issue was the original GSM 102 program, which had general terms and conditions that applied on a non-product-specific basis to many agricultural products. Brazil claimed that this measure involved export subsidies applied in a manner that circumvented the United States' export subsidy commitments for all thirteen of its scheduled products and for unscheduled products, under Article 10.1 of the *Agreement on Agriculture*.

12. The original panel found that Brazil had demonstrated application by the United States of GSM 102 to circumvent U.S. export subsidy commitments for "unscheduled" products and for one "scheduled" product – rice. On appeal, Brazil challenged the original panel's failure to find that the export credit guarantees ("ECG") programs were applied in a manner which results in circumvention of U.S. export subsidy commitments for three other scheduled products – pig meat, poultry meat and vegetable oil.[12] At the oral hearing, Brazil withdrew its appeal with respect to vegetable oil.[13]

13. On review, the Appellate Body reversed the original panel's finding that Brazil had failed to demonstrate actual circumvention with respect to pig meat and poultry meat.

14. However, the Appellate Body concluded that there were insufficient uncontested facts of record to enable it to complete the analysis.[14] Because the Appellate Body was unable to complete the analysis, there is no adopted finding that the original GSM 102 program is applied in a manner that circumvents the United States' commitments with respect to pig meat and poultry meat. At the same time, however, there is also no adopted finding that the original GSM 102 program, again with respect to pig meat and poultry meat, is not inconsistent with Article 10.1 of the *Agreement on Agriculture*.

15. During implementation, the United States could have taken steps to amend the GSM 102 program exclusively with respect to the terms and conditions applicable to rice and unscheduled products. However, it did not do so. Instead, it revised the general terms and conditions of the program, including the guarantee fee schedule, adopting an amended GSM 102 program that still applies on a non-product-specific basis. In adopting an amended GSM 102 program, the United States was obliged to ensure that this new measure respected all of the United States' obligations under the covered agreements.

16. In these compliance proceedings, Brazil claims that the amended GSM 102 program is not consistent with the United States' obligations under, among others, Article 10.1 of the *Agreement on Agriculture* because this new measure is applied in a manner that circumvents U.S. obligations with respect to three scheduled products – pig meat, poultry meat and rice – and unscheduled products.

17. There is no dispute between the Parties that this claim is included in Brazil's request for establishment, which states, in relevant part, as follows:

> ... [S]ubsequent to 1 July 2005, ECGs [export credit guarantees] under the GSM 102 and SCGP [Supplier Credit Guarantee] programs have been applied to circumvent US export subsidy commitments, within the meaning of Article 10.1 of the *Agreement on Agriculture*. Brazil is concerned that ECGs under the GSM 102 and SCGP programs have been provided subsequent to 1 July 2005 to support the export of: upland cotton and other unscheduled products; and, rice, **pigmeat and poultry meat**, in excess of US reduction commitment levels for those products.[15]

18. Brazil now turns to consider whether there are any limitations in these compliance proceedings on its right (1) to challenge the amended GSM 102 program in these proceedings as a "measure taken to comply" or (2) to claim that this new measure circumvents the United States' export subsidy commitments for pig meat and poultry meat.

19. The DSU contains limits on: (i) the measures that may properly be subject to review in Article 21.5 proceedings; and, (ii) the claims that may properly be subject to review in Article 21.5 proceedings. Brazil will address these two limits – on measures, and on claims – separately.

[12] Appellate Body Report, *U.S. – Upland Cotton*, para. 683.
[13] Appellate Body Report, *U.S. – Upland Cotton*, para. 683.
[14] Appellate Body Report, *U.S. – Upland Cotton*, paras. 689-694.
[15] WT/DS267/30, para. 27 (emphasis added).

20. The distinction between measures and claims is important, given the basis for the United States' objection.

C. Measures

1. Limits on **measures** subject to Article 21.5 review

21. Article 21.5 enables a compliance panel to review claims regarding the existence, or the consistency with the covered agreements, of "measures taken to comply" with the recommendations and rulings of the DSB. Measures that are not "taken to comply" with the DSB's recommendations and rulings may not be pursued in Article 21.5 proceedings.[16]

22. According to the Appellate Body, the phrase "measure taken to comply" in Article 21.5 includes a new measure "in its totality".[17] Exactly what constitutes the bounds of a "measure taken to comply" varies according to the circumstances of the dispute, however.

2. Erroneous basis for U.S. objection and the relevance of that objection for assessment of "measures"

23. In these proceedings, Brazil has fully observed the limits on the measures subject to Article 21.5 review.

24. In its Rebuttal Submission, the United States clarifies that Brazil's claim is not properly within the scope of these Article 21.5 proceedings because it relates to a measure that is not a "measure taken to comply". The United States describes the "measure" subject to Brazil's claim as "pig meat and poultry meat GSM 102 guarantees".[18] The United States argues that such a "measure" could not be a "measure taken to comply", because there was no recommendation compelling action with respect to "pig meat and poultry meat GSM 102 guarantees".[19]

25. With these statements, the United States confounds Brazil's claim, and the measure that is the subject of that claim.

26. As noted above, Brazil's claims of inconsistency are product-specific with respect to scheduled products, as they must be.[20] Article 10.1 prohibits the use of export subsidies not listed in

[16] Appellate Body Report, *Canada – Aircraft (21.5)*, para. 36 ("Proceedings under Article 21.5 do not concern just *any* measure of a Member of the WTO; rather, Article 21.5 proceedings are limited to those 'measures *taken to comply* with the recommendations and rulings' of the DSB. In our view, the phrase 'measures taken to comply' refers to measures which have been, or which should be, adopted by a Member to bring about compliance with the recommendations and rulings of the DSB. In principle, a measure which has been 'taken to comply with the recommendations and rulings' of the DSB will *not* be the same measure as the measure which was the subject of the original dispute, so that, in principle, there would be two separate and distinct measures: the original measure which *gave rise* to the recommendations and rulings of the DSB, and the 'measures taken to comply' which are – or should be – adopted to *implement* those recommendations and rulings.").

[17] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 67; Appellate Body Report, *U.S. – Shrimp (21.5)*, para. 87.

[18] U.S. Rebuttal Submission, para. 10 ("In other words, as Brazil expressly concedes, there have *never* been any findings of WTO inconsistency against the pig meat and poultry meat GSM 102 guarantees, and consequently there were no DSB recommendations and rulings against these measures with which the United States was obligated to comply.") (emphasis added). *See also Id.*, paras. 14, 15.

[19] U.S. Rebuttal Submission, para. 10.

[20] *See also* Brazil's Rebuttal Submission, para. 378. Consistent with its request for establishment, Brazil's claims concerning GSM 102 ECGs for *unscheduled* products are also product-specific, since they are limited to *any* unscheduled product that has received GSM 102 support subsequent to 1 July 2005.

Article 9.1 of the *Agreement* to circumvent (or threaten to circumvent) "export subsidy commitments". The first clause of Article 3.3 of the *Agreement on Agriculture* specifies that with respect to scheduled products, those "export subsidy commitments" include the commitment not to provide export subsidies "in excess of the budgetary outlay and quantity commitments levels specified" in its Schedule.[21]

27. To establish its product-specific claims of circumvention with respect to scheduled products, Brazil has established: (i) that in FY 2006, the United States provided GSM 102 ECGs to support the export of rice, pig meat and poultry meat in excess of its annual quantity commitment levels for those products; and, (ii) that during the period 1 July – 30 September 2005, the United States provided GSM 102 ECGs to support the export of rice and poultry meat in excess of its annual quantity commitment levels for those products.[22]

28. In contrast, the measure subject to Brazil's claims of inconsistency with the covered agreements is not product-specific, as the United States asserts. The measure subject to Brazil's claims of inconsistency, "in its totality"[23], is the GSM 102 program as amended by the United States' "measures taken to comply" – the modification of the GSM 102 fee schedule (including the removal of certain risk categories from eligibility).[24]

29. There is no factual basis for the United States to characterize the measure subject to Brazil's claims of inconsistency as "the pig meat and poultry meat GSM 102 guarantees".[25] No such "measure" exists. Neither the amended GSM 102 program in its totality, nor the individual amendments, set out terms or conditions that differ as between different eligible products:

- Fees under the amended GSM 102 schedule effective 1 July 2005 differ according to country risk, repayment term and repayment frequency, but not according to the eligible products involved.[26]

- The regulations relating to the GSM 102 program do not set out differing terms and conditions for GSM 102 ECGs depending on the specific eligible product at issue.[27]

- The USDA FAS press release announcing amendments to the ECG programs effective 1 July 2005 does not indicate that those amendments apply differently to different eligible products[28];

[21] *See* Appellate Body Report, *U.S. – FSC*, para. 145. In an export subsidy dispute involving products listed in Annex I to the *Agreement on Agriculture*, Article 3 of the *SCM Agreement* also applies on a product-specific basis. The *chapeau* to Article 3.1 prohibits export subsidies "[e]xcept as provided in the Agreement on Agriculture". If export subsidies are provided for products listed in Annex I to the *Agreement on Agriculture* within the limits of a Member's "export subsidy commitments" – meaning, for scheduled products, below the Member's budgetary outlay and quantity commitments levels specified in its Schedule – the safe harbour in the *chapeau* to Article 3.1 applies.

[22] Exhibits Bra-552, Bra-553 and Bra-554. *See also* Brazil's First Written Submission, para. 452.

[23] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 67; Appellate Body Report, *U.S. – Shrimp (21.5)*, para. 87.

[24] *See* WT/DS267/30, paras. 8 ((ii) and (iii)), 26. Throughout its response, Brazil will refer to the measure subject to its claims as "the GSM 102 program as amended by the modified GSM 102 fee schedule".

[25] U.S. Rebuttal Submission, para. 10.

[26] Exhibit Bra-504 ("USDA changes its fees to risk-based method for the GSM-102 and Supplier Credit Guarantee programs," USDA FAS Online News Release, 30 June 2005, accessed November 2006 at http://www.fas.usda.gov/scriptsw/PressRelease/pressrel_dout.asp?PrNum=0093-05); Exhibit Bra-505 (GSM-102 Guarantee Fee Rate Schedule, USDA FAS Online, accessed September 2006 at www.fas.usda.gov/excredits/gsm102fees.html).

[27] Exhibit Bra-519 (7 C.F.R. Part 1493, Subparts A and B, GPO Access Online, January 2006, accessed July 2006 at http://www.gpoaccess.gov/cfr/index.html).

- USDA FAS "FAQs" issued with the announcement of the amendments to the ECG programs effective 1 July 2005 does not indicate that those amendments apply differently to different eligible products[29];

- The USDA FAS "fact sheet" describing the amendments to the ECG programs effective 1 July 2005 does not indicate that those amendments apply differently to different eligible products.[30]

30. The measure subject to Brazil's claims in this dispute, and the GSM 102-related "measures taken to comply", are identical – namely, the GSM 102 program as amended by the modified GSM 102 fee schedule. The measure does not apply on a product-specific basis; the terms and conditions for ECGs under the GSM 102 program as amended by the modified GSM 102 fee schedule are the same for pig meat, poultry meat, and all other eligible scheduled as well as unscheduled products. While Brazil's claims regarding the consistency of the GSM 102 program as amended by the modified GSM 102 fee schedule are product-specific, the measure at issue is not.

31. The United States' objection to the inclusion of Brazil's Article 10.1 claims concerning pig meat and poultry meat within the scope of these Article 21.5 proceedings, is that those claims identify a *product-specific* measure. That objection is misplaced and should be rejected.[31] By challenging the amended GSM 102 program, Brazil is in full compliance with the limits imposed by Article 21.5 on the measures that may properly be subject to Article 21.5 review.

D. Claims

1. Erroneous basis for U.S. objection and the relevance of that objection for assessment of "*claims*"

32. As noted, the contested measure taken to comply – the GSM 102 program as amended by the modified GSM 102 fee schedule – applies uniformly and without variation to all eligible products. In these Article 21.5 proceedings, Brazil's claims apply to GSM 102 support for only some of those eligible products – unscheduled products and three scheduled products – rice, pig meat and poultry meat.

33. Given the Appellate Body's inability to complete the analysis with respect to Brazil's product-specific claims concerning support for exports of pig meat and poultry meat[32], there is no final resolution to Brazil's claims regarding the *original* GSM 102 program. Specifically, there are no adopted findings that the ECG programs, with respect to pig meat and poultry meat, are inconsistent with Article 10.1 of the *Agreement on Agriculture*, and there are no adopted findings that the ECG programs, again with respect to pig meat and poultry meat, are not inconsistent with Article 10.1.

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[28] Exhibit Bra-502 ("USDA announces changes to export credit guarantee programs to comply with WTO Findings," USDA FAS Online News Release, 30 June 2005, accessed November 2006 at http://www.fas.usda.gov/scriptsw/PressRelease/pressrel_dout.asp?PrNum=0092-05).

[29] Exhibit Bra-501 ("FAQs: Risk-Based Fees," Foreign Agriculture Service, USDA, accessed November 2006 at www.fas.usda.gov/excredits/faqs.html).

[30] Exhibit Bra-520 ("Export Credit Guarantee Program," USDA FAS Fact Sheet, March 2006, accessed November 2006 at http://www.fas.usda.gov/info/factsheets/gsm102-03.asp).

[31] As a result, the manifestations of "potential procedural unfairness" identified by the compliance Panel in *U.S. – Certain EC Products (21.5)*, which arose from the fact that the EC was bringing a new claim against an aspect of the original measure that remained unchanged following adoption by the United States of its "measures taken to comply", do not arise in the current compliance proceedings. Panel Report, *U.S. – Certain EC Products (21.5)*, para. 7.75 (note 294).

[32] Appellate Body Report, *U.S. – Upland Cotton*, paras. 689-694.

34. The United States does not appear to challenge the "final resolution" standard *per se*. That is, the basis for the United States' objection is not that Brazil is prohibited from pursuing the same claims that it maintained in the original proceedings, where there has not been final resolution of those claims. Rather, as discussed above, the United States argues that Brazil is prohibited from pursuing those same claims in these Article 21.5 proceedings, because the claims concern a measure that is not a "measure taken to comply".

35. Brazil has demonstrated above that its claims concern a *new* "measure taken to comply" that replaces the original measure. That is, the original GSM 102 program has been replaced by the amended GSM 102 program, including a modified guarantee fee schedule. In the situation where the Article 21.5 proceedings concern a new aspect of a new measure, there are *no* limits on the scope of Brazil's claims in these proceedings. The text of Article 21.5 allows claims regarding both the existence of measures taken to comply, and the consistency of those measures with all of the United States' obligations under the covered agreements.

36. The situation in these Article 21.5 proceedings is very similar to the situation that arose in the Article 21.5 proceedings in *Canada – Aircraft*. In that dispute, Canada amended the terms and conditions of an export subsidy program.[33] The Appellate Body held that the "measure taken to comply" was "a new measure, the *revised* TPC program", which was "separate and distinct" from the *original* TPC program.[34] In this dispute, the United States also amended the terms and conditions of an export subsidy program. The "measure taken to comply" is, therefore, "a new measure, the *revised* [GSM 102] program".

37. With respect to a new measure, the Appellate Body held that a compliance panel operating under the authority of Article 21.5 "is not confined to examining the 'measures taken to comply' from the perspective of the claims, arguments and factual circumstances that related to the measure that was the subject of the original proceedings."[35] Thus, a compliance panel can assess any claims made with respect to the new measure. The Appellate Body expressly endorsed the view that the complaining Member can make the "*same*" claims that were made in the original proceedings.[36]

38. Thus, in these compliance proceedings, Brazil is entitled to claim that the amended GSM 102 program is applied in a manner that circumvents the United States' commitments for pig meat and poultry meat.

39. The compliance Panel's asks Brazil to justify its position – that it may pursue, in Article 21.5 proceedings, the same claim that it maintained in the original proceedings, where there has not been final resolution of that claim – under the DSU, as interpreted by panels and the Appellate Body. Brazil explores the limits on claims that can be made in compliance proceedings in the paragraphs that follow.

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[33] Appellate Body Report, *Canada – Aircraft (21.5)*, para. 34.

[34] Appellate Body Report, *Canada – Aircraft (21.5)*, para. 36 (italics in original, underlining added).

[35] Appellate Body Report, *Canada – Aircraft (21.5)*, para. 41.

[36] Appellate Body Report, *Canada – Aircraft (21.5)*, footnote 35 (emphasis in original) ("We note that the claim made by Brazil relating to the revised TPC program, in this Article 21.5 dispute, is the *same* as the claim made by Brazil in the original proceedings in relation to the TPC program as previously constituted. In both cases, Brazil complained that the measure at issue was inconsistent with Article 3.1(a) of the *SCM Agreement*. These proceedings do not, therefore, involve a claim under a provision of the *SCM Agreement*, or, even, a claim under a covered agreement, that was not examined in the original proceedings in *Canada - Aircraft*.") (emphasis in original).

2. Limits on **claims** subject to Article 21.5 review

a. Limits concerning **"new"** claims

40. Several disputes have explored limits on the ability in Article 21.5 proceedings to pursue new claims regarding *unchanged* components of the *original* measure that were not pursued in the original proceedings. Panels have determined that a complaining Member may not, in Article 21.5 proceedings, pursue a new claim on an aspect of the original measure that remains unchanged from the original proceedings, and that was not challenged in the original proceedings.[37]

41. This line of jurisprudence is not relevant to the issue currently before the compliance Panel. The United States' objection does not relate to a new claim made by Brazil in these Article 21.5 proceedings, but instead relates to the same Brazilian claim made first in the original proceedings, and again in these Article 21.5 proceedings. This line of case-law is also irrelevant in this proceeding because Brazil's claims relate to the *changed* guarantee fee schedule of the amended GSM 102 program, and not to an *unchanged* aspect of the original measure.

b. Limits concerning the **"same"** claims: "final resolution" standard

42. Another line of disputes addresses limits on a complaining Member's ability to pursue the same claim, in Article 21.5 proceedings, that it had previously pursued in the original proceedings. On several occasions, the Appellate Body and compliance panels have explored the limits on the ability in Article 21.5 proceedings to pursue the same claims previously pursued in the original proceedings regarding an unchanged aspect of the original measure.

43. In *EC – Bed Linen (21.5)*, the Appellate Body concluded that[38]

> an *unappealed* finding included in a panel report that is *adopted* by the DSB must be treated as a *final resolution* to a dispute between the parties in respect of the *particular* claim and the *specific* component of a measure that is the subject of that claim.[39]

44. As noted in Brazil's 16 January submission[40], the situation posed by the Appellate Body is different from the circumstances in the present dispute. To recap, the original panel limited its findings regarding circumvention to unscheduled products and one scheduled product – rice. Brazil

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[37] Panel Report, *Chile – PBS (21.5)*, paras. 7.141, 7.147, 7.152; Panel Report, *U.S. – Certain EC Products (21.5)*, para. 7.74; Panel Report, *EC – Bed Linen (21.5)*, para. 6.43.

[38] In *U.S. – Softwood Lumber VI (21.5)*, the Appellate Body concisely described this aspect of its conclusion in *EC – Bed Linen (21.5)* in the following terms: "a party cannot make the same claim of inconsistency against the same measure (or component of a measure) in an Article 21.5 proceeding if … the original panel found that the complaining party had not made out its claim with respect to the measure (or component of a measure (Appellate Body Report, *EC – Bed Linen (Article 21.5 – India)*, paras. 92-93 and 99)." Appellate Body Report, *U.S. – Softwood Lumber VI (21.5)*, para. 102 (note 150).

[39] Appellate Body Report, *EC – Bed Linen (21.5)*, para. 93 (emphasis in original). The original panel in that dispute stated that: "The issue before us is whether India should be allowed to raise, in this Article 21.5 proceeding, claims with respect to Article 3.5 which it **could and did** raise before the original panel, but which it did not pursue, and which the Panel dismissed for failure to present a *prima facie* case of violation." Panel Report, *EC – Bed Linen (21.5)*, para. 6.48 (emphasis in original). On review, the Appellate Body held that "the effect, for the parties, of findings adopted by the DSB as part of a panel report is the same, regardless of whether a panel found that the complainant failed to establish a *prima facie* case that the measure is inconsistent with WTO obligations, that the Panel found that the measure is fully consistent with WTO obligations, or that the Panel found that the measure is not consistent with WTO obligations." Appellate Body Report, *EC – Bed Linen (21.5)*, para. 96.

[40] Brazil's 16 January Submission, para. 12.

did not, as was the case for India in *EC – Bed Linen*, leave this finding unappealed. Rather, Brazil successfully appealed the original panel's finding. The Appellate Body reversed the original panel's finding that Brazil had failed to demonstrate actual circumvention with respect to pig meat and poultry meat, but was unable to complete the analysis given insufficient uncontested facts of record.[41]

45. The Appellate Body's reversal of the original panel's ruling, joined with its inability to complete the analysis, left the parties without final resolution of Brazil's claims regarding the provision of ECGs for exports of pig meat and poultry meat in excess of U.S. reduction commitments for those two products. This situation constitutes the effective equivalent of the exercise of false judicial economy, to which the Appellate Body also spoke in *EC – Bed Linen (21.5)*:

> The issue raised in this appeal is different from a situation where a panel, on *its* own initiative, exercises "judicial economy" by not ruling on the substance of a claim. … We believe that in a situation where a panel, in declining to rule on a certain claim, has provided only a partial resolution of the matter at issue, a complainant should not be held responsible for the panel's false exercise of judicial economy, such that a complainant would not be prevented from raising the claim in a subsequent proceeding.[42]

46. The circumstances in the present dispute are similar. The original panel erroneously excluded ECGs for pig meat and poultry meat from its findings regarding Brazil's circumvention claims. As a result of the original panel's failure to make the necessary factual findings, the Appellate Body, while reversing the original panel's conclusion as a matter of law, was unable to complete the analysis and offer Brazil satisfaction on its claims, through no fault of Brazil. In these circumstances, Brazil "should not be held responsible" for the lack of final resolution of its claims[43], and should be permitted, in these Article 21.5 proceedings, to renew its claims that the amended GSM 102 program has been applied to circumvent U.S. export subsidy commitments on pig meat and poultry meat.

47. In short, the circumstances that prevented India from renewing, in Article 21.5 proceedings in *EC – Bed Linen*, the same claim it had pursued in the original proceedings, are <u>not</u> present in the current dispute. Moreover, circumstances highlighted by the Appellate Body as not indicating final resolution of a claim <u>are</u> present in the current dispute.

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[41] Appellate Body Report, *U.S. – Upland Cotton*, paras. 689-694.

[42] Appellate Body Report, *EC – Bed Linen (21.5)*, para. 96 (note 115) (emphasis in original). In the past, the Appellate Body's use of the term "false judicial economy" has only been attached to an exercise of judicial economy that has been reversed on appeal. Thus, the Appellate Body's use of the phrase "false judicial economy" in *EC – Bed Linen (21.5)* suggests that in the circumstances it envisions, the complaining party will, in the original proceedings, have successfully appealed and secured reversal of that exercise of false judicial economy, therefore preserving its rights in the Article 21.5 proceedings. The compliance panel in *U.S. – OCTG Sunset Reviews (21.5)* faced a slightly different situation. In the Article 21.5 proceedings in that dispute, the compliance panel was asked whether an *unappealed* exercise of judicial economy in the original proceedings precludes review in Article 21.5 proceedings of the *same* claim raised with respect to a changed element of the measure. The compliance panel concluded that it did not:

> The fact that a panel, in an original dispute settlement proceeding, did not make findings [due to judicial economy] regarding certain issues relating to the investigating authorities' determination that were raised and argued before the panel, can not preclude a compliance panel, in its assessment under Article 21.5 of the DSU of the measures taken to comply with the DSB recommendations and rulings, from reviewing those aspects which have been incorporated by the authorities in the measure taken to comply."

Panel Report, *U.S. – OCTG Sunset Reviews (21.5)*, para. 7.92. This issue is currently on appeal. WT/DS268/19, para. 2.

[43] Appellate Body Report, *EC – Bed Linen (21.5)*, para. 96 (note 115) (emphasis in original).

48. In *U.S. – Shrimp (21.5)*, the Appellate Body similarly addressed limitations on the ability of a complaining Member to seek review, at the Article 21.5 phase, of the same claim addressed in the original proceedings. The Appellate Body concluded that a complaining Member can not pursue such a claim if it involved an unchanged aspect of the original measure that, in the original proceedings, had been found to be WTO-consistent.[44]

49. The situation confronted by the Appellate Body in *U.S. – Shrimp (21.5)* is different from the circumstances in the present dispute, for at least two reasons.[45]

50. First, in the original proceedings in the present dispute, the Appellate Body *reversed* the original panel's finding that Brazil had failed to demonstrate actual circumvention with respect to pig meat and poultry meat, but was unable to complete the analysis given insufficient uncontested facts of record.[46] There is, therefore, no finding of *WTO-consistency* with respect to Brazil's circumvention claims on pig meat and poultry meat, in stark contrast to the situation faced by the compliance panel and Appellate Body in *U.S. – Shrimp (21.5)*.

51. Second, as explained above, Brazil's claims of circumvention with respect to pig meat and poultry meat are not against an *unchanged aspect* of the same measure reviewed in the original proceedings. The measure subject to Brazil's claims, and the GSM 102-related "measures taken to comply" in this dispute, are the amendments to the GSM 102 fee schedule, and the amended GSM 102 program in its totality. Those measures taken to comply do not apply on a product-specific basis; in other words, the amended GSM 102 fee schedule makes no distinction between pig meat, poultry meat, other scheduled products, or unscheduled products.

52. The United States' attempt to *distinguish* the situation in the current Article 21.5 proceedings from relevant aspects of the second Article 21.5 proceedings in *Canada – Dairy* confirms the *similarity* between the two cases. As the United States notes, the United States and New Zealand requested a second Article 21.5 proceeding in *Canada – Dairy* "where the Appellate Body was unable to reach a decision in [an earlier proceeding] regarding the WTO-consistency of certain Canadian measure taken to comply because of a lack of sufficient facts."[47] That is precisely the situation in which Brazil finds itself. In the original proceedings, the Appellate Body reversed the original panel's finding that Brazil had failed to demonstrate actual circumvention with respect to pig meat and poultry meat, but was unable to complete the analysis given a lack of sufficient facts.[48]

53. While the United States possibly means to distinguish the two disputes with its observation that in *Canada – Dairy (21.5)*, the complaining Members' claims concerned "measures taken to comply", while in the present dispute, Brazil's claims do not, Brazil has already demonstrated that its claims are indeed with respect to a "measure taken to comply".

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[44] Appellate Body Report, *U.S. – Shrimp (21.5)*, paras. 89, 96 ("89. ... Malaysia seems to suggest ... that a panel must re-examine, for WTO-consistency, even those aspects of a new measure that were part of a previous measure that was the subject of a dispute, and were found by the Appellate Body to be WTO-consistent in that dispute, and that remain unchanged as a part of the new measure. .... 96. [T]he Panel ... rightly concluded that our ruling in *United States – Shrimp* with respect to the consistency of [the unchanged aspect of the measure], therefore, still stands").

[45] In *U.S. – Softwood Lumber VI (21.5)*, the Appellate Body concisely described this aspect of its conclusion in *U.S. – Shrimp (21.5)* in the following terms: "a party cannot make the same claim of inconsistency against the same measure (or component of a measure) in an Article 21.5 proceeding if the original panel and Appellate Body found the measure to be consistent with the obligation at issue (Appellate Body Report, *U.S. – Shrimp (Article 21.5 – Malaysia)*, paras. 89-99) ...." Appellate Body Report, *U.S. – Softwood Lumber VI (21.5)*, para. 102 (note 150).

[46] Appellate Body Report, *U.S. – Upland Cotton*, paras. 689-694.

[47] U.S. Rebuttal Submission, para. 13 (note 19).

[48] Appellate Body Report, *U.S. – Upland Cotton*, paras. 689-694.

54. Finally, a further reason that the circumstances of this dispute differ from those in *EC – Bed Linen (21.5)* and *U.S. – Shrimp (21.5)* is that Brazil's claims do not concern an *unchanged* aspect of the original measure. Rather, as noted, Brazil's claims concern the *changed* guarantee fee schedule of the amended GSM 102 program.

c. Interpretive bases for limits on claims

55. Based on the jurisprudence, Brazil has demonstrated that its claims of circumvention with respect to pig meat and poultry meat are legitimately within the scope of these Article 21.5 proceedings. To respond to part (a) of the compliance Panel's question, Brazil now reviews the interpretive basis for the various limitations on the right of a complaining Member to assert particular claims in Article 21.5 proceedings.

56. First, Brazil addresses the interpretive basis for the limits on new claims discussed above. According to panels, allowing any and all new claims in expedited compliance proceedings, without imposition of the limits discussed above in respect of an unchanged aspect of the original measure, would jeopardize the "security and predictability" of the WTO dispute settlement system, in contravention of Article 3.2 of the DSU[49], and the principles of fundamental fairness and due process inherent to dispute settlement[50], as well as the object and purpose of Article 21.5.[51]

57. Second, Brazil addresses the interpretive basis for the limits discussed above on the ability of a complaining Member to bring the same claim it had pursued in the original proceedings regarding an unchanged aspect of the original measure. The interpretive basis for these limits is somewhat richer, and is based on reading Article 21.5 in the context of Articles 16.4, 19.1, 21.1, 21.3 and 22.1 of the DSU. The Appellate Body's interpretation is best developed in its report in *EC – Bed Linen (21.5)*:

> Where a panel concludes that a measure is inconsistent with a covered agreement, that panel shall *recommend*, according to Article 19.1, that the Member concerned bring that measure into conformity with that agreement. A panel report, including the *recommendations* contained therein, shall be *adopted* by the DSB within the time period specified in Article 16.4 – unless appealed. Members are to *comply* with recommendations and rulings *adopted* by the DSB promptly, or within a reasonable period of time, in accordance with paragraphs 1 and 3 of Article 21 of the DSU. A Member that does not comply with the recommendations and rulings adopted by the DSB within these time periods must face the consequences set out in Article 22.1, relating to compensation and suspension of concessions. Thus, a reading of Articles 16.4 and 19.1, paragraphs 1 and 3 of Article 21, and Article 22.1, taken together, makes it abundantly clear that a panel finding which is not appealed, and which is included in a panel report *adopted* by the DSB, must be accepted by the parties as a *final* resolution to the dispute between them, in the same way and with the same finality as a finding included in an Appellate Body Report adopted by the DSB – with respect to the particular claim and the specific component of the measure that is the subject of the claim.[52]

58. These interpretive elements do not bar the compliance Panel from considering Brazil's claims of circumvention with respect to pig meat and poultry meat. As observed above, Brazil's claims relate to the changed guarantee fee schedule of the amended GSM 102 program, which is not an unchanged aspect of the original measure. Brazil's claims also do not involve a panel finding that was "not

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[49] Panel Report, *Chile – PBS (21.5)*, para. 7.152.
[50] Panel Report, *U.S. – Certain EC Products (21.5)*, para. 7.75
[51] Panel Report, *EC – Bed Linen (21.5)*, para. 6.43.
[52] Appellate Body Report, *EC – Bed Linen (21.5)*, para. 93 (emphasis in original).

appealed", that was "included in a panel report *adopted* by the DSB", and that must therefore, as a result of Articles 16.4, 19.1, 21.1, 21.3 and 22.1 of the DSU, be accepted by Brazil "as a *final* resolution" of the claim.

59. As support for its conclusion on the limits announced in *EC – Bed Linen (21.5)*, the Appellate Body also referred to the object and purpose of the DSU, noting that

> Article 3.3 provides that the *prompt* settlement of disputes is "essential to the effective functioning of the WTO". Article 21.5 advances the purpose of achieving a prompt settlement of disputes by providing an expeditious procedure to establish whether a Member has fully complied with the recommendations and rulings of the DSB. For that purpose, an Article 21.5 panel is to complete its work within 90 days, whereas a panel in an original dispute is to complete its work within 9 months of its establishment, or within 6 months of its composition. It would be incompatible with the function and purpose of the WTO dispute settlement system if a claim could be reasserted in Article 21.5 proceedings after the original panel or the Appellate Body has made a finding that the challenged aspect of the original measure is *not* inconsistent with WTO obligations, and that report has been adopted by the DSB. At some point, disputes must be viewed as definitely *settled* by the WTO dispute settlement system.[53]

60. These interpretive elements do not bar the compliance Panel from considering Brazil's claims of circumvention with respect to pig meat and poultry meat. As observed above, Brazil's claims do not involve reassertion of the same claim in Article 21.5 proceedings regarding an unchanged aspect of the original measure, following a finding by the original panel or the Appellate Body "that the challenged aspect of the original measure is *not* inconsistent with WTO obligations"; indeed, the Appellate Body reversed the original panel's finding that the ECG programs with respect to pig meat and poultry meat were not inconsistent with the export subsidy provisions of the *Agreement on Agriculture* and the *SCM Agreement*.

E. Conclusion

61. In its response to this question, Brazil has demonstrated that the measures and claims subject to the United States' ECG-related request for preliminary ruling pertain to a "measure taken to comply". Specifically, Brazil has demonstrated that its challenge relates to a new aspect of a new measure – the modified fee schedule that is part of the amended GSM 102 program. Brazil's answer demonstrates that in these circumstances, its challenge adheres to the textual and jurisprudential limits on the measures that may properly be challenged in Article 21.5 proceedings.

62. Separately, Brazil has demonstrated that in these proceedings, it is raising the same claims that it raised in the original proceedings, with respect to this new aspect of a new measure. Specifically, Brazil has demonstrated that its claims relate to the application of the amended GSM 102 to circumvent U.S. export subsidy commitments on pig meat and poultry meat; in the original proceedings, Brazil similarly claimed that the old GSM 102 was applied to circumvent U.S. export subsidy commitments on these two products. No final resolution was achieved, even with respect to this now-changed aspect of the old measure. Brazil's answer demonstrates that in these circumstances, its challenge adheres to the textual and jurisprudential limits on the claims that may properly be subject to review under Article 21.5.

[53] Appellate Body Report, *EC – Bed Linen (21.5)*, para. 98 (emphasis in original). *See also* Panel Report, *Chile – PBS (21.5)*, para. 7.135.

Questions to Brazil

7. Is Brazil of the view that it is only in the circumstances identified by the Appellate Body in EC – Bed Linen (Article 21.5 – India) that the scope of Article 21.5 proceedings is limited by the scope of the original proceedings? [Paragraphs 11-15 of Submission of Brazil to the Panel Regarding US Requests for Preliminary Ruling]

63. No. As discussed in Brazil's response to question 6, panels and the Appellate Body have addressed a number of circumstances in which the scope of Article 21.5 proceedings is limited by the scope of the original proceedings. None of these apply to Brazil's claims regarding the modified guarantee fee schedule of the amended GSM 102 program.

8. How does Brazil respond to the arguments of the United States that Brazil "incorrectly assumes that the standard is one of whether there has been a 'final resolution' of the issue in the original proceeding" and that Brazil misreads the Appellate Body report in EC – Bed Linen (Article 21.5 – India) and confuses the issue of "the scope of a compliance proceeding pursuant to Article 21.5 of the DSU" and the distinct issue of "when a claim against a specific measure or aspect of a measure can be considered to be 'finally resolved' for purposes of WTO dispute settlement"? [Paragraphs 8 and 12 of the Rebuttal Submission of the United States]

64. Brazil agrees that assessing the proper scope of an Article 21.5 proceeding requires separate determinations that (i) the measure at issue is a "measure taken to comply", and (ii) the claims levied by the complaining Member with respect to that measure are subject to review in compliance proceedings.

65. In its submissions to the compliance Panel, the United States does not appear to challenge the "final resolution" standard *per se*, as a means of assessing the question in part (ii). That is, the basis for the United States' preliminary objection is not that Brazil is prohibited from pursuing the same claims that it maintained in the original proceedings, where there has not been final resolution of those claims.

66. Rather, as discussed in Brazil's response to question 6, the United States' ECG-related request for preliminary ruling concerns solely part (i) of the assessment. Specifically, the United States argues that Brazil is prohibited from pursuing those same claims in these Article 21.5 proceedings, because the claims concern a measure that is allegedly not a "measure taken to comply". In its response to question 6, Brazil has demonstrated that its claims do indeed concern a "measure taken to comply".

9. What are the comments of Brazil on the arguments in footnote 22 of the United States' rebuttal submission?

67. Brazil's first comment is that the United States has never addressed the fact that Brazil's claims in this dispute pertain to the *modified guarantee fee schedule* of the *amended* GSM 102 program. Thus, the limitations in Article 21.5 on raising claims in compliance proceedings regarding an *unchanged* aspect of the *original* measure do not apply.

68. There are several arguments raised by the United States in footnote 22 of its Rebuttal Submission.

69. The United States appears to argue, **first**, that where the Appellate Body has reversed an original panel's finding of WTO-inconsistency with respect to a particular claim, but found itself

unable to complete the analysis given a lack of sufficient facts, that claim can not be considered by a compliance panel in subsequent proceedings.[54]

70. The U.S. argument is inconsistent with *EC – Bed Linen (21.5)*[55], in which the Appellate Body concluded that the exercise of judicial economy with respect to a claim raised in the original proceedings does not bar a complaining Member from reasserting that same claim in Article 21.5 proceedings.[56]

71. In some respects, the situation in the current dispute is the effective equivalent of the exercise of judicial economy described by the Appellate Body as presenting no bar to consideration of a claim in subsequent Article 21.5 proceedings. The original panel erroneously excluded ECGs for pig meat and poultry meat from its findings regarding Brazil's circumvention claims. As a result of the original panel's failure to make the necessary factual findings, the Appellate Body, while reversing the original panel's conclusion as a matter of law, was unable to complete the analysis and offer Brazil satisfaction on its claims, through no fault of Brazil. In these circumstances, Brazil "should not be held responsible" for the lack of final resolution of its claims regarding the *original* measure[57], and should be permitted, in these Article 21.5 proceedings, to renew its claims that the *amended* GSM 102 program has been applied to circumvent U.S. export subsidy commitments on pig meat and poultry meat.

72. **Second**, implicit in the United States' argument is an assertion that "the measures" subject to Brazil's claims remain unchanged from the original proceedings. As demonstrated in response to questions 6 and 8, however, Brazil's ECG-related claims of inconsistency with the covered agreements do indeed involve a new "measure taken to comply" and, in particular, the modified guarantee fee schedule in that new measure. The measure subject to Brazil's claims is a "measure taken to comply" – the GSM 102 program as amended by the modified GSM 102 fee schedule.

73. **Third**, in arguing that "Brazil would have this compliance Panel assume that the Appellate Body *had* made a finding of WTO-inconsistency with respect to the pig meat and poultry meat GSM 102 guarantees and *had* made a recommendation that the United States bring these measures into compliance,"[58] the United States reveals a misunderstanding of the compliance Panel's task. The Appellate Body has clarified that the task of a compliance panel operating under Article 21.5 is not limited to the issue whether the defending Member has implemented the recommendations of the DSB.[59] Instead, the compliance Panel must examine whether the *revised* measure is consistent with all of the implementing Member's WTO obligations – including the United States' export subsidy commitments for pig meat and poultry meat.

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[54] U.S. Rebuttal Submission, para. 14 (note 22) ("Brazil is effectively asking the Panel to render meaningless the fact that the Appellate Body *declined* to make any finding of WTO-inconsistency with respect to the measures because it *did not* find uncontested facts showing that the measures were provided inconsistently with any U.S. WTO obligations. Brazil would have this Panel assume that the Appellate Body *had* made a finding of WTO-inconsistency with respect to the pig meat and poultry meat GSM 102 guarantees and *had* made a recommendation that the United States bring these measures into compliance with the obligations assumed to be breach [sic] (and further to assume that this recommendation was adopted by the DSB). None of these things happened, and Brazil has no basis for asking the Panel to pretend otherwise.").

[55] As described in Brazil's response to question 6, the U.S. argument would similarly have prevented it from bringing the claims asserted in the second Article 21.5 proceeding in *Canada – Dairy*.

[56] Appellate Body Report, *EC – Bed Linen (21.5)*, para. 96 (note 115). *See also* Panel Report, *U.S. – OCTG Sunset Reviews (21.5)*, para. 7.92 (currently on appeal).

[57] Appellate Body Report, *EC – Bed Linen (21.5)*, para. 96 (note 115) (emphasis in original).

[58] U.S. Rebuttal Submission, para. 14 (note 22).

[59] *See, e.g.*, Appellate Body Report, *Canada – Aircraft (21.5)*, paras. 40-41. *See also* Panel Report, *Chile – PBS (21.5)*, paras. 7.136-7.137.

74. **Fourth**, and finally, the United States argues that, if Brazil is permitted to pursue its claim against U.S. use of the amended GSM 102 program to circumvent U.S. export subsidy commitments for pig meat and poultry meat, in the absence of a finding by the original panel or the Appellate Body of circumvention with respect to pig meat and poultry meat, and in the consequent absence of a DSB recommendation concerning circumvention with respect to pig meat and poultry meat, the United States could be "deprived of a reasonable period of time to bring any measures found to be WTO-inconsistent into compliance with its obligations", "where a measure (that is not a measure taken to comply) is found to be WTO-inconsistent for the first time in an Article 21.5 proceeding."[60]

75. The underlined portion of this statement reveals the fundamental error in the United States' reasoning. As demonstrated in response to questions 6 and 8, Brazil's ECG-related claims of inconsistency with the covered agreements do indeed involve a "measure taken to comply". The measure subject to Brazil's claims is the "measure taken to comply" – the GSM 102 program as amended by the modified GSM 102 fee schedule.

76. For systemic reasons, Brazil would like to address the relevance of the potential "deprivation" highlighted by the United States, assuming that the measure at issue is a "measure taken to comply" (and, thus, assuming that the underlined parenthetical is stricken from the United States' statement).

77. In that case, the potential "deprivation" noted by the United States is inherent to the Article 21.5 process. Where a Member adopts a "measure taken to comply", it is subject to review, under the expedited procedures of Article 21.5, for "consistency with a covered agreement". The text of Article 21.5 does not specify that consistency must be judged with reference to the particular provisions of the particular covered agreement under which a violation was found in the original proceedings. As noted above, the compliance Panel's mandate is to review the consistency of the measure with the covered agreements, and not with the specific recommendations made by the DSB.

78. If the Member's "measure taken to comply" is found to be WTO-inconsistent, the Member is not accorded an additional "reasonable period of time" to bring its measure into compliance. This has been confirmed by the Appellate Body and the compliance panel in *U.S. – FSC (21.5 II)*, another dispute involving recommendations under Article 4.7 of the *SCM Agreement*. The Appellate Body noted that if findings of violation in Article 21.5 proceedings "were to result in an extension of the time period set for" compliance,

> compliance proceedings could have the effect of extending implementation periods … in successive Article 21.5 proceedings. This could lead to a potentially "never-ending cycle" of dispute settlement proceedings and inordinate delays in the implementation of recommendations and rulings of the DSB.[61]

79. The compliance panel in that dispute in fact noted a problem that the United States ignores – allowing Members to secure additional time to implement recommendations through the Article 21.5 process would give them an incentive to adopt non-compliant "measures taken to comply":

> Nowhere do we find any indication in the text or context of Article 21.1/21.5 of the *DSU* or of Article 4.7 of the *SCM Agreement*, nor in the object or purpose of the *DSU* (nor, for that matter, the *SCM Agreement*) that would require repeated extensions of the implementation period in Article 21.5 *DSU* compliance proceedings. Indeed, such an interpretation would reduce the textual treaty terms "prompt compliance" and "without delay" to redundancy and inutility. We are not permitted to adopt such an

[60] U.S. Rebuttal Submission, para. 14 (note 22) (emphasis added).
[61] Appellate Body Report, *U.S. – FSC (21.5 II)*, para. 86, *quoting* Panel Report, *U.S. – FSC (21.5 II)*, para. 7.46.

> interpretation. Such an approach might lead to a potentially never-ending cycle, whereby a Member continues to adopt non-compliant measures in order to win more time to comply with adopted DSB recommendations and rulings. This would entirely undermine the effective operation of the WTO dispute settlement system.[62]

80. The potential "deprivation" of which the United States speaks is not unique to the current Article 21.5 proceeding; it is inherent to Article 21.5 proceedings generally, and is why it is incumbent on a defending Member, having already been found to be in violation of its WTO obligations, to adopt "measures taken to comply" that are fully WTO-consistent. No more time for implementation is, or should be, accorded. Having already been found to be in violation of its WTO obligations, the defending Member's curative "measures taken to comply" violate its obligations and commitments at its peril. As noted by the compliance panel in *U.S. – FSC (21.5)*,

> Article 21.5 comes after the "recommendation" provision in Article 19 of the *DSU*, and the principle of "prompt compliance" in Article 21.1, as part of the WTO dispute settlement process. The title of Article 21 – "Surveillance of recommendations and rulings" – is telling. It informs us that the proceedings are to follow the implementation of recommendations and rulings that have been made. This finds further support in the particular nature and purpose of *compliance* panel proceedings.[63]

81. Using the Article 21.5 process to "add[] to the 'non-implementing' Member's rights under the covered agreements through an extension of the time-period for implementation" would undermine the object and purpose of compliance proceedings.[64]

82. The rights and obligations of complaining and defending Members in Article 21.5 proceedings are finely balanced. The potential "deprivation" noted by the United States is a burden a defending Member in an Article 21.5 proceedings must bear, as a result of the terms of Article 21.5 and the object and purpose of compliance proceedings. Similarly, Brazil has described in detail (in its response to question 6) the limits imposed on complaining Members in Article 21.5 disputes – they may challenge only "measures taken to comply", and they may pursue only those claims not yet subject to final resolution.

Question to the US

10. Could the United States explain why it considers that what it describes as the "final resolution" standard is not the correct standard to decide whether Brazil's claims regarding export credit guarantees for pig meat and poultry meat are within the scope of this proceeding?

2. Preliminary objections of the United States with respect to claims of Brazil regarding marketing loan and counter-cyclical payment programs

Questions to Brazil

11. Is Brazil of the view that a finding under Article 6 of the SCM Agreement that a "subsidy" is causing serious prejudice necessarily always applies to both the subsidy "payments" and the subsidy "program"? [Paragraphs 31-35 of Submission of Brazil Regarding US Requests for Preliminary Ruling and paragraph 38 of the Rebuttal Submission of Brazil]

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[62] Panel Report, *U.S. – FSC (21.5 II)*, para. 7.46 (emphasis added).
[63] Panel Report, *U.S. – FSC (21.5 II)*, para. 7.42.
[64] Panel Report, *U.S. – FSC (21.5 II)*, para. 7.45.

83. Brazil considers that the answer to this question depends on the particular facts before a panel. Brazil recognizes that there might be situations where a Member makes subsidy "payments" in the absence of a subsidy "program". In that case, a finding of serious prejudice could be made regarding payments alone. However, if a Member challenges "payments" that are mandated by a program, a finding regarding the payments necessarily implicates the program.

84. There may also be situations where a Member challenges subsidy "programs". In that event, a finding of serious prejudice necessarily applies to payments mandated under the program. When a subsidy program mandates certain subsidy payments, an examination of the "*effects*" of the program necessarily includes an assessment of the circumstances in which mandatory payments are made; the nature of those payments, including their general amount and the intended recipients; and the impact of those payments in the marketplace. In short, the WTO-consistency of a program under Article 6 of the *SCM Agreement* cannot be artificially separated from the WTO-consistency of payments mandated by a program.

85. Turning to the specific facts of this case, in the original proceedings, Brazil challenged both the subsidy "programs" and the subsidy "payments" mandated under those programs. As a result, the original panel's findings under Article 6 apply to both. This is confirmed by the original panel's description of the contested measures; its examination of those measures; and its conclusion that those measures cause serious prejudice.

86. The original panel's findings regarding its terms of reference illustrate that the contested measures found to be WTO-inconsistent included the subsidy programs in the FSRI Act of 2002 and the payments mandated by them. The United States contended that the panel's terms of reference excluded payments made after the date of the panel's establishment. The original panel rejected this argument, stressing that:

> The *programs and legislation* identified [in Brazil's request for establishment of a panel] *include payments* made before the date of establishment of the Panel, *and those made subsequently*. *All such payments were and are made under the same legislative and regulatory provisions which entered into effect prior to the consultations and have remained in place throughout the Panel proceeding. Therefore, the Panel rules that payments under programs and legislation within the Panel's terms of reference, made after the date on which the Panel was established … are within its terms of reference*.[65]

87. The original panel, therefore, found that the contested measures included "*programs and legislation*" identified in the panel request, together with "*payments*" made under the contested programs *at any time during the panel proceedings*. Thus, the original panel viewed the mandatory payments as intrinsic to the contested programs, and as part of its terms of reference. Nothing in this finding suggests that the original panel artificially separated the subsidy programs from mandatory payments made pursuant to those programs. Further, the original panel stated no temporal limitations on the subsidy measures examined. The United States did not appeal these findings.

88. In making this finding, the original panel opined that it would undermine the object and purpose of the *SCM Agreement* if a Member were unable to challenge subsidies "until they were actually paid".[66] The panel, therefore, had in mind that a subsidy program mandating payments could cause adverse effects, even before payments are disbursed. In this regard, the original panel found

[65] Panel Report, *U.S. – Upland Cotton*, para. 7.187.
[66] Panel Report, *U.S. – Upland Cotton*, para. 7.191.

that "it is clear that the existing subsidy programs are currently envisaged to remain in effect between MY 2003-MY 2007."[67]

89. Having found that its terms of reference encompassed the subsidy programs and past, present and future payments mandated by those programs, the original panel also stated expressly, in paragraph 7.1107 of its report, that the measures at issue in Brazil's "present" serious prejudice included the "*legislative and regulatory provisions currently providing*" for marketing loan, CCP, and Step 2 payments, as well as the "payments" mandated by those legislative and regulatory provisions.[68] Again, the original panel stated no general temporal limitation on the scope of the measures and, again, these findings were not appealed by the United States.

90. Significantly, the original panel noted that the measures involved in Brazil's present serious prejudice claims included cottonseed payments *limited to* the "2000 crop".[69] This is a clear temporal limitation on a subsidy measure. Thus, any findings by the original panel would have been restricted to the effects of cottonseed payments made in MY 2000.[70] However, no such temporal limitation is placed on any of the other measures listed in paragraph 7.1107.[71]

91. Immediately after listing the "legislative and regulatory provisions" as measures that were part of the present serious prejudice analysis, the original panel cross-referenced to Brazil's "per se" claims. It used the phrase "*see also* Brazil's *per se* actionable subsidy claims in Section VII:I."[72] Contrary to the U.S. argument, this cross-reference, and the use of the word "also", confirms that the "legislative and regulatory provisions" of the FSRI Act of 2002 were included in the present serious prejudice analysis and "also" in the *per se* claims.

92. The original panel then chose a "reference period" for assessing the effects of the contested subsidy programs and mandatory payments. Although the original panel chose MY 2002 as an appropriate "reference period", it declared that it would be "inappropriate" to focus its analysis on MY 2002 alone. It found that subsidies have been provided "over a longer period of time than one year" and that consideration of developments over a period longer provided a more robust basis for its conclusion.[73] The original panel, therefore, sought to put the effects of the contested subsidy programs into "a broader temporal context".[74] This is also consistent with the fact that its terms of reference extended to mandatory payments made throughout the panel proceedings.

93. Thus, the choice of MY 2002 served as a *methodological tool* to marshal and examine evidence relating to the "effects" of the contested subsidy programs. Moreover, the original panel's use of that tool was not exhaustive, but was complemented by an examination of data from other periods. Also, in selecting a "reference period", the panel did not make a jurisdictional decision that the measures at issue were limited to payments within the "reference period". Indeed, any such finding would have contradicted the panel's conclusion that the measures at issue included the "legislative and regulatory provisions" establishing the subsidy programs, as well as all payments made under these programs "throughout the Panel proceeding".[75]

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[67] Panel Report, *U.S. – Upland Cotton*, para. 7.1500.
[68] Panel Report, *U.S. – Upland Cotton*, paras, 7.1107.
[69] Panel Report, *U.S. – Upland Cotton*, para. 7.1107(viii).
[70] The original panel did not find that cottonseed payments caused significant price suppression.
[71] Further, Brazil has explained in its answer to Question 11 that the panel's cross-reference using the phrase "see **also** Brazil's per se actionable subsidy claims in Section VII:1" confirms that the panel examined both the payments and programs in making its present serious prejudice findings.
[72] Panel Report, *U.S. – Upland Cotton*, para. 7.1107, note 1247.
[73] Panel Report, *U.S. – Upland Cotton*, para. 7.1199.
[74] Panel Report, *U.S. – Upland Cotton*, para. 7.1199.
[75] Panel Report, *U.S. – Upland Cotton*, para. 7.187.

94. The United States' contention that the original panel's findings were confined to "payments" is further contradicted by that panel's treatment of "payments" in its reasoning. The United States tried, but failed, to demonstrate that Brazil was required to quantify precisely the amount of the payments made.[76] The original panel dismissed these arguments, holding that there was no duty to quantify the amount of the payments nor to trace payments to particular recipients and/or products.[77]

95. Instead, the original panel undertook an analysis of the "effects" of the contested subsidy programs by focusing on their "*structure, design and operation*".[78] It stated that this "*qualitative*" analysis was to be complemented, "to some extent", by a "quantitative analysis" of the "general order of magnitude of the subsidies" (*i.e.*, the general level of payments).[79] The Appellate Body bolstered this qualitative aspect of the original panel's approach, noting the importance of the "*nature* of the subsidy" to an assessment of the subsidy's effects under Article 6 of the *SCM Agreement*.[80]

96. If the original panel's findings had related to "payments" alone, and not to the subsidy programs, its reasoning would have been very different indeed. The panel would have required precise identification of the contested subsidy payments, including their amount, and the recipients and products receiving them, because these would have been the measures at issue. A precise quantitative examination of the magnitude of "payments" would have been of central importance and not merely conducted "to some extent", as a complement to the qualitative examination. Moreover, the *qualitative* examination of the "structure, design and operation" of the measures would have been meaningless because the dollar amount of payments do not have "structure", "design" or "operation".

97. The focus by the original panel on "programs" in its present serious prejudice analysis is illustrated in its finding that the price suppression in the world market was "significant." It reasoned as follows:

> During the period under consideration, given the relative magnitude of United States production and exports, the overall price trends we identified in the world market, and <u>*the nature of the mandatory United States subsidies in question – in particular*</u>, *the market-price contingent, countercyclical,* <u>*nature of the marketing loan program*</u>, *the user marketing* <u>*(Step 2) program*</u>, *MLA payments, and CCP payments* - and the readily available evidence of the order of magnitude of the subsidies, we are certainly not, by any means, looking at an insignificant or unimportant world price phenomenon.[81]

98. This is a crucial finding because it was the basis for the determination that the amount of price suppression in the world market was high enough to cause a violation of Article 6.3(c) ("significant" price suppression). And the *nature* of the *mandatory*, *price-contingent* marketing loan *program* was a vital factor in the original panel's finding. The passage shows, again, that the subsidy measures found by the original panel to be WTO-inconsistent included "*mandatory*" subsidy "*programs*", and not just

[76] Panel Report, *U.S. – Upland Cotton*, paras 7.1159-7.1174.
[77] Panel Report, *U.S. – Upland Cotton*, para. 7.1173.
[78] Panel Report, *U.S. – Upland Cotton*, para 7.1194.
[79] Panel Report, *U.S. – Upland Cotton*, para 7.1173; *see also* Appellate Body Report, *U.S. – Upland Cotton*, para. 467 ("a panel should have regard to the magnitude of the challenged subsidy *and its relationship to prices of the product in the relevant market* when analyzing whether the effect of a subsidy is significant price suppression"; the issue of when prices are low enough to trigger the subsidies is part of the design and operation of the subsidy program set out in a legislative and regulatory framework).
[80] Appellate Body Report, *U.S. – Upland Cotton*, para. 450 ("The <u>nature</u> of a subsidy plays an important role in any analysis of whether the effect of the subsidy is significant price suppression under Article 6.3(c).").
[81] Panel Report, *U.S. – Upland Cotton*, para. 7.1332 (emphasis added).

"payments". These findings were also consistent with extensive evidence of the price suppressing effects of the price-contingent "programs" presented by Brazil to the original panel.[82]

99. Given all of these findings, it is of no surprise that in describing its conclusions on present serious prejudice, the original panel confirmed that the WTO-inconsistent measures causing serious prejudice included the "present statutory and regulatory framework" of the FSRI Act of 2002:

> Because the Panel's "present" serious prejudice findings include findings of inconsistency that deal with the FSRI Act of 2002 and subsidies granted thereunder in MY 2002, the United States is obliged to take action concerning its present statutory and regulatory framework as a result of our "present" serious prejudice finding. We recall that, pursuant to Article 7.8 of the *SCM Agreement*, the United States is under an obligation to "take appropriate steps to remove the adverse effects or ... withdraw the subsidy.[83]

100. In paragraph 7.1503 of its report, the original panel confirmed that, during implementation, the United States was required to "*significantly transform[]*" the contested subsidy programs such that, after implementation, any subsidy programs maintained by the United States would be "*manifestly different*" from those originally contested. The United States never appealed these findings.

101. These findings were crucial to the original panel's decision that there was no need for the original panel to address Brazil's claims of threat of serious prejudice. The original panel noted that Brazil's threat claims extended throughout "the remaining period of application of the FSRI Act of 2002"; that is, through MY 2007.[84] Because the United States was obliged by the present serious prejudice findings to "significantly transform" the "present statutory and regulatory framework" of the FSRI Act of 2002, there was no need for the panel to consider a threat of serious prejudice through MY 2007.

102. Thus, the original panel held that the United States was obliged to take action to modify, or withdraw, the contested subsidy programs to eliminate present serious prejudice that would otherwise persist throughout "the remaining period of application of the FSRI Act of 2002".[85] On any other view, the original panel would have examined Brazil's claims of a threat of serious prejudice in MY 2007.

103. This is also confirmed by paragraph 8.1(g)(i) of the original panel report, in which the panel concludes that "*mandatory price-contingent* United States subsidy *measures*" are inconsistent with Article 5(c) and 6.3(c) of the *SCM Agreement*. The reference to "mandatory price-contingent" measures refers to the contested subsidy *programs* that mandate payments on price-contingent basis. This expression does not encompass payments of specific dollar amounts made during a defined period of time because the payments do not mandate anything.

104. Thus, the original panel's description of the measures, its reasoning regarding present and threat of serious prejudice, and its conclusions, demonstrate that the measures found to be causing significant price suppression in the world market included the "statutory and regulatory framework" establishing the subsidy programs, as well as the continual flow payments mandated under these programs year after year through until MY 2007.

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[82] Brazil Submission Regarding the U.S. Request for Preliminary Ruling, para. 38, note 47.
[83] Panel Report, *U.S. – Upland Cotton*, para. 7.1501.
[84] Panel Report, *U.S. – Upland Cotton*, para. 7.1500.
[85] Panel Report, *U.S. – Upland Cotton*, para. 7.1500.

105. Thus, given the original panel's finding in paragraph 7.1501, any "appropriate steps" that the United States was obligated to take must have included changes to its "present statutory and regulatory framework".

106. Indeed, the United States took one such "statutory and regulatory" step (albeit insufficient). Brazil has observed that statements by the United States on the significance of the repeal of the Step 2 program – itself set forth in the FSRI Act of 2002 – demonstrate that the United States itself considered that it was required "to take action concerning its present statutory and regulatory framework as a result of our 'present' serious prejudice finding."[86] In August 2006, a USTR spokeswoman, Gretchen Hamil, stated that "repeal of the Step 2 program ... addresses [the] ... actionable subsidy findings in the dispute."[87] The U.S. Department of Agriculture also stated that the "legislative action" to repeal the Step 2 program "addresses a WTO finding regarding suppression of world cotton prices."[88]

107. It is only in these compliance proceedings that the United States has, for the first time, espoused the view that compliance required it to take no action whatsoever to change the contested subsidy programs, and instead permitted it to eliminate the effects of "payments" by payments of billions more dollars under the very same programs.

108. In conclusion, the compliance Panel inquired whether a finding under Article 6 of the *SCM Agreement* always necessarily applies to subsidy "payments" and subsidy "programs". As observed in Brazil's response, there might be situations in which a Member makes subsidy "payments" in the absence of a subsidy "program"; in that case, a finding of serious prejudice could be made regarding subsidy "payments" alone. However, Brazil has demonstrated above that in this dispute, the findings of the original panel applied to both subsidy "payments" and subsidy "programs".

12. In paragraph 44 of its Rebuttal Submission, Brazil states:

> ***"Accordingly, there is no need for Brazil to challenge per se the FSRI Act of 2002. Nor does it assert an 'as applied' challenge to the FSRI Act of 2002. Rather, Brazil challenges the counter-cyclical and marketing loan programs in the FSRI Act of 2002 and the payments that such programs require to U.S. upland cotton farmers, as they cause adverse effects." (emphasis added)***

Could Brazil please explain:

> ***a) How its claims against "programs and payments... as they cause adverse effects" differ from claims against programs as such?***

109. As explained in reply to Question 11, in the context of claims regarding the "effects" of subsidy programs that mandate subsidy payments, Brazil does not see any practical difference between challenging the programs and payments, and challenging the programs as such. Nor does Brazil see any difference in terms of a finding that the United States has not complied with Article 7.8 of the *SCM Agreement.*

110. Brazil's request for establishment of a panel in this Article 21.5 proceeding identifies the contested measures as the marketing loan and counter-cyclical "programs" and the marketing loan and counter-cyclical "payments." The use of the terms "program" and "payments" describes collectively

[86] Panel Report, *U.S. – Upland Cotton*, para. 7.1501.
[87] Exhibit Bra-438 ("U.S. Trade Officials Say Disappointed With Brazil's WTO Request Over Cotton Flap," Daily Report for Executives, 21 August 2006).
[88] Exhibit Bra-436 (Cotton and Wool Outlook, USDA, 13 March 2006, p. 4, accessed October 2006 at http://usda.mannlib.cornell.edu/usda/ers/CWS//2000s/2006/CWS-03-13-2006.pdf).

the "subsidy" measures involved in this dispute. Brazil's claims relate to the effects of the marketing loan and counter-cyclical subsidy programs and the payments mandated by those programs.

111. Brazil has demonstrated that these two subsidy programs, and the payments they mandate, cause significant price suppression in the world market for upland cotton as well as an increase in the U.S. world market share of upland cotton in MY 2005. The evidence and arguments set forth by Brazil establishes that the United States has failed to take appropriate steps to either withdraw the marketing loan and counter-cyclical subsidies or to remove the adverse effects caused by these subsidies.

112. While Brazil has challenged the marketing loan and counter-cyclical "programs" and their mandatory, price-contingent "payments", to the extent they cause adverse effects, it has not asserted an "as such" claim regarding the marketing loan and counter-cyclical payment programs in the FSRI Act of 2002. As explained in reply to Question 11, if Brazil had made such a claim (which Brazil believes is unnecessary in view of the original panel's findings), the compliance Panel's examination of the "*effects*" of the program would necessarily have included an assessment of the terms and conditions under which payments are mandated; the nature of those payments, including their general amount, and the intended recipients and/or products benefiting from them; and the impact (or "effect") of those payments in the marketplace.

113. If Brazil's "as such" claim had been successful, the result would be a finding by the compliance Panel that the United States failed to take appropriate steps, pursuant to Article 7.8 of the *SCM Agreement* to withdraw the marketing loan and counter-cyclical subsidies, or to remove the adverse effects caused by these subsidies. Therefore, the ultimate conclusion of this compliance Panel would be the same whether the compliance Panel were to find that the "subsidies" cause present serious prejudice, or whether the marketing loan and counter-cyclical payment "program" is "as such" inconsistent with the *SCM Agreement*.

114. Finally, Brazil agrees with the United States' observation in *EC – Selected Customs Matters* that certain claims under the covered agreements are "not readily classifiable in the categories of 'as such' and 'as applied.'"[89] An "as such" claim is typically understood to involve an examination of a *general rule or norm in the abstract*. However, as the original panel found, an examination of the "*effects*" of the general statutory and regulatory provisions establishing a subsidy program "*cannot be conducted in the abstract*" because they must be considered in light of the market-based effects of the measures.[90] Thus, Brazil considers that serious prejudice claims are among those that cannot be readily classifiable as "as such" and "as applied."

b) How these claims differ from claims against programs as applied?

115. As explained below, there is no practical difference in terms of this compliance Panel's ultimate finding that the United States has not complied with Article 7.8 of the *SCM Agreement.*

116. While Brazil's request for the establishment of a panel does not make an explicit "as applied" claim, that request is broad enough to encompass a claim described in these terms, if this compliance Panel were to deem it necessary to affix an "as applied" label to it. As noted above, Brazil's claims challenge, *inter alia*, the marketing loan and counter-cyclical subsidies, to the extent they cause adverse effects. Brazil sets out evidence and argument addressing the effects of the subsidy programs, including reference to the operation (or application) of the programs in the prior periods. If the compliance Panel finds that the marketing loan and counter-cyclical subsidies cause present serious prejudice, then the compliance Panel would find that the United States has not taken appropriate steps to withdraw the subsidies or to remove their adverse effects.

[89] Appellate Body Report, *EC – Selected Customs Matters,* para. 165.
[90] Panel Report, *U.S. – Upland Cotton*, para. 7.1198.

117. If the compliance Panel were to label Brazil's claims as "as applied" adverse effects claims, then presumably those claims would be cast in terms of whether the application of the marketing loan and counter-cyclical payment "programs" cause serious prejudice. Assuming the compliance Panel were to find that the application of the marketing loan and counter-cyclical "programs" (presumably accomplished through the means of mandatory and price-contingent "payments") causes serious prejudice, the compliance Panel would find that the United States had failed, pursuant to Article 7.8 of the *SCM Agreement*, to take appropriate steps to withdraw the marketing loan and counter-cyclical program subsidies or to remove their adverse effects.

118. Brazil again expresses its agreement with the United States' observation in *EC – Selected Customs Matters* that certain claims under the covered agreements are "not readily classifiable in the categories of 'as such' and 'as applied.'"[91]

13. In paragraph 45 of its Rebuttal Submission, Brazil refers to the failure of the United States "to implement the original recommendation of the DSB requiring the United States to take actions concerning its present statutory and regulatory framework providing for marketing loan and counter-cyclical payments".

a) Does Brazil consider that the statement in paragraph 7.1501 of the original panel report that "the United States is obliged to take action concerning its present statutory and regulatory framework..." forms an integral part of the recommendation made by the original panel in paragraph 8.3(d) of its report?

119. Yes, Brazil considers that the statement in paragraph 7.1501 of the original panel report forms an integral part of the recommendation made by the original panel in paragraph 8.3(d) of its report. The statement in paragraph 7.1501 is part of the assessment of the matter undertaken by the original panel and is found in the portion of the original panel report dealing with "findings." In paragraph 8.1, the original panel stated that, "[i]n light of the findings above, we conclude as follows …." The original panel then listed its conclusions, including its conclusions regarding present serious prejudice. In paragraph 8.3, the original panel sets forth its recommendations "[i]n light of these conclusions." This demonstrates that also the original panel considered its findings – including its statement in paragraph 7.1501 – to form an integral part of, and basis for, its conclusions and recommendations. As noted, these findings were never appealed by the United States.

b) Does Brazil consider that the absence of actions by the United States "concerning its present statutory and regulatory framework providing for marketing loan and counter-cyclical payments" is in itself a sufficient basis for this Panel to find that the United States has not complied with the DSB recommendation under Article 7.8 of the SCM Agreement?

120. Yes, Brazil considers that the absence of actions by the United States "concerning its present statutory and regulatory framework providing for marketing loan and counter-cyclical payments" is in itself a sufficient basis for the compliance Panel to find that the United States has not complied with the DSB recommendation under Article 7.8 of the *SCM Agreement*.

121. However, Brazil also demonstrates that the marketing loan and counter-cyclical payments programs, as well as payments mandated thereunder, cause adverse effects in violation of Article 5(c) and 6.3 of the *SCM Agreement*. In other words, following the U.S. repeal of the Step 2 subsidy, the new basket of measures involving these two subsidies causes significant price suppression in the world market for upland cotton and an increase in the U.S. world market share, in violation of Articles 5(c) and 6.3(c) and (d). In establishing these violations, Brazil provides evidence on the structure, design and operation of the subsidy programs, including the nature and magnitude of the

[91] Appellate Body Report, *EC – Selected Customs Matters*, para. 165.

payments mandated by them, as well as the relevant conditions of competition in the world market for upland cotton.[92]

122. Should the compliance Panel find that the absence of actions by the United States is a sufficient basis to conclude that the United States has not complied with the DSB recommendation under Article 7.8 of the *SCM Agreement*, Brazil nevertheless requests that the compliance Panel make factual findings that these subsidies continue to cause significant price suppression and an increase in the U.S. world market share, in the event that these factual findings prove to be relevant for an appeal.

c) Is there any difference, in Brazil's view, between, on the one hand, the nature of the action the United States was obliged to take with respect to its statutory and regulatory framework as a consequence of the recommendation in paragraph 8.3(d) of the original panel report and, on the other, the nature of the action the United States would have been obliged to take if the original panel had found that the relevant provisions of this statutory and regulatory framework were WTO-inconsistent as such?

123. No, the action required by the United States would have been the same in both cases.

124. The scope of the United States' implementation obligations turns on the identity of the measures that the original panel found to be WTO-inconsistent. In this dispute, as explained in reply to Question 11, the entirety of the original panel's findings demonstrate that the measures found to be WTO-inconsistent included the "statutory and regulatory framework" establishing the contested subsidy programs. As a result, the United States' implementation obligations required it to take action to amend or repeal this statutory and regulatory framework.

125. The original panel expressly stated that the *contested measures* included "*current legislative and regulatory provisions* providing for the payment" of the contested subsidies, as well as payments mandated by the programs throughout the panel proceedings.[93] Consistent with this statement, the original panel's examination of the contested measures "focus[ed]" on the *design, structure and operation* of the contested *programs*, as set forth in the statutory and regulatory framework establishing the programs.[94] In contrast, the original panel found that it was not necessary to quantify precisely the level of payments made under the contested programs.[95] Instead, as part of a "quantitative" assessment of the programs, it considered, "to some extent", the "general order of magnitude" of the payments made under the programs.[96]

126. In keeping with the description of the contested measures, and the examination of those measures, the original panel held, in paragraph 7.1501, that the measures causing "adverse effects" included the "*statutory and regulatory framework*" establishing the contested subsidy *programs*.

127. Immediately after making this statement, in paragraph 7.1503, the original panel also emphasized that, during implementation, the United States was required to "*significantly transform[]*" the contested subsidy programs such that, after implementation, any subsidy programs maintained by the United States would be "*manifestly different*" from those originally contested. For this reason, the original panel found that there was no need to examine whether the contested programs threatened serious prejudice during "the remaining period of application of the FSRI Act of 2002", that is

[92] Brazil's First Written Submission, Sections 7-9; Brazil's Rebuttal Submission, Sections 2.3-2.4. In its Opening Statement at today's meeting with the compliance Panel, Brazil will present further rebuttal evidence.
[93] Panel Report, *U.S. – Upland Cotton*, paras. 7.187 and 7.337.
[94] Panel Report, *U.S. – Upland Cotton*, para. 7.1194.
[95] Panel Report, *U.S. – Upland Cotton*, paras. 7.1173 and 7.1194.
[96] Panel Report, *U.S. – Upland Cotton*, paras. 7.1173 and 7.1194.

through MY 2007.[97] In short, the United States was required to make future payments under "manifestly different" "statutory and regulatory framework", or not make them at all. Nor was it necessary, for the same reasons, to rule on the WTO-inconsistency of the subsidy programs "as such".[98]

128. The findings or the original panel, in paragraphs 7.1501 and 7.1503 of its report, demonstrate that the measures found to be WTO-inconsistent included the "*statutory and regulatory framework*" establishing the contested subsidy *programs*.

129. This is also confirmed by paragraph 8.1(g)(i) of the original panel report, in which the Panel concludes that "*mandatory price-contingent* United States subsidy *measures*" are inconsistent with Article 5(c) and 6.3(c) of the *SCM Agreement*. As noted in reply to Question 11, the measures referenced in this paragraph are the subsidy programs, including mandatory payments, and not the "payments" on their own, because "payments" alone do not mandate anything.

130. The action required by the United States to "significantly transform" – or withdraw – the "*statutory and regulatory framework*" establishing the contested subsidy programs is the same as the action that the United States would have been obliged to take if the measures had been found to be "as such" WTO-inconsistent.

14. Could Brazil please explain how this Panel should interpret the relationship between the three categories of measures identified in paragraph 3.1(v),(vii) and (viii) of the original panel report? Is it the view of Brazil that "subsidies provided" or "subsidies mandated to be provided" must be interpreted to encompass both payments of subsidies and the regulatory provisions pursuant to which such payments were "provided" or "mandated to be provided"?

131. The compliance Panel's question refers to three categories of measure identified in paragraphs 3.1***(v)***, (vii) and (viii). Brazil believes that the Panel's question is intended to refer to paragraphs 3.1***(vi)***, (vii) and (viii), and answers on that basis.

132. The measures identified in paragraphs 3.1(vi) and 3.1(vii) must be interpreted to encompass the statutory and legislative framework establishing the contested subsidy programs, as well as payments mandated by those programs. Under paragraph 3.1(viii), the measures encompass simply the statutory and legislative framework establishing the contested programs. Brazil notes that its goal in defining these different categories of measures was to be *over-inclusive* in identifying comprehensively the range and combination of measures included in the original panel's terms of reference.

133. As explained in answers to Questions 11 and 13(c), the original panel found "present" serious prejudice with respect to the measures in paragraph 3.1(vi), that is the statutory and regulatory framework establishing the contested subsidy programs, as well as payments mandated by those programs. As the original panel stated in paragraphs 7.1501 and 7.1503 of its report, the United States' implementation obligations required it, therefore, to take action with respect to that framework to staunch the flow of the mandated payments.

15. Does Brazil agree or disagree with the United States that the listing of certain legislative and regulatory provisions in paragraph 7.1107 of the original panel report reflects the original panel's view that "payments under a program constitute programs 'as applied' "? [Paragraphs 46-47 of the Rebuttal Submission of the United States]

[97] Panel Report, *U.S. – Upland Cotton*, para. 7.1500.
[98] Panel Report, *U.S. – Upland Cotton*, para. 7.1511.

134. Brazil does not agree with the United States that the listing of certain legislative and regulatory provisions in paragraph 7.1107 of the original panel report reflects the original panel's view that "payments under a program constitute programs 'as applied.'" In fact, the original panel report indicated that the original panel did not make "as applied" findings (either expressly or by implication).

135. The United States attempts to rewrite the original panel report such that its implementation obligation would be limited to removing adverse effects of Step 2, marketing loan, and counter-cyclical payment subsidies for MY 1999-MY 2002. Brazil has set forth in detail its position regarding the original panel's findings in its Response to U.S. Requests for Preliminary Rulings. It reiterates those arguments together with its answers to the compliance Panel's earlier questions, in particular question 11, above. Brazil sets out additional explanation for its views below.

136. The United States' "as applied" argument incorrectly transforms the original panel's decision to use MY 2002, and the longer period of MY 1999-MY 2002, as "reference periods", into a period that circumscribes the *measures* involved in Brazil's present serious prejudice claims. Yet, as explained in reply to Question 11, the "reference period"[99] was merely a methodological tool used to marshal evidence and assess data. Nothing suggests that the original panel intended to restrict its conclusions and recommendations to any historical period of "effects".

137. Had the original panel intended to limit the measures at issue, as a jurisdictional matter, to payments in a particular historical period, any such finding would have contradicted its ruling that its terms of reference included mandatory payments made throughout the original panel proceedings.[100] Also, if the original panel's present serious prejudice findings were limited to payments made in MY 2002, or any other historical period, this would contradict its conclusion, in paragraph 7.1501 of its report, that changes to statutory framework resulting from its *present* serious prejudice obviated the need for examination of a *threat* of serious prejudice through MY 2007.

138. Moreover, the original panel's serious prejudice conclusion, set out in paragraph 8.1(g)(i) of its report, did not reference *any* time period. The original panel concluded that:

> (g) Concerning serious prejudice to the interests of Brazil:
>
> (i) the effect of the mandatory price-contingent United States subsidy measures – marketing loan program payments, user marketing (Step 2) payments, MLA payments and CCP payments – is significant price suppression in the same world market within the meaning of Article 6.3(c) of the *SCM Agreement* constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement.*

139. The United States claims that this conclusion is limited to the effects caused by mandatory price-contingent United States subsidy payments made only *during MY 2002*, or effects caused by mandatory price-contingent subsidy payments made only *during* MY 1999-2002. However, if applicable, any such temporal limitation would have been set out expressly in both the description of the measures at issue in paragraph 7.1107, and the panel's conclusion in paragraph 8.1(g)(i). Yet, as a jurisdictional matter, there is no temporal limitation on the measures at issue in these or any other paragraph of the original panel report.

140. Further, the final panel report was issued to the parties on 18 June 2004 – 10 ½ months *after* MY 2002 ended and only six weeks *before* MY 2003 ended. By the time the Dispute Settlement Body adopted the "present" serious prejudice findings, conclusions and recommendations on

[99] Panel Report, *U.S. – Upland Cotton*, para. 7.1195 (heading title for Section VII.G.3(e)).
[100] Panel Report, *U.S. – Upland Cotton*, para. 7.187.

21 March 2005, almost two-thirds of MY 2004 had been completed. If the intention of the original panel had been to make an "as applied" finding limited to serious prejudice caused *only* in MY 2002 or *only* in MY 1999-2002, it would have used the *past* tense in its conclusions in paragraph 8.1(g)(i) of its report. Instead, it used the *present* tense: "the effect of mandatory price-contingent United States subsidy measures … is significant price suppression …."). That conclusion and the accompanying recommendation in paragraph 8.3 – along with the U.S. obligation under Article 7.8 to take appropriate steps to remove the adverse effects or withdraw the subsidy – continues to be applicable today.

141. Significantly, the original panel's findings that the United States was obligated to take action concerning its "present statutory and regulatory framework" existing in MY 2003 as a result of the panel's "present" serious prejudice findings also is inconsistent with the U.S. argument that the original panel made an "as applied" finding. The original panel found that "it is clear that the existing subsidy programs are currently envisaged to remain in effect between MY 2003-MY 2007." And immediately after making this finding, the original panel held:

> Because the Panel's "present" serious prejudice findings include findings of inconsistency that deal with the FSRI Act of 2002 and subsidies granted thereunder in MY 2002, the United States is obligated to take action concerning its present statutory and regulatory framework as a result of our "present" serious prejudice findings. We recall that, pursuant to Article 7.8 of the *SCM Agreement*, the United States is under an obligation to "take appropriate steps to remove the adverse effects or … withdraw the subsidy.[101]

142. If the original panel had made an "as applied" finding limited to only *past* effects of *past* mandatory and price-contingent payments, then there would be no reason for the original panel to state in June of 2004 that "*the United States is obligated to take action concerning its present statutory and regulatory framework as a result of our "present" serious prejudice finding*s." Moreover, there would also have been every reason for the original panel to examine a threat of serious prejudice through MY 2007.

143. Instead, under the U.S. theory, because the original panel made only "as applied" findings of present serious prejudice for past payments, and because it neglected to make any "threat" findings, the United States had every right to continue making massive *future* mandatory and price-contingent payments during MY 2003, MY 2004, and MY 2005. On this view, when the United States was required to "take appropriate steps" in *MY 2005* to withdraw the adverse effects of payments made in MY 1999-MY 2002, the United States could credibly assert that the $5.4 billion paid out in marketing loan counter-cyclical subsidies in MY 2003-2005[102] were not subject to any implementation obligations, and were *the* intervening cause of significant price suppression in MY 2005.

144. In conclusion, the original panel *never* described its findings, conclusions or recommendations as being "as applied." Nor did the original panel conclude that Brazil's present serious prejudice claims constituted only "as applied" claims limited to payments made within a specified period. As demonstrated above, neither the panel's terms of reference, the measures the original panel found to be applicable to Brazil's serious prejudice claims in paragraph 7.1107 of its report, or the measures the original panel concluded cause significant price suppression were so limited.

145. Finally, even assuming that the original panel's findings of present serious prejudice were "as applied" findings limited to marketing loan and counter-cyclical payments made during a particular

[101] Panel Report, *U.S. – Upland Cotton*, para. 7.1501.
[102] Exhibit Bra-471 (Table 6 in Detail).

historical period (*quod non*), subsequent payments made under the same program are also subject to the United States' implementation obligations.

146. In *U.S. – Softwood Lumber IV (21.5)*, Canada challenged a periodic review measure that was not declared by the United States to be a "measure taken to comply". The effect of the periodic review was to render nugatory the declared measure taken to comply. Following findings in *Australia – Leather (21.5)* and *EC – Bed Linen (21.5)*, the Appellate Body upheld the compliance panel's finding that the review measure was a WTO-inconsistent "measure taken to comply":

> Some measures with a particularly close relationship to the declared "measure taken to comply", and *to the recommendations and rulings of the DSB*, may also be susceptible to review by a panel acting under Article 21.5.[103]

147. In this dispute, subsequent payments made by the United States pursuant to the marketing loan and counter-cyclical payment programs have such a close relationship to measures subject to the original proceedings, and to the DSB's recommendations and rulings, that they are susceptible to review by this compliance Panel. In particular, the payments collectively constitute an unbroken stream of identical subsidies. The payments subject to the DSB's recommendations and the payments subject to these proceedings are mandated by the very same subsidy programs; they are made to the very same recipients; they support the very same crops; and they are granted on the very same terms and conditions. The subsequent payments are, therefore, "clearly connected" and "inextricably linked" to the measures found to be WTO-inconsistent in the original proceedings.[104]

148. Indeed, the connection between the payments is much closer than the connection between the measures at issue in *U.S. – Softwood Lumber IV (21.5)*, *Australia – Leather (21.5)* and *EC – Bed Linen (21.5)*. In sum, Brazil's dispute with the United States in these proceedings regarding the adverse effects of marketing loan and counter-cyclical subsidies is identical to its dispute regarding precisely the same subsidies in the original proceedings. The only significant change is that the level of the subsidies has *increased* with time.

149. Similar to the U.S. arguments in *U.S. – Softwood Lumber IV (21.5)*, if the U.S. view that subsequent marketing loan and counter-cyclical payments are *not* subject to this compliance Panel's review, the U.S. grant of recurring subsidies become "*a moving target that escape from [the WTO subsidy] disciplines*".[105] Subsequent mandatory payments would always have to be subject to new dispute settlement proceedings, and by the time these proceedings were completed, the effects of the latest payments would be superseded by yet more payments, which could in turn only be challenged in yet another original panel process. WTO dispute would dissolve into a "Groundhog Day" situation, with no remedy available to Members suffering adverse effects.[106]

150. Thus, even if the United States were correct (*quod non*), that the DSB's recommendations pertain solely to marketing loan and counter-cyclical payments made during a defined historical period, Brazil is entitled to challenge subsequent marketing loan and counter-cyclical payments in these compliance proceedings because these payments are "inextricably linked".

16. Could Brazil clarify whether or not its claim in this Article 21.5 proceeding regarding a threat of serious prejudice caused by marketing loan and counter-cyclical payments is a claim with respect to the marketing loan and counter-cyclical payment programs as such? [Paragraphs 237-314 of the First Written Submission of Brazil]

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[103] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 77.

[104] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 79.

[105] Panel Report, *U.S. – Softwood Lumber IV (Article 21.5 – Canada)*, para. 4.30.

[106] Panel Report, *U.S. – Softwood Lumber IV (Article 21.5 – Canada)*, para. 4.30, *quoting* arguments of the European Communities.

151. The scope of the compliance Panel's terms of reference in these proceedings is determined by the Brazil's Request for the Establishment of a Panel.[107] Paragraph 20 of the Panel Request specifies:

> Specifically, Brazil believes that the US marketing loan and counter-cyclical payment programs under the FSRI Act of 2002, as amended, *as well as payments mandated to be made thereunder*, threaten to cause significant price suppression in the world market for upland cotton in marketing years 2006 and until the expiry or repeal of these programs.[108]

Thus, Brazil claims that the contested subsidy programs, as well as payments to be made under those programs, threaten to cause serious prejudice.

152. To examine this claim, following the approach of the original panel, as upheld by the Appellate Body, the compliance Panel must consider the *structure, design and operation* of the contested *programs*, as set forth in the statutory and regulatory framework establishing the programs.[109] In addition, along with other evidence, the compliance Panel may also consider the general order of the magnitude of payments made under the contested programs in the past. On this basis, the compliance Panel may establish whether the effect of the contested programs is to threaten serious prejudice in the future.[110]

153. Brazil recalls its agreement with the United States' observation in *EC – Selected Customs Matters* that certain claims under the covered agreements are "not readily classifiable in the categories of 'as such' and 'as applied.'"[111] Brazil considers that serious prejudice claims are among those that cannot be readily classifiable as "as such" and "as applied."

Questions to the United States

17. The United States argues in paragraph 16 of its Rebuttal Submission that "[a]ccording to Brazil, its claims apply not only to the marketing loan and counter-cyclical payment programs, as such, but to the programs in addition to all payments authorized under the programs" (original emphasis). The United States also argues in this respect that "it is abundantly clear that the original panel did not make any finding under Article 5(c) and 6.3(c) of the SCM Agreement against the marketing loan and counter-cyclical payment programs, as such, whether alone or in addition to payments". [Paragraph 43 of Rebuttal Submission of the United States]

a) How does the United States respond to the argument of Brazil that the United States mischaracterizes Brazil's claims in these proceedings in that Brazil is not challenging the subsidy programs at issue as such? [Paragraph 31 of Submission of Brazil to the Panel Regarding US Requests for Preliminary Ruling; paragraph 33 of Rebuttal Submission of Brazil]

b) Could the United States also comment in this regard on the arguments in paragraph 31 of the Third Party Submission of Chad? Does the United States agree or disagree with the proposition that statutory or regulatory provisions can be challenged on an as applied basis and that Brazil's claims in the original proceeding "were as applied claims regarding measures that included legislative and regulatory provisions"?

[107] WT/DS267/30.
[108] WT/DS267/30 (footnote omitted).
[109] Panel Report, *U.S. – Upland Cotton*, para. 7.1194.
[110] Panel Report, *U.S. – Upland Cotton*, paras. 7.1173 and 7.1194.
[111] Appellate Body Report, *EC – Selected Customs Matters*, para. 165.

18. The United States submits that the only measures subject to the DSB's recommendation under Article 7.8 of the SCM Agreement are payments made under the Step 2, marketing loan, and counter-cyclical payment programs in 1999-2002. The United States also asserts, in this regard, that Brazil fails to submit evidence "as to the present effects, if any, of the measures that were subject to the original panel's actionable subsidy finding".

a) Do these statements mean that the United States considers that the DSB recommendation under Article 7.8 of the SCM Agreement only obliged the United States to ensure that payments made in 1999-2002 would no longer have any adverse effects?

b) Could the United States comment on the argument of New Zealand in paragraph 4.08 of the Third Party Submission of New Zealand?

19. Regarding the argument of the United States that the marketing loan and counter-cyclical payments programs are not measures "taken to comply", is it the view of the United States that Article 21.5 of the DSU only applies to measures actually taken by a party to comply and does not apply to measures that a Member should have taken to comply?

20. How does the United States respond to the argument in the Third Party Submission of Japan that the Appellate Body report in EC – Bed Linen (Article 21.5 – India) does not support the argument of the United States that the marketing loan and counter-cyclical payments programs are not within the scope of this Article 21.5 proceeding?

3. Claim of Brazil regarding the failure of the United States to comply with the DSB recommendations between 21 September 2005 and 1 August 2006

Questions to Brazil

21. Could Brazil please explain whether its request for a finding that the United States failed to comply with the DSB recommendations between 21 September 2005 and 1 August 2006 is supported by prior panel practice in Article 21.5 proceedings? [Paragraph 68 of the Rebuttal Submission of the United States]

154. In *Australia – Salmon(21.5)*, Canada made claims similar to those advanced by Brazil in this dispute on the non-existence of compliance measure during a specified period following the end of the implementation period. In that dispute, Australia adopted certain compliance measures after the expiry of the reasonable period of time on 6 July 1999. Canada claimed that, during the period between 6 July 1999 and the adoption of the compliance measures, no compliance measures existed. The compliance panel found as follows:

> [T]he date of entry into force of the new measures varies according to the products covered. In all cases, the entry into force – and thus the "existence" of the measures taken to comply – occurred *subsequent* to 6 July 1999, the date of expiry of the reasonable period of time given to Australia to implement the DSB recommendations and rulings. Since, in this case, Australia was under an obligation to implement the DSB recommendations and rulings by the end of the reasonable period of time,[154] we find that for the period of time that the new measures did not and will not apply subsequent to 6 July 1999, no measures taken to comply existed or will exist in the sense of Article 21.5.
>
> ---
>
> [154] Since Australia and Canada could so far not agree on compensation as a temporary measure pursuant to Article 22.1 of the DSU, <u>Australia was under an obligation to comply</u>

> with DSB recommendations and rulings by the end of the reasonable period of time. If it did not do so, Australia could face suspension of concessions or other obligations under Article 22.6 of the DSU.[112]

155. The findings of the compliance panel in *Australia – Salmon (21.5)*, therefore, support fully Brazil's claims.

156. Brazil notes that, in this dispute, there are two arbitrations pending under Article 22.6 of the DSU and Articles 4.11 and 7.10 of the *SCM Agreement* respectively. Thus, similarly to the situation in *Australia – Salmon 21.5*, the United States could face countermeasures or suspension of concessions or other obligations under those provisions with respect to non-implementation by the end of the implementation period.

157. Finally, Brazil notes that no such arbitration was pending in the two cases cited by the United States: *EC – Bed Linen (21.5)* and *U.S. – Shrimp (21.5)*.

22. How does Brazil respond to the argument of the European Communities that "the lack of positive action taken by the United States to comply with the panel and Appellate Body's findings and recommendations between the implementation date of 21 September 2005 and 31 July 2006 is not necessarily fatal to its defence"? [Paragraph 48 of the Third Party Submission of the European Communities]

158. Brazil disagrees that a subsidizing Member implementing pursuant to Article 7.8 of the *SCM Agreement* can do nothing and be in compliance with the findings, conclusions, and recommendations of panels and the Appellate Body. By 21 September 2005, the United States was required to take affirmative action under Article 7.8 of the *SCM Agreement.* But it did nothing.

159. Article 7.8 requires action, not inaction, no later than the end of the six-month implementation period following adoption by the DSB of the panel or Appellate Body report contemplated by Article 7.9 of the *SCM Agreement.* Read together, these two Articles impose an obligation that a subsidizing Member "shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy" during that six-month period.

160. During this period, a Member may choose to withdraw the subsidy. That involves some type of statutory, regulatory, or executive action to eliminate a subsidy.

161. The second part of Article 7.8 provides that a Member "shall *take* appropriate *steps* to remove the adverse effects." The ordinary meaning of the term "take" is "to undertake and perform (a specified function, service, etc.)" or "to perform, make, or do (an act, movement, etc.)".[113] In turn, the ordinary meaning of "step" is "the action, measure, or proceeding, especially one of a series, which leads towards a result."[114] Thus, to "take" appropriate "steps" means to *undertake action* that fully removes the adverse effects to the interests of another Member. What constitutes the specific "appropriate" steps to be taken will vary according to the particular facts in a given situation. Nonetheless, taking steps, or undertaking some affirmative action, to remove the adverse effects of "any subsidy" is required by this part of Article 7.8. Doing nothing is not undertaking action.

162. Having taken *no* action whatsoever by 21 September 2005, the United States had "not taken appropriate steps to remove the adverse effects of the subsidy or withdraw the subsidy within six months from the date when the DSB adopts the panel report and the Appellate Body report".

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[112] Panel Report, *Australia – Salmon (Article 21.5 – Canada)*, para. 7.30. *See, also*, para. 8.1(i) of the Panel's findings and conclusions. Underlining added.

[113] New Shorter Oxford English Dictionary, 1993 Edition, Vol. 2, pp. 3207, 3208.

[114] New Shorter Oxford English Dictionary, 1993 Edition, Vol. 2, p. 3050.

163. In its responses to questions 24 and 25, due to the Panel on 6 March, Brazil will explore further the proper interpretation of Article 7.8, alone and in conjunction with Article 21.5 of the DSU. Those responses will bear on the matter covered by the Panel in question 22.

Question to the United States

23. Does the United States consider that the text of Article 21.5 of the DSU should be interpreted to mean that a compliance panel may only review the "existence" or "consistency" with a covered agreement of measures taken to comply as of the date that the matter was referred to the panel and not as of the date of the end of the implementation period? [Paragraph 68 of the Rebuttal Submission of the United States]

ANNEX D-7

RESPONSES OF BRAZIL TO THE PANEL'S FIRST SET OF QUESTIONS (SECTIONS D&E)

(6 March 2007)

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Brazil – Aircraft (21.5)	Panel Report, *Brazil – Export Financing Program for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW, adopted 4 August 2000, modified by Appellate Body Report, WT/DS46/AB/RW, DSR 2000:IX, 4093.
Brazil – Aircraft (21.5 II)	Panel Report, *Brazil – Export Financing Program for Aircraft – Second Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW/2, adopted 23 August 2001, DSR 2001:X, 5481.
Canada – Aircraft	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377.
Canada – Aircraft (21.5)	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/AB/RW, adopted 4 August 2000, DSR 2000:IX, 4299.
Canada – Aircraft Credits and Guarantees	Panel Report, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R and Corr.1, adopted 19 February 2002, DSR 2002:III, 849.
U.S. – FSC (21.5)	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW, adopted 29 January 2002, DSR 2002:I, 55.
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U.S. – Shrimp (21.5)	Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse to Article 21.5 of the DSU by Malaysia*, WT/DS58/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6481.
U.S. – Softwood Lumber IV	Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, adopted 17 February 2004, DSR 2004:II, 571.
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U.S. – Upland Cotton	Panel Report, *United States – Subsidies on Upland Cotton*, WT/DS267/R, and Corr.1, adopted 21 March 2005, modified by Appellate Body Report, WT/DS/267/AB/R.

D. CLAIMS OF BRAZIL REGARDING PRESENT SERIOUS PREJUDICE

1. General

<u>Questions to both parties</u>

24. Could the parties explain how they interpret the phrases "take appropriate steps to remove the adverse effects" and "withdraw the subsidy" in Article 7.8 of the SCM Agreement?

1. The phrases "take appropriate steps to remove the adverse effects" and "withdraw the subsidy" in Article 7.8 of the *SCM Agreement* require action that secures the full and complete removal of any adverse effects, or the full withdrawal of any actionable subsidy found to cause adverse effects.

2. As Brazil stated in its answer to Question 22, the terms used in Article 7.8 require *action* by a defending Member, rather than *inaction*, and that removal of the adverse effects or withdrawal of the subsidy must be *complete*, rather than *partial*.

3. Before addressing this interpretive question, Brazil notes a threshold question that must be addressed by a compliance Panel confronted with recommendations under Article 7.8 of the *SCM Agreement* – what is the "subsidy" to be withdrawn, or the adverse effects of which must be removed in the present dispute?

4. In its 26 February response to question 11, Brazil explained that the subsidy subject to the Article 7.8 recommendation includes both the legislative and regulatory subsidy programs in the FSRI Act of 2002 and the price-contingent and mandatory payments made under those programs. In its 26 February response to question 15, Brazil explained that even if the original panel's findings of present serious prejudice were limited to marketing loan and counter-cyclical payments ("CCP") made during a particular historical period (*quod non*), subsequent payments made under the same program are also subject to the United States' implementation obligations. [1]

5. Article 7.8 has two implementation elements set out in the phrases "take appropriate steps to remove the adverse effects" and "withdraw the subsidy", and demonstrates that action, rather than inaction, is required of an implementing Member.

6. The ordinary meaning of the term "take" is "to undertake and perform (a specified function, service, etc.)" or "to perform, make, or do (an act, movement, etc.)".[2] In turn, the ordinary meaning of "step" is "the action, measure, or proceeding, especially one of a series, which leads towards a result."[3] Because the object of the action is "adverse effects", the "appropriate" "steps" must involve action that removes the adverse effects to the interests of another Member.

7. What constitutes the specific "appropriate" steps to take to remove the adverse effects will vary according to the facts of each case. Fundamentally, steps can only be "appropriate" if they achieve full and permanent removal of the adverse effects. For example, the original panel identified the particular *appropriate step* under Article 7.8 that the United States must take regarding the "basket" of price-contingent and mandatory subsidies found to cause present significant price suppression:

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[1] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 77 ("Some measures with a particularly close relationship to the declared 'measure taken to comply', and *to the recommendations and rulings of the DSB*, may also be susceptible to review by a panel acting under Article 21.5.").

[2] New Shorter Oxford English Dictionary, 1993 Edition, Vol. 2, pp. 3207, 3208.

[3] New Shorter Oxford English Dictionary, 1993 Edition, Vol. 2, p. 3050.

> [b]ecause the Panel's "present"' serious prejudice findings include findings of inconsistency that deal with the FSRI Act of 2002 and subsidies granted hereunder in MY 2002, *the United States is obliged to take action concerning its present statutory and regulatory framework as a result of our "present" serious prejudice findings. We recall that, pursuant to Article 7.8 of the SCM Agreement, the United States is under an obligation to "take appropriate steps to remove the adverse effects or … withdraw the subsidy*.[4]

8. At no time did the original panel suggest that an "appropriate step" to remove the adverse effects could involve doing nothing other than waiting for the effects of past payments to dissipate. As Article 7.8 requires action, rather than inaction, to do so would have rendered both Articles 6.3 and 7.8 of the *SCM Agreement* inutile. Any objective reading of the original panel's findings demonstrates that it expected the United States to take action to ensure that present serious prejudice would not continue during the remaining life of the FSRI Act of 2002.[5]

9. The second relevant phrase found in Article 7.8 is "withdraw the subsidy." The structure and placement of the phrase "take appropriate steps," as confirmed by both the French and Spanish versions of the official texts,[6] indicates that it only qualifies and refers to the phrase "remove the adverse effects" – not "withdraw the subsidy."

10. In examining the meaning of the identical phrase "withdraw the subsidy" in Article 4.7 of the *SCM Agreement*, the Appellate Body, in *Brazil – Aircraft (21.5)*, required affirmative action by the defending Member:

> Turning to the ordinary meaning of "withdraw", we observe first that this word has been defined as "remove" or "take away", and as "to take away what has been enjoyed; to take from." This definition suggests that "withdrawal" of a subsidy, under Article 4.7 of the *SCM Agreement*, refers to the "removal" or "taking away" of that subsidy.[7]

11. Given the identity of this aspect of Articles 4.7 and 7.8, the Appellate Body's finding regarding the meaning and action required to "withdraw the subsidy" in Article 4.7 applies also to Article 7.8.

12. A subsidy could be "removed" or "taken away" by the implementing Member enacting new legislation or taking regulatory steps to cease operation or disbursements of payments under the terms of the subsidy measure. As demonstrated above, Article 7.8 requires *affirmative action* to remove the adverse effects or withdraw the subsidy. Inaction is not sufficient.

13. Moreover, *full* removal of the adverse effects or *full* withdrawal of the subsidy is also required. As noted by the Appellate Body, "full withdrawal of a prohibited subsidy within the meaning of Article 4.7 of the *SCM Agreement* cannot be achieved by a 'measure taken to comply' that replaces the original subsidy with yet another subsidy found to be prohibited."[8] The same reasoning should apply to Article 7.8. Removing the adverse effects of a subsidy measure or withdrawing a

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[4] Panel Report, *U.S. – Upland Cotton*, para. 7.1501.

[5] Panel Report, *U.S. – Upland Cotton*, paras. 7.1499-7.1503, 8.1(g)(i).

[6] The Spanish text states: "… el Miembro que otorgue o mantenga esa subvención adoptará las medidas apropiadas para eliminar los efectos desfavorables o retirará la subvención." The French text states: "... le Membre qui accorde ou maintient cette subvention prendra des mesures appropriées pour eliminer les effets défavorables ou retirera la subvention."

[7] Appellate Body Report, *Brazil – Aircraft (21.5)*, para. 45 (footnotes omitted).

[8] Appellate Body Report, *U.S. – FSC (21.5 II)*, para. 83.

subsidy measure found to cause adverse effects, and subsequently *replacing* it with another subsidy measure that causes adverse effects, is not sufficient.

14. Even assuming, *arguendo*, that the only finding by the original panel was with respect to adverse effects flowing from MY 1999-2002 payments, it is insufficient for the United States to satisfy its obligation to remove the adverse effects or withdraw the subsidy by simply allowing the effects of MY 1999-2002 payments to wane and die a natural death, only to be replaced by even higher price-contingent and mandatory payments during the period MY 2003-2005. Brazil has demonstrated that these "replacement" payments cause similar, if not even greater, significant price suppression in the world market for upland cotton.

25. How do the parties interpret the relationship between Article 7.8 of the SCM Agreement and Article 21.5 of the DSU?

15. Brazil refers the Panel to its answer to Question 24, above, which sets forth the particular characteristics of Article 7.8 of the *SCM Agreement.*

16. Article 7.8 of the *SCM Agreement* is a special and *additional* rule, under Appendix 2 of the DSU. Because there is no conflict between Article 7.8 and Article 21.5 of the DSU, Article 7.8 does not *replace* Article 21.5 in compliance proceedings, but instead *supplements* Article 21.5.

17. An Article 21.5 compliance panel assessing implementation under Article 7.8 plays two, overlapping roles. First, the compliance panel assesses whether an implementing Member has taken affirmative action constituting either appropriate steps to remove the adverse effects, or withdrawal of the subsidy causing those adverse effects. Second, the compliance panel assesses whether any measures taken to comply exist, and if they exist, whether those measures, in their totality[9], are consistent with the covered agreements.

18. As a practical matter, these two assessments can overlap, and may involve the same evidence. But there may be instances in which a Member has, *e.g.*, "withdrawn the subsidy" under Article 7.8 but, nevertheless, *is not* in compliance with Articles 5 and 6 of the *SCM Agreement*. For example, an actionable subsidy found to cause adverse effects may be withdrawn within a period of six months in apparent compliance with Articles 7.8 and 7.9 thereof. However, if the implementing Member later enacts a replacement subsidy of a relatively similar nature, structure, design and operation as the older subsidy, then an Article 21.5 panel would be required to determine (a) whether the replacement subsidy is taken to comply with the recommendations and rulings, and (b) whether this new measure taken to comply – the replacement subsidy – is consistent with the covered agreements and does not cause adverse effects. Such an interpretation is necessary to avoid a Member simply withdrawing one subsidy and replacing it somewhat later with a similar subsidy.

19. In this case, the compliance Panel, under Article 7.8 of the *SCM Agreement* and Article 21.5 of the *DSU*, must first assess Brazil's claim that no measures taken to comply exist with respect to the period 21 September 2005 and 1 August 2006. Second, the compliance Panel must assess whether the United States took action constituting full removal of the adverse effects caused by the basket of three price-contingent and mandatory measures, or fully withdrew those measures. Third, the compliance Panel must determine whether the measure taken to comply, *i.e.*, the limited amendment of the FSRI Act of 2002, is inconsistent with Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*. In this case, steps two and three above involve the same proof, *i.e.*, that Brazil suffers serious prejudice by reason of the collective effect of marketing loan and CCP subsidies.

[9] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 67; Appellate Body Report, *U.S. – Shrimp (21.5)*, para. 87.

26. Could the parties explain whether they agree or disagree with the arguments of New Zealand in its Third Party Submission that Article 7.8 of the SCM Agreement has certain consequences for the burden of proof in an Article 21.5 proceeding? [Paragraphs 5.04-5.06 of the Third party Submission of New Zealand]

20. Brazil does not agree entirely with New Zealand's "burden of proof" arguments. In the particular circumstances of this case, the original panel found that the "basket" of marketing loan, Step 2, and CCP subsidies caused significant price suppression in the world market for upland cotton. However, the United States repealed one of those three measures – the Step 2 legislation in the FSRI Act of 2002. In view of these particular facts and as set out in Answer to Question 25, Brazil has the burden of demonstrating under Article 7.8 that the United States did not take appropriate steps to remove the adverse effects caused by the original basket of measures. Viewed from the Article 21.5 perspective, Brazil has the burden of demonstrating that the revised FSRI Act of 2002 providing for marketing loan and CCP subsidies and mandatory and price-contingent payments was a measure taken to comply that is inconsistent with Articles 5 and 6.3 of the *SCM Agreement.*

21. Where no changes to the basket of measures found to cause collectively adverse effects have been made, then a complaining member would have the right to proceed immediately to Article 7.9 of the *SCM Agreement* and Article 22.2 of the *DSU*. The rationale for this right is set forth in Brazil's answer to Question 24 above, *i.e.*, that Article 7.8, at a minimum, requires an implementing Member to take *some* action.

22. However, if *arguendo*, a complaining member was required to challenge in an Article 21.5 proceeding the fact that an *unchanged* basket of measures continued to cause significant price suppression, then Brazil agrees with New Zealand that it might be appropriate to permit the complaining Member to establish a *prima facie* case simply by demonstrating the absence of any change in the measures. Further, for the reasons set forth in Brazil's Answer to Question 30, a complaining party would be entitled to rely in an Article 21. 5 proceeding on the prior findings of a panel. This is particularly the case where the same basket of measures found to cause adverse effects continues to exist, unchanged, at the time of the Article 21.5 proceeding.

27. Could the parties comment on the following statement of the European Communities:

> **"The text of Article 7.8 of the *SCM Agreement* does not state expressly that a Member that has been requested by the DSB to implement its recommendations and rulings under Article 7.8 of the *SCM Agreement* has to *do* anything" (original emphasis)**

23. Brazil disagrees with this assertion of the European Communities for the reasons set forth in Brazil's Answer to Panel Questions 22, 24, and 25.

28. The parties present divergent views with respect to the relevant marketing year to be considered by the panel in its analysis of Brazil's serious prejudice claims.

> ***a) Could the parties explain what they consider to be the relevant legal considerations by which the Panel should be guided in determining whether MY 2005 or MY 2006 is the appropriate marketing year?***

24. In assessing the effects of marketing loan and CCP subsidies, the Panel should use the methodological tool of a "reference period."[10] The appropriate reference period is MY 2005, the last recent marketing year for which essentially complete data exists.[11] It may also be appropriate to use partial MY 2006 data where the data has particular indicia of reliability and credibility. However,

[10] Panel Report, *U.S. – Upland Cotton*, paras. 7.1195-1.1201.
[11] Panel Report, *U.S. – Upland Cotton*, para. 7.1198.

partial year data should be used with caution because historical data shows that there have been fairly significant shifts of prices, demand, supply based on a number of different factors.

25. The relevant legal considerations for selecting a representative period of time, or a "reference period," to assess the existence of serious prejudice were discussed by the original panel as follows:

> Article 5(c) and 6(c) of the *SCM Agreement* do not refer to any specific time period within which we must conduct our evaluation. … The Panel concurs with the United States assertion that MY 2002 is a relevant year for our serious prejudice inquiry. It represents a recent period for which essentially complete data exists. The identification of "significant price suppression" flowing from the "effect of the subsidy" calls for an evaluation of this effects-based phenomenon that cannot be conducted in the abstract. Rather, discerning adverse effects of subsidies seems to us to require reference to a recent historical period. We believe, however, that it is important for the establishment of "current" serious prejudice that such prejudice would be established to exist up to, and including, a recent point in time.[12]

26. The original panel also found that "consideration of developments over a period longer than one year [is] not necessarily required (at least for Articles 5(c) and 6.3(c))," but that a longer period "provides a more robust basis for a serious prejudice evaluation than merely paying attention to developments in a single year."[13]

27. As the original panel noted, there is no specific guidance for selecting a reference period for assessing price suppression claims. However, context for interpreting Article 6.3(c) is found in other provisions of Part III of the *SCM Agreement*. Paragraph 2 of Annex IV provides that in "determining whether the overall rate of subsidization exceeds 5 percent of the value of the product … the "12-month period, for which sales data is available, preceding the period in which the subsidy is granted" be used. Similarly, paragraph 5 of Annex IV provides that the "rate of inflation experienced in the 12 months preceding the month in which the subsidy is to be given" be used.

28. Article 6.4 of the *SCM Agreement* provides in respect of claims of displacement or impedance under Article 6.3(b) that "an appropriate *representative period* sufficient to demonstrate clear trends in the development of the market for the product concerned … in normal circumstances, shall be at least one year." Article 6.7 refers to "the relevant period" for the purpose of Article 6.3(a) and 6.3(b) claims. Article 6.3(d) provides for the assessment of an increase in the world market share by comparing data from one year with "the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted." Less specific time periods are referred to regarding price undercutting claims under Articles 6.3(c) and 6.5 where the comparison of prices "shall be made … at comparable times."

29. These various provisions indicate that *some* period of time should be used to assess various forms of serious prejudice. While Article 6.3 provides for no particular time period for the assessment of significant price suppression, Brazil agrees with the original panel that significant price suppression in the same market requires an examination of some representative time period to assess trends, data, and evidence in order to conduct the necessary counter-factual analysis.

30. However, the use of such a "reference period" to determine whether serious prejudice exists, does not limit the "measures" at issue to that reference period. As Brazil demonstrated in its answers to Questions 11 and 15, challenges to subsidies causing serious prejudice are not "as applied" or "*per se*" claims. Rather, they are challenges based on the "effects" of "any subsidy." By contrast, the

[12] Panel Report, *U.S. – Upland Cotton*, para. 7.1198.
[13] Panel Report, *U.S. – Upland Cotton*, para. 7.1199.

United States seeks to turn the "reference period" for assessing serious prejudice into a jurisdictional limitation on the measures themselves. The United States is incorrect. The necessary use of a reference period has no implications for the implementation obligations of a subsidizing Member – and certainly does not limit those obligations to only payments made in the past during the reference period. Rather, the finding of adverse effects creates an implementation obligation to ensure that the use of the subsidy in the future does not cause adverse effects.

31. In sum, this compliance Panel should use the reference period of MY 2005 to assess whether serious prejudice exists from the new basket of measures. Partial MY 2006 data should also be used when it can be considered reliable and credible.

b) Do the parties agree or disagree with the argument of the European Communities that in a dispute involving a claim of present serious prejudice the parties must provide the "most recent reasonably available" data? [Paragraphs 43 and 54-55 of the Third Party Submission of the European Communities]

32. Brazil disagrees with European Communities to the extent that the European Communities asserts that panel considering serious prejudice challenges should rely on any partial year data simply because it is the most recent, regardless of its reliability in allowing an assessment of trends. As set out in Brazil's answer to Question 28(a), above, in assessing the effects of marketing loan and CCP subsidies, the compliance Panel should use the methodological tool of a "reference period."[14] The appropriate reference period is MY 2005, the last recent marketing year for which essentially complete data exists.[15] However, to assess effects, the compliance Panel can also use data throughout the lifetime of the FSRI Act of 2002. This permits the Panel to assess the continued relevance of the numerous findings of fact made by the original panel based on the earlier reference period MY 2002 and MY 1999-2002. The data to be assessed includes annual marketing year data regarding planted and harvested acreage, yields, production, exports, various futures and actual prices, production costs and the magnitude of subsidies in a given marketing year. Single week, month, or even partial year data do not provide as clear a picture because data on supply, demand, exports, prices, and price-contingent subsidies changes over time.

33. However, the reference period could be expanded to allow the assessment of evidence after the end of MY 2005. This is particularly the case given the fact that marketing loan and CCP programs in the FSRI Act of 2002 result in an unending stream of price-contingent subsidies that cause, with no clear dividing line, present serious prejudice today and a threat thereof tomorrow, and in the years ahead. Mandated marketing loan and CCP subsidies are paid today, and will continue to be paid months from now when the compliance Panel issues its report. In fact, current projections by USDA indicate that they will be paid every day until the FSRI Act of 2002 is repealed. Brazil's various serious prejudice claims in this proceeding, as before the original panel, involve past, present and future serious prejudice from this unending river of subsidies mandated by the FSRI Act of 2002. It is, therefore, appropriate for the compliance Panel to assess, with caution and only where it finds it credible and reliable, evidence concerning reference periods *after* 31 July 2006.

<u>Questions to the United States</u>

29. Does the United States contest the fact that a "strong positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production" exists?[16] In particular, does the US disagree with the following statements[17]:

[14] Panel Report, *U.S. – Upland Cotton*, paras. 7.1195-1.1201.
[15] Panel Report, *U.S. – Upland Cotton*, para. 7.1198.
[16] See para. 131 of Brazil's First Submission. The Panel clarifies that this phrase refers to the fact that "the recipients who hold upland cotton base acres" and "those who continue to plant upland cotton" overlap with

- *a very large proportion of farms with upland cotton base acres continue to plant upland cotton in the year of payment;*

- *the overwhelming majority of farms enrolled in the programs which plant upland cotton also hold upland cotton base?*

Question to Brazil

30. How does Brazil respond to the argument of the United States that "whether or not the marketing loan and counter-cyclical payment programs or payments under the programs cause significant price suppression is a question of first impression"? [Rebuttal Submission of the United States, paragraph 219]

34. Brazil agrees that it is a question of "first impression" whether the new basket of price-contingent subsidy measures – consisting of marketing loan and CCP subsidies – causes significant price suppression in the world market for upland cotton. The original panel made its overall price suppression and causation findings largely based on the collective effects of the "basket of measures" that included Step 2, marketing loan, and CCP subsidies.

35. But this does not mean, as the United States argues, that all findings of the original panel regarding the individual effects of marketing loan and CCP subsidies, or even some of the collective effects of the original basket of measures are irrelevant. Brazil fully agrees with the United States that the original panel's findings "are taken as a given for purposes of this Article 21.5 proceeding."[18] As the Appellate Body stated, a compliance panel should apply the findings of the original panel "in the absence of any change in the underlying evidence in the record and explanations."[19]

36. In making a new assessment of whether marketing loan and CCP subsidies collectively cause serious prejudice, the compliance Panel can and must rely on the many findings of the original panel that isolated and examined *separately* the text, nature, magnitude, and effects of marketing loan and CCP subsidies.[20] The statutory and regulatory framework of these subsidies has not changed. Other unchanged findings involve the existence of Brazilian and U.S. cotton in the same world market, the continued relevance of the large world market share of U.S. supply, and the resulting substantial proportionate influence of U.S. production and exports on the world market price for cotton. Because the conditions of competition have not changed in any fundamental way since the original panel's reference period of MY 2002, the compliance Panel should rely on these earlier findings in making its new assessment of whether marketing loan and CCP subsidies cause significant price suppression in the world market for upland cotton.

2. The structure, design and operation of the countercyclical and marketing loan payment programs

Question to the United States

31. Brazil claims that the structure, design and operation of US counter-cyclical payments stimulate US upland cotton production. Both Brazil and the United States have referred to the

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each other to a great extent. (See para. 7.637 of the report of the original panel.) The Panel understands that Brazil uses this phrase in the same sense.

[17] These passages are reproduced from para. 7.636 of the report of the original panel.

[18] U.S. First Written Submission, para. 180.

[19] Appellate Body Report, *U.S. – Softwood Lumber VI (21.5)*, para. 103.

[20] Brazil First Submission, Sections 7.3 and 7.8; Brazil's Rebuttal Submission, Section 2.3.1.

Westcott (2005)[21] *study to provide support for their opposing analysis of the possible production impact of counter-cyclical payments. In its rebuttal, Brazil quotes the following passage from Westcott:*

> So where do CCPs fit compared with other farm commodity programs in the 2002 Farm Act? Marketing loans are fully coupled since they are available on all production and their link to market prices means they affect production decisions of farmers. Direct payments are mostly decoupled, since they are paid on a fixed, historically-based quantity rather than on current production and are not dependent on market prices or other factors that would affect production. …
>
> CCPs fall in between these two programs, having some properties similar to mostly decoupled direct payments and other properties similar to fully coupled marketing loans. Like direct payments, CCPs do not depend on current production since they are paid on a fixed, historically-based quantity. However, similar to marketing loans, CCPs are linked to market prices so there may be some influence on current production decisions of farmers, which would potentially make CCPs at least partially or somewhat coupled.

a) *Does the United States agree with this characterization of the CCP?*

b) *How would the United States respond to the argument that, by design, counter-cyclical payments are in some measure coupled to production decisions because part of the payments is contingent on the actual realization of market prices?*

3. Economic simulation model

Question to the United States

32. Brazil has presented a partial equilibrium model to simulate the effects of eliminating US upland cotton payments, particularly the marketing loan and counter-cyclical payments. In both its submission and rebuttal, the United States has provided reactions to the simulation model.

a) *Would it be accurate to describe the United States' response as constituting a general acceptance of the framework of analysis adopted by Brazil but contesting the assumptions made regarding the values of the parameters, the supply and demand elasticities and the "coupling factor", used in the model? (The coupling factor is the amount by which the expected price is increased by each dollar per unit of subsidy payments.)*

b) *In its First Written Submission and Rebuttal Submission, the United States uses the same value of 1 that Brazil adopts for the coupling factor assigned to marketing loan payments. Does this imply an acceptance by the United States that, by design, marketing loan payments provide a one-for-one incentive to upland cotton production?*

c) *In its First Written Submission and Rebuttal Submission, the United States used a non-zero value of 0.25 (not much lower from the 0.4 that Brazil adopts) for the coupling factor assigned to counter-cyclical payments. Does this imply an acceptance by the United States that, by design, counter-cyclical payments are partially tied to upland cotton production, and of a magnitude (25 cents to a dollar of*

[21] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" (Exhibit US-35).

counter-cyclical payments) not very far from Brazil's own estimate (of 40 cents to a dollar of counter-cyclical payments)?

E. EXPORT CREDIT GUARANTEES

1. Permissibility of an *a contrario* interpretation of item (j) of the Illustrative List

Questions to the United States

33. Please discuss whether (and if so, how) the panel rulings in Korea – Vessels and Brazil - Aircraft (21.5) (I and II) affect the United States' approach to the interpretation of the relationship between item (j) of the Illustrative List and Article 3.1(a) of the SCM Agreement.

34. Does the United States considers that item (j) of the Illustrative List is one of the provisions to which footnote 5 of the SCM Agreement applies? What impact does this have for the United States' interpretation of the interaction between item (j) of the Illustrative List and Article 3.1(a) of the SCM Agreement?

35. How does the United States address Brazil's argument that permitting an a contrario reading of item (j) would prevent a Member from challenging specific export credit guarantees or cohorts of such guarantees granted by a Member, as opposed to export credit guarantee programs? [see paragraphs 472 ff. of Brazil's Rebuttal]

Questions to Brazil

36. What is Brazil's reading of the Appellate Body's statement in paragraph 80 of its Report in Brazil – Aircraft (21.5) that it "... would have been prepared to find that the payments made under the revised PROEX are justified under item (k) of the Illustrative List"? Should the Panel take this statement into account in deciding whether item (j) can be interpreted a contrario?

37. Brazil has explained that, in its view, footnote 5 of the *SCM Agreement* expressly identifies the only circumstances in which the Illustrative List can be relied upon to identify measures that are not prohibited—namely, where the measures are "referred to…as not constituting export subsidies." This is also the view adopted, after extensive analysis, by the panels in *Brazil – Aircraft (21.5)* and *Korea – Vessels*, the latter of which concluded on this basis that item (j) of the Illustrative List does not meet the requirements of footnote 5 and therefore cannot be interpreted *a contrario*.

38. This position is not inconsistent with the Appellate Body's statement, in *dicta* in *Brazil – Aircraft (21.5)*, that it "would have been prepared," in effect, to accept an *a contrario* reading of the first paragraph of item (k) of the Illustrative List.[22]

39. As a threshold matter, it must be noted that the Appellate Body's statement appeared in *dicta*, and was accompanied by an express reservation that the Appellate Body did *not* purport to interpret or apply footnote 5 to this question. The Appellate Body was very clear on this point: "[W]e wish to emphasize that we are not interpreting footnote 5 of the *SCM Agreement*, and we do not opine on the scope of footnote 5…"[23] Accordingly, the analysis of footnote 5 by the panel in *Brazil – Aircraft (21.5)* and, subsequently, by the panel in *Korea – Vessels*, stands unaffected by the Appellate Body's statement. The *Korea –Vessels* panel expressly considered the Appellate Body's statement on

[22] Appellate Body Report, *Brazil – Aircraft (21.5)*, para. 80.
[23] Appellate Body Report, *Brazil – Aircraft (21.5)*, para. 80 (emphasis added).

item (k), first paragraph. It concluded that that statement posed no bar to the panel's analysis, which relied on footnote 5 to preclude an *a contrario* reading of item (j).[24]

40. Furthermore, item (k) is substantively distinct from other Illustrative List items. That is, even if the Appellate Body could be understood to have contemplated a possible *a contrario* reading of the first paragraph of item (k) notwithstanding footnote 5, such license would not extend beyond item (k).

41. As Brazil explained to the original panel[25], the first paragraph of item (k) is not like item (j). Paragraph 1 of item (k) calls for an analysis of "material advantage," which is closely related to the "benefit" standard under Article 1.1.[26] Both focus on an assessment of the "benefit to the recipient." An *a contrario* reading of the first paragraph of item (k) would not supplant the "benefit to recipient" standard in Article 1.1(b).

42. Not so with an *a contrario* reading of item (j). A determination that an ECG program breaks even tells one nothing about whether ECGs confer benefits on recipients relative to market benchmarks. Yet an *a contrario* application of item (j) would definitively eliminate any consideration of that "benefit". As such, it cannot be contemplated, whether or not an *a contrario* application of item (k), first paragraph, might conceivably be available.

43. Again, however, Brazil does not understand the Appellate Body's statement in *Brazil – Aircraft (21.5)* to have embraced an *a contrario* reading of item (k), because the Appellate Body did not carry out an analysis addressing the impact of footnote 5 on that question. To the contrary, the Appellate Body insisted that it was not taking that step, leaving the question entirely open to this compliance Panel.

2. Outstanding export credit guarantees / measures taken to comply

<u>Questions to Brazil</u>

37. Brazil relies on the panel and Appellate Body Reports in Brazil – Aircraft (21.5) in support of its arguments that the United States has not "withdrawn" the subsidy and is, "[a]t a minimum... prohibited from making 'payments' on claims against" any outstanding export credit guarantees [Paragraph 397 of Brazil's Rebuttal Submission]. Please discuss how the findings of the panel and Appellate Body in that case apply to the provision of the US export credit guarantees at issue.

44. Brazil's claim is supported by two elements of the compliance panel and Appellate Body reports in *Brazil – Aircraft (21.5)*.

45. First, these reports concluded that in continuing, <u>after</u> the implementation deadline, to perform on financial commitments undertaken <u>before</u> adoption of the DSB's recommendation, Brazil was not fully withdrawing the subsidy.[27] Analogously, in continuing, <u>after</u> the implementation deadline, to perform on ECGs issued <u>before</u> adoption of the DSB's recommendation, the United States has not fully withdrawn the subsidy.

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[24] Panel Report, *Korea – Commercial Vessels*, para. 7.197.

[25] Panel Report, *U.S. - Upland Cotton*, Annex I-1 (Answers of Brazil to Questions from the Panel, 11 August 2003), paras. 143-149.

[26] Appellate Body Report, *Brazil – Aircraft (21.5)*, para. 61 ("We ruled [...] that the determination of whether a payment is 'used to secure a material advantage' calls for a comparison between the export credit terms available under the measure at issue and some other 'market benchmark'.").

[27] Appellate Body Report, *Brazil – Aircraft (21.5)*, para. 45. *See also* Panel Report, *Brazil – Aircraft (21.5)*, para. 6.17. The compliance panel considered that "the obligation to cease performing illegal acts in the future is a fundamentally prospective remedy." Panel Report, *Brazil – Aircraft (21.5 I)*, para. 6.15.

46. Second, continuing to perform on ECGs outstanding on 1 July 2005 does not satisfy the definition of "withdraw" offered by the Appellate Body in *Brazil – Aircraft (21.5)*. The original panel found that the ECG programs were export subsidies within the meaning of item (j). The recommendation that the United States "withdraw the subsidy" therefore applied to the ECG programs. However, the recommendation also includes the subsidiary obligation not to perform on certain outstanding ECGs issued under those programs (*i.e.*, those ECGs issued for export transactions involving unscheduled products and rice).[28] The Appellate Body defined the term "withdraw" as to "remove" or "take away" the subsidy.[29] Paying a claim on default of a GSM 102 credit subject to the DSB's recommendation to "withdraw the subsidy" does not "remove" or "take away" that subsidy.

3. "Benefit" under Articles 1 and 3.1(a) of the *SCM Agreement*

Question to the United States

38. Please discuss the relevance of the original panel's characterization, in paragraph 6.31 of its report, of Brazil's reliance on Articles 1 and 3.1(a) of the SCM Agreement as "not a separate claim, but merely another argument" on the United States' view in this respect (and notably the United States statement, in paragraph 67 of its First Written Submission, that "... the panel in the original proceeding specifically declined to address Brazil's alleged 'claim' under Articles 1 and 3.1(a) of the SCM Agreement")?

Questions to Brazil

39. The Panel understands the United States to argue that it has relied on the Panel's findings under item (j) to implement the DSB recommendations with respect to export credit guarantees. How would this, in Brazil's view, affect the compliance panel's role in this proceeding? Was the United States also expected to implement changes in order to make its export credit guarantee programs consistent with article 1.1 and 3.1(a) of the SCM Agreement, even though there were no findings of the original panel in this respect?

47. The United States' "reliance" on the original Panel's findings under item (j) should not affect the compliance Panel's role in these Article 21.5 proceedings.

48. The United States cannot escape the export subsidy disciplines of the *Agreement on Agriculture* and the *SCM Agreement* by arguing that it somehow relied on the factual and legal basis for the original panel's finding that the GSM 102 program constitutes an export subsidy – to wit, item (j) of the Illustrative List. The question in these compliance proceedings is not limited to whether the United States has cured the basis on which the original panel found a violation. The Appellate Body has stated that in Article 21.5 proceedings, "a panel is not confined to examining the 'measures taken to comply' from the perspective of the claims, arguments and factual circumstances that related to the measure that was the subject of the original proceedings."[30]

49. Brazil thus understands that the compliance Panel is charged with reviewing the "new" measure – the amended GSM 102 program – from the perspective of the claims and arguments (as well as the facts) put before it in <u>these</u> proceedings, and not the claims and arguments before it in the original proceedings, with respect to the "old" measure.

[28] Appellate Body Report, *U.S. – FSC (21.5)*, paras. 223-231 (recommendation to withdraw a subsidy in the form of an overarching measure, the FSC, includes the obligation to stop making pre-committed payments to existing FSCs); Appellate Body Report, *Brazil – Aircraft (21.5)*, para. 45 ("… to continue to make payments under an export subsidy measure found to be prohibited is not consistent with the obligation to 'withdraw' prohibited export subsidies, in the sense of 'removing' or 'taking away'.").

[29] Appellate Body Report, *Brazil – Aircraft (21.5)*, para. 45.

[30] Appellate Body Report, *Canada – Aircraft (21.5)*, para. 41. *See also Id*., para. 40.

50. Moreover, the United States could not legitimately have "relied on" the original panel's findings under item (j) as the bounds of its implementation obligations. The United States is surely aware that under the Appellate Body's interpretation of Article 21.5, any U.S. "measure taken to comply" would be a new measure subject to review from the perspective of claims, arguments and factual circumstances that may differ from the original proceedings. This new measure must be fully consistent with every relevant provision of the covered agreements.

51. In fact, in the original proceedings, Brazil urged the original panel to make findings on Brazil's extensive evidence and argument that under the "old" measure, GSM 102 ECGs confer "benefits" and constitute export subsidies under Articles 1.1 and 3.1(a) of the *SCM Agreement*.[31] While Brazil repeatedly urged it not to do so[32], the original panel exercised judicial economy with respect to the evidence and argument offered by Brazil under Articles 1.1 and 3.1(a). Nonetheless, the arguments are familiar to the United States, and should have been anticipated.

52. As emphasized in Brazil's oral statement at the meeting with the compliance Panel, all of this is not to say that the DSB's recommendations are irrelevant in implementation proceedings implicating prohibited subsidies and Article 4.7 of the *SCM Agreement*. As noted by the Appellate Body, "full *withdrawal* of a prohibited subsidy within the meaning of Article 4.7 of the *SCM Agreement* cannot be achieved by a 'measure taken to comply' that replaces the original subsidy with yet another subsidy found to be prohibited."[33]

53. Thus, even if the United States has withdrawn the elements of the GSM 102 program that made it an export subsidy under item (j) (a proposition with which Brazil does not agree), it has "replace[d] the original subsidy with yet another" prohibited subsidy – the provision of export-contingent GSM 102 ECGs at below-market fees. It has, therefore, failed to achieve "full withdrawal" of the subsidy, consistent with the Article 4.7 recommendation. In urging the Panel not to examine whether its replacement measure confers export-contingent "benefits", the United States seeks precisely to escape its obligation under that provision to <u>fully</u> withdraw the prohibited subsidy.

40. In paragraph 410 of its Rebuttal, Brazil refers to paragraph. 7.398 of the Panel Report in Canada – Aircraft II. The Panel notes, however, that in the same paragraph, the Canada – Aircraft II panel also indicated that there would be a "'benefit' when the cost-saving for a Bombardier customer for securing a loan with an IQ loan guarantee is not offset by IQ's fees". Please discuss, in light of this sentence, whether the Panel should read the Canada – Aircraft II panel as having rejected the "total cost of funds" as the proper benchmark under Article 14(c) of the SCM Agreement.

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[31] In addition to Brazil's exhibits in the original proceedings, *see* Brazil's 18 February 2004 Comments on U.S. Answers to Additional Questions, para. 65 (Panel Report, *U.S. – Upland Cotton*, Annex I-20); Brazil's 28 January 2004 Comments on U.S. Answers to Questions, paras. 139-144 (Panel Report, *U.S. – Upland Cotton*, Annex I-13); Brazil's 20 January 2004 Answers to Additional Questions, para. 14 (Panel Report, *U.S. – Upland Cotton*, Annex I-10); Brazil's 18 November 2003 Further Rebuttal Submission, *U.S. – Upland Cotton*, paras. 229-242; Brazil's 7 October 2003 Oral Statement, *U.S. – Upland Cotton*, para. 72; Brazil's 27 August 2003 Comments on U.S. Rebuttal Submission, paras. 68-80 (Panel Report, *U.S. – Upland Cotton*, Annex D-3); Brazil's 22 August 2003 Rebuttal Submission, *U.S. – Upland Cotton*, paras. 102-107; Brazil's 11 August 2003 Answers to Questions, paras. 139-140, 152-157, 182-189, 192-196 (Panel Report, *U.S. – Upland Cotton*, Annex I-1); Brazil's 22 July 2003 Oral Statement, *U.S. – Upland Cotton*, para. 116; Brazil's 24 June 2003 First Submission, *U.S. – Upland Cotton*, paras. 287-294.

[32] *See* Brazil's 2 November 2004 Other Appellant Submission, *U.S. – Upland Cotton*, para. 19; Brazil's 17 May 2004 Interim Comments, *U.S. – Upland Cotton*, paras. 19-23; Brazil's 28 January 2004 Comments on U.S. Answers, para. 145 (Panel Report, *U.S. – Upland Cotton*, Annex I-13); Brazil's 18 November 2003 Further Rebuttal Submission, *U.S. – Upland Cotton*, para. 228; Brazil's 11 August 2003 Answers to Questions, para. 150 (Panel Report, *U.S. – Upland Cotton*, Annex I-1).

[33] Appellate Body Report, *U.S. – FSC (21.5 II)*, para. 83 (italic emphasis in original; underlining supplied).

54. The sentence quoted by the compliance Panel from the report in *Canada – Aircraft Credits and Guarantees* appears to be a rough approximation of what the United States characterizes as a "total cost of funds" approach to Article 14(c).[34] Brazil does not believe that the panel in that dispute rejected the "total cost of funds" approach, or Article 14(c) in general, in subsequently concluding that "it is safe to assume that such cost difference would not be covered by [guarantee] fees if it is established that [the guarantee] fees are not market-based."[35] Rather, consistent with the proper interpretation of the provision, the panel merely declined to apply it rigidly, without consideration of the factual circumstances at hand.

55. At the United States' urging, the Appellate Body has rejected a "rigid" approach to the quantification methodologies included in Article 14, even for disputes regarding countervailing measures, to which the provision expressly applies. Quoting from a U.S. submission, the Appellate Body in *U.S. – Softwood Lumber IV* noted "that the use of the term 'guidelines' in Article 14 suggests that paragraphs (a) through (d) should not be interpreted as 'rigid rules that purport to contemplate every conceivable factual circumstance'."[36] Absent flexibility in Article 14, the Appellate Body worried that "the subsidy disciplines in the *SCM Agreement* . . . could be undermined or circumvented."[37]

56. *Canada – Aircraft Credits and Guarantees* was an export subsidy dispute under Part II of the *SCM Agreement*, to which Article 14 applies, but as context for a conclusion that Article 1.1(b) involves a "benefit to recipient", rather than a "cost to government", standard.[38] As noted above, even in the context of *countervailing measures* disputes, Article 14 admits of flexibility; the Appellate Body has cautioned against applying the provision too rigidly, without reference to the particular factual circumstances at hand. *Outside* the context of countervailing measures disputes, the *SCM Agreement* does not mandate that the existence of a "benefit" under Article 1.1(b) be established using a particular quantification methodology. Indeed, unlike in countervailing duty proceedings, where a duty must be calculated, disputes under Part II of the *SCM Agreement* do not require precise quantification of the "benefit" found under Article 1.1(b).

57. Thus, while the panel in *Canada – Aircraft Credits and Guarantees* was correct in acknowledging the relevance of the "total cost of funds" approach in Article 14(c) at some level, declining to follow it rigidly was entirely appropriate in the factual circumstances of that dispute. Unlike in countervailing duty proceedings, where a duty must be calculated as a function of the amount of "benefit" conferred by government support, no such precise calculation of the "benefit" flowing from government support is required for an export subsidy dispute. In *Canada – Aircraft Credits and Guarantees*, all Brazil, as the complaining Member, was required to show, was that *some* "benefit" was conferred. The panel in that dispute concluded that *some* "benefit" would have been conferred were fees for the government guarantee to be shown to be below-market.[39] Doing so did not constitute "rejection" of Article 14(c), but instead, was consistent with the proper interpretation of Article 14, and constituted a flexible approach called for by the factual circumstances at hand.

[34] U.S. First Written Submission, para. 138.

[35] Panel Report, *Canada – Aircraft Credits and Guarantees*, para. 7.345.

[36] Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 92. *See also* U.S. Appellant's Submission, *U.S. – Softwood Lumber IV*, para. 25, accessed February 2007 at http://www.ustr.gov/assets/Trade_Agreements/Monitoring_Enforcement/Dispute_Settlement/WTO/Dispute_Settlement_Listings/asset_upload_file760_6326.pdf ("[T]he provisions of Article 14 are explicitly designated as "guidelines" and they must be interpreted in accordance with the ordinary meaning of that word. A "guideline" is "a directing or standardizing principle laid down as a guide" to procedure or policy. The fact that Members are obligated to follow the guidelines in Article 14 does not alter their character. Members have specifically designated the provisions in Article 14 as "guides" or "principles," not rigid rules that purport to contemplate every conceivable factual circumstance.").

[37] Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 100.

[38] Appellate Body Report, *Canada – Aircraft*, para. 155.

[39] Panel Report, *Canada – Aircraft Credits and Guarantees*, para. 7.345.

Questions to both parties

41. What are the relevant considerations to guide the Panel in the selection of a market benchmark in this case?:

> ***a) That the institution that provides the product is, on the whole, or on a program or product-specific basis, profitable? If so, is "any" profit sufficient to qualify an institution/product/program as a relevant "market benchmark" or must the institution/product/program achieve a certain level of profit? Must the Panel conduct an examination of the level of profit achieved by commercial or private actors operating in the field?***
>
> ***b) Are the institution/program/products' stated goals relevant in assessing whether they can be used as a "market benchmark"?***
>
> ***c)* Is the "governance" of the institution relevant?**
>
> ***d) What other factors are relevant?***

58. When assessing a benchmark drawn from an entity that is truly a participant in the "marketplace"[40] – meaning an entity the financial independence of which is not "[]distorted by government intervention"[41] – a panel need not review the entity's profitability, goals or governance. If the entity is truly a participant in the marketplace, the terms on which it offers its products *are* the market, by definition. In those circumstances, it is not relevant for a panel to inquire into the entity's profitability, goals or governance (unless those elements are alleged to reveal that the entity is not truly a participant in the marketplace).

59. In these proceedings, Brazil has demonstrated that there is no credit protection product available in the marketplace that is comparable to a GSM 102 ECG.[42] Accordingly, the GSM 102 program offers a unique financial instrument without any parallel at market, and therefore confers "benefits" *per se*. Where other Members' measures were at issue, the United States has agreed.[43]

60. In addition, Brazil has offered evidence demonstrating that GSM 102 fees are considerably below those charged for virtually identical products offered by an entity that is not a participant in the marketplace – the U.S. Export-Import Bank ("ExIm Bank"). Benchmarking to fees charged by an entity that is not a participant in the marketplace likely understates the extent of the "benefit" conferred by a GSM 102 ECG, for reasons expressed in Brazil's submissions to the compliance Panel.[44] In the circumstances of these particular proceedings, Brazil is willing to accept that understatement. The Panel will recall that in a prohibited subsidies dispute, unlike in a countervailing measures dispute, quantification of the precise amount of "benefit" is not required.

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[40] Appellate Body Report, *Canada – Aircraft*, para. 157 ("In our view, the marketplace provides an appropriate basis for comparison in determining whether a 'benefit' has been 'conferred', because the trade-distorting potential of a 'financial contribution' can be identified by determining whether the recipient has received a 'financial contribution' on terms more favourable than those available to the recipient in the market.").

[41] Panel Report, *Brazil – Aircraft (21.5 II)*, para. 5.29.

[42] Brazil's First Written Submission, paras. 377-378. *See also Id.*, Annex III (Statement of Professor Rangarajan Sundaram), paras. 8-9.

[43] Panel Report, *Canada – Aircraft Credits and Guarantees*, Annex C-2 (para. 7) ("If the commercial market does not offer a particular borrower the exact terms offered by a government, then the government is providing a benefit to the recipient whenever those terms are more favorable than the terms that are available in the market. A government entity "operating on commercial principles" is still a government entity. It is not the commercial market.").

[44] *See, e.g.*, Brazil's Oral Statement, paras. 188-192.

61. In a dispute under Part II of the *SCM Agreement*, a defending Member may not, however, justify the terms on which it offers a challenged financial contribution with reference to a benchmark associated with a product offered by a government/public entity. Brazil believes that the compliance Panel's question is whether, in these circumstances, the defending Member could appeal to the profitability, goals or governance of that government/public entity, to show that even if the *entity* is not truly a participant in the marketplace, the *product* serving as the proposed benchmark is offered on market terms.

62. In Brazil's view, the answer must be in the negative, to avoid circumvention of the disciplines in the *SCM Agreement*.

63. Brazil addressed the issue of "profitability" of a government/public entity in its opening statement at the meeting with the compliance Panel.[45] The original panel in this dispute observed that public entities tend to borrow from government treasuries, or enjoy a guarantee flowing from the full faith and credit of governments.[46] As a result, government/public entities tend to enjoy a lower cost of funds than their market-based counterparts. Other immunities enjoyed by government/public entities – from taxation, in particular – lower costs even further.[47] The United States made this point forcefully in *Canada – Aircraft Credits and Guarantees*:

> . . . [T]he competitive pressures on financial actors in the marketplace generate financing offers that reflect any internal cost advantages enjoyed by a particular actor. For wholly commercial actors, however, the ability and willingness to compete is constrained by such factors as balance sheets, true market-determined borrowing costs, arms-length shareholder lending policies, arms-length business costs, and the disciplines imposed by the need to provide returns to owners. [Government/public entity's] operations are largely free of these constraints, and thus are in a position to confer benefits by exceeding, if sometimes only in a small way, what purely market-based financial institutions can (or may be willing to) offer. Their ability to do so explains their existence, since there would otherwise be no reason for [government/public entity operations] to exist in parallel with private financial market actors, much less any logical reason for governments to limit their [entities'] activities to nationals.[48]

64. Whatever the definition of the term, making a "profit" does not mean that fees charged by a government/public entity are consistent with market. A government/public entity can charge below-market fees and still make a "profit", particularly because its costs are below those faced by its market-based counterparts. A market-based entity must go a step further to survive: it must charge fees high enough to make a profit on costs higher than those faced by its government/public counterpart, and the profit must offer a sufficient return to attract capital from investors. "Profitability" of a government/public entity does not provide a relevant or sufficient measure of the "benefit" conferred by a government financial contribution.

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[45] Brazil's Oral Statement, paras. 188-192. To show the conservative nature of its ExIm Bank exercise, Brazil has discussed the extent to which ExIm Bank is loss-making. *See* Brazil's First Written Submission, para. 384 and Annex III (Statement of Professor Rangarajan Sundaram), paras. 17-24. ExIm Bank's fees are apparently not high enough to turn a "profit" on the low cost of funds it enjoys as a U.S. government agency backed by the full faith and credit of the United States Treasury.

[46] Panel Report, *U.S. – Upland Cotton*, para. 7.858.

[47] Brazil's Rebuttal Submission, paras. 439 (IFC immune from taxation), 441 (EBRD immune from taxation), 442 (IDB immune from taxation).

[48] Panel Report, *Canada – Aircraft Credits and Guarantees*, Annex C-2 (Third Party Submission of the United States), para. 5.

65. The United States made this point in the panel *Korea –Vessels*. The panel asked whether the United States considered it relevant, in assessing "benefit", that a Korean government bank, KEXIM, "operated at a profit". The United States responded as follows:

> No. … [T]he benefit-to-recipient approach must be applied to KEXIM financing. That approach, in turn, requires a comparison of KEXIM financing to a market-based benchmark; *i.e.*, comparable commercial financing. <u>Evidence that KEXIM earned a profit would be irrelevant to this exercise, because it would not prove that KEXIM was charging market rates</u>.[49]

66. A government/public entity's stated goal of offering products consistent with market is equally irrelevant, as such a goal can be considered little more than self-serving. The governance of a government/public entity will tend, as noted by the original panel[50], to demonstrate access enjoyed by the entity to low-cost funds or government guarantees, which in turn highlight the irrelevance of the entity's ability to turn a profit.

4. Claims under item (j) of the Illustrative List

<u>Questions to the United States</u>

42. How does the United States address Brazil's arguments with respect to the MPRs under the OECD Arrangement?

<u>Question to Brazil</u>

43. What is Brazil's reaction to paragraph 25 of Japan's Third Party Submission?

67. As the Panel will recall, Brazil has demonstrated that fees charged by the United States in the GSM 102 program are significantly lower than the minimum premium rates ("MPRs") of the OECD Arrangement on Officially Supported Export Credits (the "OECD Arrangement") for similar risk categories, tenors and repayment profiles. Brazil offers this comparison as additional evidence that GSM 102 fees are not structured and designed to cover the long-term costs and losses of the program, because the OECD Arrangement MPRs are set with the objective of ensuring "that Participants…charge premium rates in addition to interest charges that…are not inadequate to cover long-term operating costs and losses."[51]

68. In paragraph 25 of its Third Party Submission, Japan objects to Brazil's invocation of the OECD Arrangement in this context. Japan's objections rest on the premise that the OECD Arrangement is factually inapposite for a comparison to GSM 102 ECGs, because the OECD Arrangement does not cover export credits for agricultural commodities such as upland cotton and it applies to export credits with different tenors than those offered under GSM 102.

69. Japan's objection appears to stem from a misunderstanding of the purpose for which Brazil has invoked the OECD Arrangement's MPRs. Brazil acknowledges these factual differences between the GSM 102 program and the OECD Arrangement, and indeed did so in its own submissions.[52] These distinctions, however, do not undermine the value of the comparison between GSM 102 fees

[49] Response of the United States to Questions from the Parties, *Korea – Measures Affecting Trade in Commercial Vessels*, 22 March 2004, paras. 6-7 (emphasis added), accessed February 2007 at <u>http://www.ustr.gov/assets/Trade_Agreements/Monitoring_Enforcement/Dispute_Settlement/WTO/Dispute_Settlement_Listings/asset_upload_file769_5561.pdf</u>.

[50] Panel Report, *U.S. – Upland Cotton*, para. 7.858.

[51] Exhibit Bra-547 (OECD Document TD/PG(2004)10/FINAL, 6 July 2004, para. 1).

[52] Brazil's First Written Submission, para. 442.

and the MPRs to this Panel's analysis under item (j). This is because Brazil does not contend that the OECD MPRs constitute a strict quantitative benchmark for analysis of the U.S. upland cotton ECG fees. Brazil is not, for example, proposing the kind of direct quantitative comparison that would be triggered under item (k), second paragraph, of the Illustrative List. Rather, this comparison offers the compliance Panel a *qualitative* reference point for appreciating the degree to which GSM 102 fees fall below internationally-accepted standards for ECG programs that are, according to the OECD, structured and designed to break even.

70. Brazil turns to Japan's specific objections. As Brazil explained in its First Written Submission, comparing GSM 102 fees for agricultural ECGs to the OECD MPRs for industrial ECGs is, if anything, conservative. As Japan itself notes, "the risks of financing arrangements" for agricultural products are "substantial." As Brazil has noted, the perishability of agricultural products diminishes their value as security for lenders.[53] Japan echoes Brazil's argument that in these circumstances, GSM 102's extended coverage is unique; Japan acknowledges that in normal circumstances, even non-market entities like ExIm Bank cap coverage under similar credit protection products "at 180 days for bulk agricultural products."[54] If the OECD Arrangement were to cover export credits for agricultural products, the MPRs would certainly not be lower; the gap between MPRs and GSM 102 fees would not decrease, and would likely increase.

71. Nor does Japan's objection concerning the divergence between tenors for credits covered by GSM 102 and credits subject to OECD MPRs undermine Brazil's reference to the latter, for two reasons.

72. First, although the OECD Arrangement formally covers export credits with a tenor of two years or more, it provides a formula that allowed Brazil to extrapolate the MPRs that *would be* applicable to export credit guarantees with terms of less than two years. This permits an "apples-to-apples" comparison with respect to fees for credits with tenors of less than two years.

73. Second, the comparison provided by Brazil spans GSM 102 ECGs with tenors ranging as long as 36 months.[55] Even if one were to accept a premise that GSM 102 fees may be compared only to MPRs for export credits with terms of two years or more, the comparison points at 24, 30 and 36 months would all remain valid.[56] Those points of comparison, in turn, reveal not only a wide gap between GSM 102 fees and MPRs, but a gap that grows as the tenor – and, correspondingly, the risk – of the transaction increases. This same pattern appeared in Brazil's comparison of GSM 102 fees and fees charged by the U.S. Export-Import Bank. As the risks of the transactions increase, the inadequacy of the GSM 102 fees as compared to the MPRs (or to ExIm's fees) becomes even more pronounced.

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[53] Brazil's First Written Submission, para. 443.

[54] *See* Japan's Third Party Submission, para. 25, *citing* Brazil's First Written Submission, paras. 387, 389.

[55] Exhibits Bra-548 (MPR and CCC Annual Comparison) and Bra-549 (MPR and CCC Semi-Annual Comparison).

[56] *See* Exhibits Bra-548 (MPR and CCC Annual Comparison) and Bra-549 (MPR and CCC Semi-Annual Comparison).

74. Accordingly, Brazil maintains that a comparison of the fees charged in the GSM 102 program with the MPRs set under the OECD Arrangement constitutes a useful reference point for this compliance Panel. The factual differences noted by Japan in fact suggest that the reference point is a conservative one, such that it is even more clear that the GSM 102 program is not structured and designed to charge fees that cover its long-term operating costs and losses.

ANNEX D-8

RESPONSES OF THE UNITED STATES TO THE PANEL'S FIRST SET OF QUESTIONS (SECTIONS A-C)

(27 February 2007)

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Table of Exhibits

Exhibit US-	Title
112	CCC Commodity Estimates Book, Feb. 5, 2007 (Program Yields)

A. GENERAL QUESTIONS

Questions to both parties

1. Is Brazil/US of the view that a party to a dispute referred to a panel established under Article 21.5 of the DSU (a party in a compliance panel) can make the same legal argument as it did in the original Panel proceedings?

1. Article 21.5 "compliance" proceedings are limited in terms of the *claims* that can be made and the *measures* in respect of which the claims can be made. As the Appellate Body has explained, "[p]roceedings under Article 21.5 do not concern just any measure of a Member of the WTO; rather, Article 21.5 proceedings are limited to those 'measures *taken to comply* with the recommendations and rulings' of the DSB."[1] Moreover, "[i]f a *claim* challenges a *measure* which is not a 'measure taken to comply,' that *claim* cannot properly be raised in Article 21.5 proceedings."[2] While Article 21.5 of the DSU does not set out any similar express limitation on the legal arguments that can be made in a compliance proceeding, the necessary implication of the limitation on claims and measures is that, for legal arguments to be relevant in a compliance proceeding, they must relate to claims and measures that are properly within the scope of DSU Article 21.5.

2. The Appellate Body has explained that "Article 21.5 proceedings involve, in principle, not the original measure, but rather a new and different measure which was not before the original panel."[3] Accordingly, it is not clear that parties would make *exactly* the same legal arguments in a compliance proceeding (*i.e.*, in support of claims against measures taken to comply) as those it made in the original proceeding (*i.e.*, in support of original claims against original measures). Nonetheless, nothing in Article 21.5 of the DSU precludes parties from applying the same *logic* or *reasoning* in the two different contexts. Indeed, the situation with Brazil in this proceeding, where it has made one set of arguments in the original proceeding and then made directly contradictory arguments in the compliance proceeding – for example, regarding the effects of the Step 2 Program and the appropriateness of the FAPRI approach to modeling – would appear to be exceptional and not the approach required by Article 21.5 of the DSU.

2. Could each party explain its view on the question of whether, and to what extent, this Panel must rely on the legal and factual analysis underlying the original panel's findings? What are the relevant provisions of the DSU in this regard?

3. The relevance of an original panel's legal and factual analysis to the resolution of the matter presented to a compliance panel depends on the measure challenged in the compliance proceeding.

4. Where a complaining party claims that a Member has *failed* to implement the recommendations and rulings of the DSB – *i.e.*, that no measure taken to comply exists – the original panel's analysis (as modified by the Appellate Body) is a key consideration. In that case, it is important to examine the DSB's recommendations and rulings in order to determine whether the responding Member was, in fact, required to take measures to come into compliance and, if so, the scope of the obligation to do so. As the DSB's recommendations and rulings are based on the original panel's analysis (as modified by the Appellate Body), that analysis is important in discerning what the DSB's recommendations and rulings actually are in the particular dispute.[4]

5. The second case is one in which the complaining party agrees that a Member has taken measures to comply with the recommendations and rulings of the DSB but challenges its "consistency

[1] *Canada – Aircraft (21.5 Brazil) (AB)*, para. 36 (italics in original; underlining added).
[2] *EC – Bed Linen (21.5 India) (AB)*, para. 78 (emphasis in original).
[3] *Canada – Aircraft (21.5 Brazil) (AB)*, para. 41.
[4] *See e.g., United States – Final Countervailing Duty Determination (21.5 – Canada) (AB)*, para. 68.

with a covered agreement." In that case, the original panel's legal and factual analysis may be much less important. As the Appellate Body reasoned in *Canada – Aircraft (21.5 – Brazil*), "Article 21.5 proceedings involve, in principle, not the original measure, but rather a new and different measure which was not before the original panel."[5] Accordingly, "the relevant facts bearing upon the 'measure taken to comply' may be different from the relevant facts relating to the measure at issue in the original proceedings."[6] Moreover, "the claims, arguments and factual circumstances which are pertinent to the 'measure taken to comply' will not, necessarily, be the same as those which were pertinent in the original dispute."[7] The Appellate Body has, therefore, clarified that:

> the utility of the review envisaged under Article 21.5 of the DSU would be seriously undermined if a panel were restricted to examining the new measure from the perspective of the claims, arguments and factual circumstances that related to the original measure, because an Article 21.5 panel would then be unable to examine fully the 'consistency with a covered agreement of the measures taken to comply,' as required by Article 21.5 of the DSU.[8]

6. The same reasoning precludes "restricting" a panel to following the exact same legal and factual reasoning as the original panel.[9] However, under DSU Article 11, the task of a compliance panel – like that of an original panel – is to make an "*objective* assessment of the matter before it, including an *objective* assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements." In so doing, it may well consider that the reasoning of the original panel to be persuasive on points that are apposite. The Appellate Body confirmed this in *United States – Shrimp (21.5 – Malaysia)*, where the Appellate Body found that the compliance panel was justified in "taking into account the reasoning" in the adopted Appellate Body report from the original proceeding. The Appellate Body recalled, in this regard that adopted panel and Appellate Body report "are an important part of the GATT *acquis*. They are often considered by subsequent panels. They create legitimate expectations among WTO Members, and, therefore, should be taken into account where they are relevant to any dispute."[10]

B. QUESTIONS WITH RESPECT TO BRAZIL'S REQUEST UNDER ARTICLE 13.1

Questions to the US

> ***3. Is the United States arguing that Brazil must identify the subsidized product for each of the types of subsidies from which it claims serious prejudice? Is the United States arguing that payments which permit planting flexibility are not tied to the production of upland cotton, so that they must be allocated by Brazil across the total value of production of each recipient?***

7. The United States *does* consider that Brazil must identify the subsidized product for each of the types of subsidies from which it claims serious prejudice. As the Appellate Body explained in the original proceeding, this is a requirement of Article 6.3(c) itself:

> the 'subsidized product' must be properly identified for purposes of significant price suppression under Article 6.3(c) of the SCM Agreement. And if the challenged

[5] *Canada – Aircraft (21.5 – Brazil) (AB)*, para. 41.
[6] *Canada – Aircraft (21.5 – Brazil) (AB)*, para. 41.
[7] *Canada – Aircraft (21.5 – Brazil) (AB)*, para. 41.
[8] *Canada – Aircraft (21.5 – Brazil) (AB)*, para. 41.
[9] This is also consistent with the fact that there is no principle of *stare decisis* applicable in WTO dispute settlement.
[10] *United States – Shrimp (21.5 – Malaysia) (AB)*, para. 108 (citing *Japan – Alcoholic Beverages (AB)* at 108).

> payments do not, in fact, subsidize that product, this may undermine the conclusion that the effect of the subsidy is significant suppression of prices of that product in the relevant market.[11]

8. The same requirement exists with respect to Article 6.3(d) of the *SCM Agreement*, which specifically refers to "subsidized primary product or commodity."[12]

9. Brazil and the United States agreed in the original proceeding – and the original panel found – that the "subsidized product" was upland cotton lint.[13] Brazil has signaled that it considers that the same "subsidized product" is at issue here in this compliance proceeding.[14] Under the Appellate Body's reasoning it is necessary to ensure that "the challenged payments do . . . , in fact, subsidize that product."[15] The challenged payments, in the case of counter-cyclical payments, are payments in respect of upland cotton base acres.[16] The United States maintains that the appropriate allocation methodology for payments such as the counter-cyclical payments – which are not tied to the production or sales of any particular product – can be found in Annex IV of the *SCM Agreement*. That Annex sets out methodologies for determining the rate of "subsidization" of a "product" for purposes of the now-defunct Article 6.1(a) of the *SCM Agreement*.

10. Annex IV does not apply directly to the serious prejudice determinations under Articles 5(c) and 6.3(c). However, as it is the only allocation methodology that Members have agreed in the *SCM Agreement* and deals specifically with the question of how to allocate subsidies that are not tied to production or sale of a given product, it provides essential context.[17]

11. Under paragraph 2 of Annex IV, "the value of the product" that is subsidized in the case of subsidies that are not tied to production or sales is equal to "the total value of the recipient firm's sales."[18] (By way of contrast, where a "subsidy is tied to the production or sale of a given product, the value of the [subsidized] product shall be calculated as the total value of the recipient firm's sales of

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[11] *Upland Cotton (AB)*, para. 472.

[12] Article 6.3(d) of the *SCM Agreement* provides that "the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted." (Footnote omitted).

[13] *See Upland Cotton (AB)*, para. 407, nn. 450-451 (stating that "the subsidized product is United States upland cotton lint. (Panel Report, paras. 7.139, 7.1221-7.1224 and footnote 191 to para. 7.139)" and "[t]he United States and Brazil confirmed during the oral hearing that they do not contest this identification of the subsidized product.")

[14] Brazil First Written Submission, para. 80.

[15] *Upland Cotton (AB)*, para. 472.

[16] As the United States explained in its letter dated January 19, 2007 and again in its rebuttal submission "support-conferring measures with respect to non-cotton historical base acres" were *not* included in the support found to exceed the limitation in the Peace Clause proviso, such measures were exempt by virtue of the Peace Clause in the *Agreement on Agriculture* from actions, including Brazil's serious prejudice claims. Therefore, there could have been no, and there were no, DSB recommendations and rulings with respect to such measures, and counter-cyclical payments for non-cotton base acres are not "measures taken to comply" within the meaning of DSU Article 21.5.

[17] While this methodology was not applied in the original proceeding, the primary reason was Brazil's insistence that no precise calculation need be undertaken in the context of claims under Part III of the *SCM Agreement*. *See e.g., Upland Cotton (AB),* paras. 98 ("the remedy under Part III focuses on the effects of the subsidy, rather than the imposition of duties, and, according to Brazil, the size of a subsidy does not necessarily determine its effects") and 467. To the extent that calculation of the precise amount of the subsidy is undertaken – and the United States continues to believe that it is important that this be done – it is appropriate to use the allocation methodology in Annex IV.

[18] *SCM Agreement*, Annex IV, para. 2 (footnote omitted).

that product."[19]) Thus, Annex IV suggests a methodology for determining the amount of a non-tied subsidy that benefits a given product: the subsidy would be allocated to the product according to the ratio of the value of sales of that product to the total value of the recipient firm's sales. In this way, the Annex IV methodology recognizes that a payment that is not tied to the production or sale of a given product benefits all of the products the recipient produces. Allocating such a non-tied payment exclusively to one product over another would be economically arbitrary. Annex IV indicates an economically neutral methodology to allocate the benefits of non-tied subsidies to which Members have agreed.

12. Applying that methodology in the present circumstance yields the following results:

Value of cotton production for farm household that harvested cotton (2003-2005)

	2003	2004	2005	2003-2005 average
Total value of farm production	388,720	367,634	406,181	387,512
Total value of cotton	162,379	198,276	189,831	183,495
Cotton as percent of total	41.8%	53.9%	46.7%	47.4%

Source: 2003-05 USDA Agricultural Resource Management Survey.

Allocating counter-cyclical payments (million dollars)

	2003	**2004**	**2005**
Total CCP payments (A)	392	1,375	1,375
Ratio of total cotton base acres up to cotton planted acres to total cotton base acres (B)[1/]	59.1%	59.0%	60.2%
CCP payments paid on total cotton base acres on farms that planted cotton (C = A * B)	231.7	811.3	827.8
Cotton as percent of total on farms that harvested cotton (D)	41.8%	53.9%	46.7%
CCP payments allocated based on cotton's share of total crop value (E = D * C)	96.8	437.3	386.6
As percent of total CCPs (F= E/A)	24.7%	31.8%	28.1%

[1/]U.S. First Written Submission, para 224

[19] *SCM Agreement*, Annex IV, para. 3 [italics added].

4. Does the United States contest the accuracy of the figures for 2003 – 2005 cited in "Table 6" of Brazil's first submission and "Table 5" of Brazil's rebuttal submission? If so, please provide the accurate figures, or the figures the US deems to be more accurate.

13. The United States does not agree that the figures in "Table 6" of Brazil's first written submission for MY2004 and MY2005 are accurate for marketing loan payments.[20] These payments are composed of three separate components – loan deficiency payments ("LDP"), marketing loan gains ("MLG"), and certificate exchange gains ("CEG"). As Brazil notes, USDA budget projections now include a "stochastic add-on" to account for variability in the projections.[21] But this "add-on" is done only for projection purposes. Brazil has incorrectly included the projected figures – including the "add-on" for MY 2004 and MY 2005.[22]

14. The actual outlays for MY 2004 and MY 2005 are the following:

	MY2004	MY2005
LDP	374	256
MLG	10	8
CEG	1,396	1,005
TOTAL	**1,780**	**1,269**

15. The United States understands that Brazil intends the counter-cyclical payment figures shown in "Table 5" of Brazil's rebuttal submission to supercede the counter-cyclical payment figures shown in "Table 6" of its first written submission. Brazil has sought to allocate counter-cyclical payments in respect of upland cotton base acres using the so-called "cotton-to-cotton" methodology.[23] For the reasons discussed in response to question 3 above, the United States considers that the methodology set out in Annex IV of the *SCM Agreement* is the more accurate and more appropriate approach.

16. Nonetheless, the United States has attempted to test the calculations conducted by Brazil in Table 5 of its Rebuttal Submission. Brazil cites Exhibit BRA-567 (Agricultural Outlook Indicators, Table 19) as the source of payments rates and payments yields. However, this source only includes data through MY 2002. The United States has used publicly available data to try and replicate Brazil's figures. These figures are shown below:

[20] The United States considers that only the MY 2005 data is relevant for purposes of Brazil's "present" serious prejudice claims. Nonetheless, for sake of completeness, the United States has tested that figures for MY 2003-2005. The United States has not tested the figures shown for crop insurance payments, direct payments, PFC payments, MLA payments, or cottonseed payments, as these are not at issue in the present proceeding.

[21] Budget Estimates from USDA's Mid-Session Review (Exhibit BRA-456).

[22] *See* Budget Estimates from USDA's Mid-Session Review (Exhibit BRA-456).

[23] The Appellate Body indicated that the so-called cotton-to-cotton methodology was appropriate for the Peace Clause analysis. *See Upland Cotton (AB)*, para. ("for purposes of the comparison envisaged by Article 13(b)(ii), the values of the four measures, namely, production flexibility contract payments, market loss assistance payments, direct payments and counter-cyclical payments in the years 1999, 2000, 2001, and 2002 are properly determined by using the "cotton to cotton" methodology. . . .")

Item	MY2003	MY2004	MY2005
Total cotton base acres up to cotton planted acres (a) [1/]	**11,108**	**11,041**	**11,155**
Payment acres (b) [2/]	**9,442**	**9,385**	**9,482**
Program yield (c) [3/]	**639**	**636**	**634**
Payment rate (d) [4/]	**.0393**	**.1373**	**.1373**
CCP payment (e) [5/]	**237**	**820**	**825**

[1/] U.S. First Written Submission, December 15, 2007, para. 224.
[2/] 85 percent of cotton base acres (a).
[3/] Data for MY 2002 is from Budget Estimates from USDA's Mid-Session Review (Exhibit BRA-456). Other years are from CCC Commodity Estimates Book, Feb. 5, 2007, page 202 (Exhibit US-112).
[4/] MY2003 is from FSA Press Release 0455.04, available at http://content.fsa.usda.gov/pas/FullStory.asp?StoryID=1897.
[5/] The CCP payments (e) are equal to b*c*d.

Question to Brazil

5. ***The Panel refers to Brazil's communication dated 22 January 2007 concerning its request in relation to Article 13.1 of the DSU. Is it correct for the Panel to understand that as far as data for 2005 is concerned, data included in Exhibit US-64 satisfies all of the requests Brazil made in Part A of Annex 1 of its 1 November communication?***

C. QUESTIONS CONCERNING THE PRELIMINARY OBJECTIONS RAISED BY THE UNITED STATES

1. Preliminary objections of the United States in respect of claims of Brazil regarding export credit guarantees in respect of pig meat and poultry meat

Question to both parties

6. ***The parties disagree with respect to whether in a proceeding under Article 21.5 of the DSU a party may present a claim that was raised in the original proceeding but on which no finding of WTO-inconsistency was made due to the fact that the Appellate Body was unable to complete the analysis.***

   a. ***Could the parties explain the legal basis in the text of Article 21.5 of the DSU and other relevant provisions of the DSU for their position on this question?***

   b. ***Could the parties explain whether and how their position on this issue is consistent with prior panel and Appellate Body reports?***

17. Where there is no finding of WTO-inconsistency with respect to a measure – whether it is because the panel or Appellate Body was unable to make proper findings, because the complaining party failed to make a *prima facie* case, or some other reason – there are no DSB recommendations and rulings in respect of the measure. As the measure has never been found to be *out* of compliance with any covered agreement there logically is no question of bringing it *into* compliance. A WTO panel is not permitted to presume that a Member is out of compliance and there is no basis to expect that a Member should do so despite its own carefully considered views of what its WTO obligations

entail.[24] Simply put, an implementation obligation arises only when DSB recommendations and rulings exist that require implementation.

18. Under Article 21.5 of the DSU, "compliance" proceedings may address two categories of matters: (a) that measures taken to comply with recommendations and rulings of the DSB do not exist; and (b) that (extant) measures taken to comply with recommendations and rulings of the DSB are not consistent with a covered agreement.[25] In both cases, a necessary predicate is that there be DSB recommendations and rulings.

19. Where a measure is not subject to any DSB recommendations and rulings because no finding of WTO-inconsistency has been found in respect of it, there is, logically, no basis for any claim that a Member has not implemented the DSB's recommendations and rulings in respect of the measure (*i.e.*, that no measure taken to comply *exists* with respect to the measure). Moreover, unless the original measure is *itself* considered to be a measure taken to comply with other recommendations and rulings – and any such determination must be compelled by the particular the recommendations and rulings that are issued, not the unilateral assertions of the complaining party – there is no basis for claims to be made against the measure in a compliance proceeding alleging that it is inconsistent with a covered agreement. In short, the measure would not be the type of measure properly within the scope of Article 21.5 and the claims that could be made against it would not be the type of claims properly within the scope of that provision.

20. This reasoning is consistent with the reasoning in prior Appellate Body reports interpreting the scope of Article 21.5. For example, in *Canada – Aircraft (21.5 – Brazil)*, the Appellate Body clarified that:

> [p]roceedings under Article 21.5 do not concern just any measure of a Member of the WTO; rather, Article 21.5 proceedings are limited to those "measures taken to comply with the recommendations and rulings" of the DSB. In our view, the phrase *"measures taken to comply" refers to measures which have been, or which should be, adopted by a* Member *to bring about compliance with the recommendations and rulings of the DSB.*[26]

21. The Appellate Body, thus, confirmed that the focus of compliance proceedings is on the DSB's recommendations and rulings – whether they have been complied with and, if so, whether the compliance measures are themselves consistent with the covered agreement.

22. The Appellate Body's (consistent) reasoning in *EC – Bed Linen (21.5 – India)* is even more salient. There the Appellate Body confirmed again that "the mandate of Article 21.5 panels is to examine either the 'existence' of 'measures taken to comply' or, more frequently, the 'consistency with

[24] It is well-established that Members' measures cannot be presumed to be WTO-inconsistent. *See e.g., United States – Argentina OCTG Sunset Reviews (AB)*, paras. 173 ("The presumption that WTO Members act in good faith in the implementation of their WTO commitments is particularly apt in the context of measures challenged 'as such.'")

[25] The fact that "compliance" proceedings deal with implementation of recommendations and rulings is apparent not only from the text of Article 21.5 but also its context; for example, the fact that it is part of Article 21, which deals in the whole with "Surveillance of Implementation of Recommendations and Rulings." The first paragraph of DSU Article 21.1 provides that "prompt compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of disputes to the benefit of all Members." And the provisions that follow all relate to implementation. For example, Articles 21.3 and 21.4 of the DSU deal with rules and procedures for establishing a reasonable period of time to implement the recommendations and rulings of the DSB. Article 21.5 deals with the dispute settlement procedures available when there is a disagreement as to whether a Member has implemented DSB recommendations and rulings consistently with its WTO obligations. And Article 21.6 deals with surveillance by the DSB of implementation by Members.

[26] *Canada – Aircraft (21.5 – Brazil) (AB)*, para. 36 (emphasis added).

a covered agreement' of *implementing measures*."[27] The Appellate Body acknowledged that the Article 21.5 panel proceeding was *not* intended to provide complaining parties with a "second chance" to reassert claims that had been unsuccessful in the original proceeding.[28] Indeed, there the Appellate Body rejected India's attempt to reassert the same claim against an aspect of an antidumping determination (the "other factors" analysis) that had been dismissed by the original panel for failure to make a *prima facie* case.[29]

23. In doing so, the Appellate Body tracked precisely the reasoning set out above as to why measures are outside the scope of Article 21.5 proceedings when they have never been found to be WTO-inconsistent and are not themselves measures taken to comply. Specifically, the Appellate Body concluded, first, that "the investigating authorities of the European Communities were not required to change the determination as it related to the 'effects of other factors' in this particular dispute."[30] In other words, the Appellate Body recognized that there was no basis for a claim regarding the *existence* of measures taken to comply in respect of that aspect of the determination. Next, the Appellate Body noted that "we do not see why that part of the redetermination that merely incorporates elements of the original determination on 'other factors' would constitute an inseparable element of a measure taken to comply with the DSB rulings in the original dispute."[31] In other words, the Appellate Body determined that the "other factors" determination was not itself a measure taken to comply with any DSB recommendations and rulings.

24. Although *EC – Bed Linen (21.5 – India)* involved slightly different facts than those at issue here – namely, there, a finding of WTO-inconsistency was made because of a failure by the complaining party to make a *prima facie* case rather than because the Appellate Body had insufficient facts before it to determine whether the measures at issue were WTO-inconsistent – the reasoning in both cases is the same. Where there is neither a basis for a claim of *existence* of measures taken to comply (because there are no DSB recommendations and rulings that must be implemented with respect to the measure) nor a claim of *consistency with a covered agreement* (because the measure is not a measure taken to comply with other DSB recommendations and rulings), neither the measure nor any claims against it are properly within the scope of an Article 21.5 proceeding.

Questions to Brazil

7. Is Brazil of the view that it is only in the circumstances identified by the Appellate Body in EC – Bed Linen (Article 21.5 – India) that the scope of Article 21.5 proceedings is limited by the scope of the original proceedings? [Paragraphs 11-15 of Submission of Brazil to the Panel Regarding US Requests for Preliminary Ruling]

8. How does Brazil respond to the arguments of the United States that Brazil "incorrectly assumes that the standard is one of whether there has been a 'final resolution' of the issue in the original proceeding" and that Brazil misreads the Appellate Body report in EC – Bed Linen (Article 21.5 – India) and confuses the issue of "the scope of a compliance proceeding pursuant to Article 21.5 of the DSU" and the distinct issue of "when a claim against a specific measure or aspect of a measure can be considered to be 'finally resolved' for purposes of WTO dispute settlement"? [Paragraphs 8 and 12 of the Rebuttal Submission of the United States]

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[27] *EC – Bed Linen (21.5 – India) (AB)*, para. 79 (emphasis added).
[28] *EC – Bed Linen (21.5 – India) (AB)*, para. 74.
[29] *EC – Bed Linen (21.5 – India) (AB)*, para. 87.
[30] *EC – Bed Linen (21.5 – India) (AB)*, para. 86.
[31] *EC – Bed Linen (21.5 – India) (AB)*, para. 86.

9. ***What are the comments of Brazil on the arguments in footnote 22 of the United States' rebuttal submission?***

Question to the US

10. ***Could the United States explain why it considers that what it describes as the "final resolution" standard is not the correct standard to decide whether Brazil's claims regarding export credit guarantees for pig meat and poultry meat are within the scope of this proceeding?***

25. Article 21.5 of the DSU defines the scope of compliance proceedings conducted pursuant to that provision. It defines the measures that are properly within the scope of a compliance proceeding – "measures taken to comply with the recommendations and rulings of the DSB." And it defines the claims that can be made in respect of such measures – (a) claims regarding the "existence" of measures taken to comply and (b) claims regarding the "consistency with a covered agreement" of measures taken to comply. Article 21.5 does not define the scope of claims properly reviewed in a compliance proceeding in terms of whether or not the claims have been finally resolved.

26. Whether or not a claim has been finally resolved between parties to a dispute is a separate question. As the Appellate Body explained in *EC - Bed Linen*, that question is governed by Article 17.14 of the DSU, which provides that "an Appellate Body report shall be adopted by the DSB and unconditionally accepted by the parties to the dispute . . . ."[32] The Appellate Body clarified that the same reasoning applies also with respect to any *unappealed* finding included in an adopted panel report.[33] Where a particular claim has been finally resolved with respect to a particular measure (or component of a measure) that was the subject of the claim, that particular resolution is binding on the parties and cannot be raised again on the basis of the same facts and arguments in any other proceeding. By contrast, even where a claim is outside the limited scope of a "compliance" proceeding under Article 21.5 of the DSU, it may well be raised in a separate proceeding.

2. Preliminary objections of the United States with respect to claims of Brazil regarding marketing loan and counter-cyclical payment programs

Questions to Brazil

11. ***Is Brazil of the view that a finding under Article 6 of the SCM Agreement that a "subsidy" is causing serious prejudice necessarily always applies to both the subsidy "payments" and the subsidy "program"? [Paragraphs 31-35 of Submission of Brazil Regarding US Requests for Preliminary Ruling and paragraph 38 of the Rebuttal Submission of Brazil]***

12. ***In paragraph 44 of its Rebuttal Submission, Brazil states:***

> ***"Accordingly, there is no need for Brazil to challenge per se the FSRI Act of 2002. Nor does it assert an 'as applied' challenge to the FSRI Act of 2002. Rather, Brazil challenges the counter-cyclical and marketing loan Programs in the FSRI Act of 2002 and the payments that such programs require to U.S. upland cotton farmers, as they cause adverse effects." (emphasis added)***

[32] *EC – Bed Linen (21.5 – India) (AB)*, para. 91.

[33] *EC – Bed Linen (21.5 – India) (AB)*, para. 93 ("an unappealed finding included in a panel report that is adopted by the DSB must be treated as a final resolution to a dispute between the parties in respect of the particular claim and the specific component of a measure that is the subject of that claim.")

Could Brazil please explain:

a. *How its claims against "programs and payments... as they cause adverse effects" differ from claims against programs as such?*

b. *How these claims differ from claims against programs as applied?*

13. ***In paragraph 45 of its Rebuttal Submission, Brazil refers to the failure of the United States "to implement the original recommendation of the DSB requiring the United States to take actions concerning its present statutory and regulatory framework providing for marketing loan and counter-cyclical payments".***

a. ***Does Brazil consider that the statement in paragraph 7.1501 of the original panel report that "the United States is obliged to take action concerning its present statutory and regulatory framework..." forms an integral part of the recommendation made by the original panel in paragraph 8.3(d) of its report?***

b. ***Does Brazil consider that the absence of actions by the United States "concerning its present statutory and regulatory framework providing for marketing loan and counter-cyclical payments" is in itself a sufficient basis for this Panel to find that the United States has not complied with the DSB recommendation under Article 7.8 of the SCM Agreement?***

c. ***Is there any difference, in Brazil's view, between, on the one hand, the nature of the action the United States was obliged to take with respect to its statutory and regulatory framework as a consequence of the recommendation in paragraph 8.3(d) of the original panel report and, on the other, the nature of the action the United States would have been obliged to take if the original panel had found that the relevant provisions of this statutory and regulatory framework were WTO-inconsistent as such?***

14. ***Could Brazil please explain how this Panel should interpret the relationship between the three categories of measures identified in paragraph 3.1(v),(vii) and (viii) of the original panel report? Is it the view of Brazil that "subsidies provided" or "subsidies mandated to be provided" must be interpreted to encompass both payments of subsidies and the regulatory provisions pursuant to which such payments were "provided" or "mandated to be provided"?***

15. ***Does Brazil agree or disagree with the United States that the listing of certain legislative and regulatory provisions in paragraph 7.1107 of the original panel report reflects the original panel's view that "payments under a program constitute programs 'as applied'"? [Paragraphs 46-47 of the Rebuttal Submission of the United States]***

16. ***Could Brazil clarify whether or not its claim in this Article 21.5 proceeding regarding a threat of serious prejudice caused by marketing loan and counter-cyclical payments is a claim with respect to the marketing loan and counter-cyclical payment programs as such? [Paragraphs 237-314 of the First Written Submission of Brazil]***

Questions to the United States

17. The United States argues in paragraph 16 of its Rebuttal Submission that "[a]ccording to Brazil, its claims apply not only to the marketing loan and counter-cyclical payment Programs, as such, but to the Programs in addition to all payments authorized under the Programs" (original emphasis). The United States also argues in this respect that "it is abundantly clear that the original panel did not make any finding under Article 5(c) and 6.3(c) of the SCM Agreement against the marketing loan and counter-cyclical payment Programs, as such, whether alone or in addition to payments". [Paragraph 43 of Rebuttal Submission of the United States]

a. How does the United States respond to the argument of Brazil that the United States mischaracterizes Brazil's claims in these proceedings in that Brazil is not challenging the subsidy programs at issue as such? [Paragraph 31 of Submission of Brazil to the Panel Regarding US Requests for Preliminary Ruling; paragraph 33 of Rebuttal Submission of Brazil]

27. Brazil asserts in paragraph 31 of its submission regarding the U.S. preliminary ruling requests – the same paragraph noted by the Panel above – that it is "challenging in this proceeding the U.S. subsidies inasmuch as they cause adverse effects." According to Brazil "the *measures that constitute these "subsidies"* are the statutory and regulatory provisions of the FSRI Act of 2002 that relate to upland cotton, *i.e.,* the marketing loan and counter-cyclical payment provisions" as well as payments under the Program that allegedly "have been and will continue to be made over the lifetime of the FSRI Act of 2002, *i.e.,* until MY 2007. . . ."[34] Therefore, Brazil contradicts its own statement that it is not challenging the marketing loan and counter-cyclical payment Programs "as such." As the Appellate Body explained in *United States – Sunset Reviews on OCTG from Argentina*: "[b]y definition, an "as such" claim challenges laws, regulations, or other instruments of a Member that have general and prospective application, asserting that a Member's conduct – not only in a particular instance that has occurred, but in future situations as well – will necessarily be inconsistent with that Member's WTO obligations."[35]

28. Brazil's statement cited above indicates that it is not seeking to challenge the marketing loan and counter-cyclical payment *only* "as such," and that it is seeking to *also* challenge the Programs "as applied" (*i.e.,* the payments under the Program). However, tacking on claims "as applied" does not relieve Brazil of proving its claims against the marketing loan and counter-cyclical payment Programs "as such." This includes the obligation of proving that application of "the statutory and regulatory provisions of the FSRI Act of 2002 that relate to upland cotton, *i.e.,* the marketing loan and counter-cyclical payment provisions" "will necessarily be inconsistent with that Member's WTO obligations."[36] Indeed, as the Appellate Body has emphasized:

> In our view, "as such" challenges against a Member's measures in WTO dispute settlement proceedings are serious challenges. . . .In essence, complaining parties bringing 'as such' challenges seek to prevent Members *ex ante* from engaging in certain conduct. The implications of such challenges are obviously more far-reaching than "as applied" claims. We also expect that measures subject to "as such" challenges would normally have undergone, under municipal law, thorough scrutiny through various deliberative processes to ensure consistency with the Member's international obligations, including those found in the covered agreements, and that the enactment of such a measure would implicitly reflect the conclusion of that

[34] Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 31.
[35] *United States – Argentina OCTG Sunset Reviews (AB),* paras. 172-173.
[36] *United States – Argentina OCTG Sunset Reviews (AB),* paras. 172-173.

> Member that the measure is not inconsistent with those obligations. The presumption that WTO Members act in good faith in the implementation of their WTO commitments is particularly apt in the context of measures challenged "as such."[37]

b. Could the United States also comment in this regard on the arguments in paragraph 31 of the Third Party Submission of Chad? Does the United States agree or disagree with the proposition that statutory or regulatory provisions can be challenged on an as applied basis and that Brazil's claims in the original proceeding "were as applied claims regarding measures that included legislative and regulatory provisions"?

29. To the extent that Chad is arguing that Brazil's claims in the original proceeding were *limited* to "as applied" claims, the United States respectfully disagrees. That argument cannot be reconciled with the original panel's own explanation of the claims made by Brazil in the original proceeding. Specifically, the original panel explained that "concerning selected provisions of the FSRI Act of 2002 and the ARP Act of 2000," Brazil was challenging "the following sections" as "violat[ing], *as such*, Articles 5(c), 6.3(c), 6.3(d) of the SCM Agreement and Articles XVI: 1 and 3 of the GATT 1994 to the extent that they relate to upland cotton . . . ."[38]

30. On the question of whether the application of statutory and regulatory provisions can be challenged in WTO dispute settlement, the United States agrees that statutory and regulatory provisions can be challenged "as applied." Indeed, in the original dispute, Brazil challenged payments made under, *inter alia*, the Step 2, marketing loan, and counter-cyclical payment Program in MY 1999-2002 as having caused significant price suppression and serious prejudice to the interests of Brazil within the meaning of Articles 5(c) and 6.3(c) of the *SCM Agreement*.[39] That constituted a challenge to the application of the Programs in those years. And Brazil prevailed on that claim:

> [i]n conclusion, in light of all of these considerations, we find that the effect of the mandatory, price contingent United States subsidies at issue – that is, marketing loan program *payments*, user marketing (Step 2) *payments* and MLA *payments* and CCP *payments* – is significant price suppression in the same world market for upland cotton in the period MY 1999-2002 within the meaning of Articles 6.3(c) and 5(c) of the SCM Agreement.[40]

31. Brazil did not prevail, however, on its claims regarding payments allegedly "mandated" to be provided in MY 2003-2007 (*i.e.*, the (alleged) application of the Programs in future marketing years).[41] Nor did Brazil prevail on its claims regarding, *inter alia*, the Step 2, marketing loan and counter-cyclical payment program *per se*.[42] The question is whether Brazil has any basis now, in this "compliance" proceeding, to make claims in respect of those measures again.

32. There is no such basis. Under the express terms of Article 21.5 of the DSU, a "compliance" proceeding under Article 21.5 of the DSU provides for an assessment of whether a Member has complied with the recommendations and rulings of the DSB consistently with its WTO obligations. Where there are no DSB recommendations and rulings in respect of statutory and regulatory provisions as such, and there are no DSB recommendations and rulings in respect of the application of those provisions in future years, there is no implementation obligation in respect of those measures. Therefore, there is no basis for a claim that measures taken to comply do not *exist* with respect to

[37] *United States – Argentina OCTG Sunset Reviews (AB)*, paras. 172-173.
[38] *Upland Cotton (Panel)*, para. 3.1(viii).
[39] *Upland Cotton (Panel)*, para. 3.1(vi) (emphasis added).
[40] *Upland Cotton (Panel)*, para. 7.1416 (emphasis added).
[41] *Upland Cotton (Panel)*, paras. 7.1503-7.1505.
[42] *Upland Cotton (Panel)*, paras. 7.1511.

them. Moreover, where the measures have not been changed in order to comply with any recommendations and rulings, there is no basis for claims regarding their "consistency with a covered agreement." The fact that the *application* of statutory and regulatory provisions can be challenged does not change that analysis.

18. The United States submits that the only measures subject to the DSB's recommendation under Article 7.8 of the SCM Agreement are payments made under the Step 2, marketing loan, and counter-cyclical payment programs in 1999-2002. The United States also asserts, in this regard, that Brazil fails to submit evidence "as to the present effects, if any, of the measures that were subject to the original panel's actionable subsidy finding".

a. Do these statements mean that the United States considers that the DSB recommendation under Article 7.8 of the SCM Agreement only obliged the United States to ensure that payments made in 1999-2002 would no longer have any adverse effects?

33. The recommendation of the original panel – which was adopted by the DSB – was that the United States was "under an obligation to 'take appropriate steps to remove the adverse effects or ... withdraw the subsidy.'"[43] Therefore, consistent with Article 7.8 of the *SCM Agreement*, the United States had a choice between withdrawing the "subsidy" subject to the original panel's "present" serious prejudice finding *or* removing its adverse effects.

34. The subsidies that were subject to Brazil's claim of "present" serious prejudice were "the subsidies provided during MY 1999-2002,"[44] including Step 2, marketing loan, and counter-cyclical *payments*.[45] The panel concluded that these subsidies caused "present" serious prejudice in the years MY 1999-2002:

> [i]n conclusion, in light of all of these considerations, we find that the effect of the mandatory, price contingent United States subsidies at issue – that is, marketing loan program *payments*, user marketing (Step 2) *payments* and MLA *payments* and CCP *payments* – is significant price suppression in the same world market for upland cotton in the period MY 1999-2002 within the meaning of Articles 6.3(c) and 5(c) of the SCM Agreement[46]

35. It was these subsidies that were, thus, also the subject to the U.S. "obligation to 'take appropriate steps to remove the adverse effects or ... withdraw the subsidy.'"[47]

b. Could the United States comment on the argument of New Zealand in paragraph 4.08 of the Third Party Submission of New Zealand?

36. New Zealand argues in paragraph 4.08 of its third party submission that "the United States distinction between payments and programs leads to an absurd result" because, according to New Zealand, "serious prejudice would have to proved annually in the light of payments that have been made by which time the adverse effects have already occurred and it would be too late to

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[43] *Upland Cotton (Panel),* para. 8.3(d).

[44] *Upland Cotton (Panel),* para. 3.1(vi). *See also Upland Cotton (Panel),* para. 7.1108 ("Brazil claims that United States subsidies provided during MY 1999-2002 have caused, cause and continue to cause "serious prejudice" to Brazil's interests. . . .")

[45] *Upland Cotton (Panel),* para. 7.1120.

[46] *Upland Cotton (Panel),* para. 7.1416 (emphasis added).

[47] *Upland Cotton (Panel),* para. 8.3(d).

withdraw the measure that caused them."[48] New Zealand's argument appears to be based on a number of incorrect assumptions that do not square even with the facts of this dispute.

37. First, New Zealand assumes that the distinction between the payments and Programs is a "United States distinction."[49] In fact, the distinction between payments and Programs is one of *fact* that Brazil recognized when it brought separate claims against particular payments and the Programs themselves in the original proceeding.[50] The original panel recognized this distinction in its resolution of the separate claims raised by Brazil.[51] And the distinction has been recognized and respected in other disputes.[52]

38. Second, New Zealand appears to assume incorrectly that recognizing the *fact* that payments are measures distinct from the statutory and regulatory provisions that authorize them means that the latter cannot be challenged in WTO dispute settlement. That is not a necessary implication of recognizing that payments and Programs are distinct measures. Indeed, this dispute is a case in point that Programs *can* be challenged as such.[53] Brazil simply did not prevail on the claims against the Programs as such. The fact is, however, that Brazil only prevailed on its claims regarding particular payments made in MY 1999-2002.

39. Third, New Zealand appears to ignore the fact that a complaining Member may make claims of "threat" of serious prejudice about payments in future years (or, indeed, regarding the Program authorizing the payments) should it not want to make claims of "present" serious prejudice against particular payments that have been made or claims against the Programs, *per se*. This, too, is illustrated in this dispute.

40. Fourth, New Zealand appears to assume that the effects of a recurring payment are limited to the year in which the subsidy is paid so that "the subsidy is over and the subsidizing effect is past" "annually." This argument was rejected by the Appellate Body in this dispute: "The context of Article 6.3(c) within Part III of the SCM Agreement does not support the suggestion that the effect of a subsidy is immediate, short-lived, or limited to one year, regardless of whether or not it is paid every year."[54] Indeed, the Appellate Body used this reasoning to conclude that Brazil could challenge U.S. payments made in MY 1999-2001, not just the payments in MY 2002, the year in which Brazil initiated the original proceeding.[55] Here, again, New Zealand's argument is contradicted by the facts of this dispute.

19. Regarding the argument of the United States that the marketing loan and counter-cyclical payments programs are not measures "taken to comply", is it the view of the United States that Article 21.5 of the DSU only applies to measures actually taken by a party to comply and does not apply to measures that a Member should have taken to comply?

41. The United States considers that Article 21.5 of the DSU provides two categories of claims: (a) claims that no measure taken to comply exist and (b) claims that measures taken to comply exist but that these measures are not consistent with a covered agreement. In the first case, there is – by definition – no measure taken to comply and, in that sense, the "measure" could be the absence of

[48] New Zealand Third Party Submission, para. 4.08.
[49] New Zealand Third Party Submission, para. 4.08.
[50] *See Upland Cotton (Panel)*, paras. 3.1(vi)-(viii) and U.S. Rebuttal Submission, paras. 30-37.
[51] New Zealand Third Party Submission, para. 4.08.
[52] *See e.g., Brazil – Aircraft (21.5 II – Canada)*, para. 2.1.
[53] *See Upland Cotton (Panel)*, paras. 3.1(vi)-(viii) and U.S. Rebuttal Submission, paras. 30-37.
[54] *Upland Cotton (AB)*, para. 477.
[55] *Upland Cotton (AB)*, paras. 484.

"measures that a Member should have taken to comply." In the second case, there is a measure taken to comply and that is the only proper subject of any WTO-inconsistency in the proceeding.

20. How does the United States respond to the argument in the Third Party Submission of Japan that the Appellate Body report in EC – Bed Linen (Article 21.5 – India) does not support the argument of the United States that the marketing loan and counter-cyclical payments programs are not within the scope of this Article 21.5 proceeding?

42. Japan appears to misunderstand the U.S. argument. Contrary to Japan's assertion, the United States has *not* argued that a complaining Member is "cut[] off" from "access to review under Article 21.5" where the responding Member has taken no action to comply with the recommendations and rulings of the DSB.[56] To the contrary, the United States notes that Article 21.5 specifically contemplates that a complaining Member can invoke "compliance" review under that provision "where there is disagreement as to the *existence* . . . of measures taken to comply with the recommendations and rulings." (Emphasis added) The United States considers that this covers the situation where a Member has taken no measures to comply with recommendations and rulings.

43. The U.S. arguments to which Japan refers deal with the question of what measures may be subject to new or renewed "claims of consistency with a covered agreement" in an Article 21.5 proceeding. Article 21.5 of the DSU provides that such claims can only be made in respect of *measures taken to comply* with the recommendations and rulings of the DSB. In the present case, neither the marketing loan and counter-cyclical payment Programs – nor the Programs and "all payments" thereunder – are measures taken to comply with any DSB recommendations and rulings. The fact that they have not been changed, either to implement any DSB recommendations and rulings or for any other reason, confirms this. And as these measures are not "measures taken to comply," they cannot – under the express terms of Article 21.5 – be subject to new and renewed "claims of consistency with a covered agreement."

44. The Appellate Body's reasoning in *EC – Bed Linens* is entirely consistent with the U.S. argument. The Appellate Body recognized there that "[i]f a claim challenges a measure which is not a 'measure taken to comply,' that claim cannot properly be raised in Article 21.5 proceedings."[57] In other words, an Article 21.5 proceeding is about whether implementation of DSB recommendations and rulings is consistent with a Member's WTO obligations. As the Appellate Body recognized, it does not provide complaining Members with a "second chance" to make "claim[s] which, as a legal and practical matter, could have been raised and pursued in the original dispute."[58]

3. Claim of Brazil regarding the failure of the United States to comply with the DSB recommendations between 21 September 2005 and 1 August 2006

Questions to Brazil

21. Could Brazil please explain whether its request for a finding that the United States failed to comply with the DSB recommendations between 21 September 2005 and 1 August 2006 is supported by prior panel practice in Article 21.5 proceedings? [Paragraph 68 of the Rebuttal Submission of the United States]

22. How does Brazil respond to the argument of the European Communities that "the lack of positive action taken by the United States to comply with the panel and Appellate Body's findings and recommendations between the implementation date

[56] Japan Third Party Submission, para. 18.
[57] *EC – Bed Linen (21.5 – India) (AB)*, para. 78.
[58] *EC – Bed Linen (21.5 – India) (AB)*, para. 74.

of 21 September 2005 and 31 July 2006 is not necessarily fatal to its defence"? [Paragraph 48 of the Third Party Submission of the European Communities]

Question to the United States

23. Does the United States consider that the text of Article 21.5 of the DSU should be interpreted to mean that a compliance panel may only review the "existence" or "consistency" with a covered agreement of measures taken to comply as of the date that the matter was referred to the panel and not as of the date of the end of the implementation period? [Paragraph 68 of the Rebuttal Submission of the United States]

45. In paragraph 68 of the U.S. rebuttal submission, the United States explained that Brazil has not identified any textual basis for making *both* (a) a claim about "existence" of measures taken to comply with a recommendation of the DSB relating to factual circumstances that both parties agree no longer even exist *and* (b) a claim about "measures taken to comply" with respect to the *same* recommendation of the DSB under factual circumstances that both parties agree *do* actually exist.

46. To the contrary, as the panel recognized in *United States – Shrimp (21.5 Malaysia)*, a finding such as the one described in (a) above regarding superceded facts does not "favour[] a prompt settlement of the dispute."[59] Similarly, the panel in *EC – Bed Linen (21.5 – India)* declined to "make two decisions on the existence or consistency of measures taken to comply – one as of the end of the reasonable period of time, and one as of the date of establishment of the Panel"[60] because "[w]e do not consider that it would be either necessary or appropriate, as a matter of judicial economy, to first examine whether compliance had occurred as of the end of the reasonable period of time, and second consider compliance as of the later date."[61] This clarification by the *EC – Bed Linen (21.5 – India)* panel – that the issue is one of "judicial economy" – is especially helpful. "Judicial economy" refers to the principle that panels have to "[make] findings only on those claims that such panels concluded were necessary to resolve the particular matter."[62] In *EC – Bed Linens*, the complaining party did not show that findings regarding compliance as of the end of the implementation period would be "necessary or appropriate" to resolving the particular matter before the panel. Similarly, here, Brazil has not shown that the requested findings regarding compliance under the superceded facts that existed on the date of implementation are necessary or appropriate to resolving the particular matter before this Panel.

[59] *United States – Shrimp (21.5 – Malaysia) (AB)*, para. 5.12.
[60] *EC – Bed Linen (Panel) (21.5 – India)*, para. 6.28.
[61] *EC – Bed Linen (Panel) (21.5 – India)*, para. 6.28.
[62] *United States – Shirts and Blouses (21.5 – India) (AB)*, p. 18.

ANNEX D-9

RESPONSES OF THE UNITED STATES TO THE PANEL'S FIRST SET OF QUESTIONS (SECTIONS D&E)

(6 March 2007)

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130	*The New Shorter Oxford English Dictionary* at 195, Volume 1, (1993 Edition)

D. CLAIMS OF BRAZIL REGARDING PRESENT SERIOUS PREJUDICE

1. General

Questions to both parties

24. Could the parties explain how they interpret the phrases "take appropriate steps to remove the adverse effects" and "withdraw the subsidy" in Article 7.8 of the SCM Agreement ?

1. "[T]ake appropriate steps to remove the adverse effects" and "withdraw the subsidy" in Article 7.8 refer to the two options available to a responding Member "where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy [of the responding Member] has resulted in adverse effects to the interests of another Member within the meaning of Article 5." To interpret these two phrases, it is necessary to examine the "ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."[1]

2. With respect to the first option – "take appropriate steps to remove the adverse effects" – "take" refers, *inter alia*, to "undertake and perform" "make oneself responsible for (a duty etc.)" "adopt or choose for a particular purpose" or "receive or obtain (something given, bestowed, or administered).[2] "Steps" – especially in the sense of "taking steps" – refers to "an action, measure, or proceeding, esp. one of a series, which leads towards a result."[3]

3. In the context of Article 7.8 of the *SCM Agreement*, the particular "result" towards which steps are to be taken is the removal of adverse effects. "Remove" is defined, *inter alia*, as "the action of taking away or getting rid of a thing."[4] The thing to be "removed," under Article 7.8 of the *SCM Agreement*, is "the adverse effects." Although Article 7.8 does not specify that it is the adverse effects *of the subsidy*, as found in the adopted panel report or Appellate Body report, that should be "removed," this is apparent from the context.[5]

4. Article 7.8 does not specify what precise steps are to be taken to "remove the adverse effects." But it does provide that these steps must be "appropriate." In other words, they must be "specially suitable (*for, to*)" the removal of the adverse effects found to exist in the panel and Appellate Body reports.[6] This confirms the fact-specific nature of adverse effects findings and remedies in respect thereof. What is "appropriate" – i.e., "specially suitable (*for, to*)" – for removing the adverse effects in a particular case will depend on the facts of the situation and the particular adverse effects found to exist.

5. With respect to the second option – "withdraw the subsidy" – "withdraw" means, among other things, "cause to decrease or disappear" and "take back or away (something bestowed or enjoyed)."[7] According to Article 7.8 of the *SCM Agreement*, the thing to be "caused to decrease or disappear" or "taken back or away" is the "subsidy." Again, the context makes clear that the "subsidy" at issue is the one identified in the panel or Appellate Body report as resulting in adverse effects to the interests of another Member within the meaning of Article 5 of the *SCM Agreement*.

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[1] *See e.g., EC – Chicken Classification (AB)*, paras. 175.

[2] *The New Shorter Oxford English Dictionary* at 3206, Volume 2, (1993 Edition) (Exhibit US-125).

[3] *The New Shorter Oxford English Dictionary* at 3050, Volume 2, (1993 Edition) (Exhibit US-126).

[4] *The New Shorter Oxford English Dictionary* at 2543, Volume 2, (1993 Edition) (Exhibit US-127).

[5] For example, the very next provision, Article 7.9 of the *SCM Agreement*, discusses the situation where a Member "has not taken appropriate steps to remove the adverse effects *of the subsidy*. . . ."

[6] *The New Shorter Oxford English Dictionary* at 103, Volume 1, (1993 Edition) (Exhibit US-128).

[7] *The New Shorter Oxford English Dictionary* at 3704, Volume 2, (1993 Edition) (Exhibit US-118).

25. How do the parties interpret the relationship between Article 7.8 of the SCM Agreement and Article 21.5 of the DSU?

6. Article 7.8 of the *SCM Agreement* establishes the obligation of a responding Member "where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy [of the responding Member] has resulted in adverse effects to the interests of another Member within the meaning of Article 5." In that situation, the responding Member has two available options under Article 7.8. As discussed above, the Member may either (a) "take appropriate steps to remove the adverse effects" or (b) may "withdraw the subsidy."

7. Article 21.5 of the DSU deals with the use of dispute settlement procedures to decide disagreements about the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings of the DSB.

8. There is no cross-reference in either Article 7.8 of the *SCM Agreement* or Article 21.5 of the DSU to the other provision. However, given the obligation under Article 7.8 to either "take appropriate steps to remove the adverse effects" or "withdraw the subsidy,"to the extent there is disagreement as to whether the responding Member has satisfied its obligations, Article 21.5 of the DSU provides for dispute settlement procedures to decide the disagreement. In other words, a complaining party could have recourse under Article 21.5 of the DSU to claim that there is no measure taken to comply by the Member concerned (i.e., the adverse effects have not been removed or the subsidy not withdrawn) or that the measure taken to comply is not consistent with a covered agreement.

26. Could the parties explain whether they agree or disagree with the arguments of New Zealand in its Third Party Submission that Article 7.8 of the SCM Agreement has certain consequences for the burden of proof in an Article 21.5 proceeding? [Paragraphs 5.04-5.06 of the Third party Submission of New Zealand]

9. The United States disagrees with New Zealand's argument that "Article 7.8 of the *SCM Agreement* operates to distribute the burden of proof somewhat differently" in a compliance proceeding.[8] That argument has no legal basis. Article 7.8 provides the following:

> Where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member within the meaning of Article 5, the Member granting or maintaining such subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy.

10. This provision says nothing about the burden of proof in Article 21.5 proceedings, let alone that it reverses the well-established rule that a complaining party – whether in an original proceeding or a compliance proceeding – bears the burden of proving its claims.[9] Just as in any other Article 21.5 proceeding, the complaining party continues to have the burden to prove its claim that a measure

[8] New Zealand Third Party Submission, para. 5.06.

[9] *See e.g., Canada – Dairy (21.5 – U.S. and New Zealand)*, para. 6.4 ("The Panel does not consider that the rules on the allocation of the burden of proof change simply because a claim is made in the context of Article 21.5 DSU proceedings.") (citing to Appellate Body report in *Brazil – Aircraft (21.5 – Canada)*, para. 66). The United States also notes that New Zealand's argument is based on a flawed reading of the findings in the original proceeding. New Zealand assumes that the original panel found the marketing loan, counter-cyclical payment and step 2 "programs" to be causing serious prejudice. However, as is clear from the original panel report, the original panel expressly stated it was declining to do so. *See* U.S. First Written Submission, paras. 31-44; U.S. Rebuttal Submission, paras. 16-63.

taken to comply does not exist (i.e., the adverse effects have not been removed or the subsidy not withdrawn) or that a measure taken to comply is not consistent with a covered agreement.

27. Could the parties comment on the following statement of the European Communities:

> ***"The text of Article 7.8 of the SCM Agreement does not state expressly that a Member that has been requested by the DSB to implement its recommendations and rulings under Article 7.8 of the SCM Agreement has to do anything" (original emphasis)***

11. The United States agrees with the European Communities' statement to the extent that it means that Article 7.8 does not specify any particular steps for removing the adverse effects of a subsidy or withdrawing a subsidy. The decision is left to the responding Member. In the case of the first option (removing the adverse effects), the only guidance provided in the text is that the steps taken must be "appropriate."[10] What is "appropriate" in a particular case is to be determined on a fact-specific basis given the particular subsidy, adverse effects, and other circumstances at issue. In the case of the second option (withdrawing the subsidy), there is no limitation whatsoever on how to remove the subsidy. And it may not always be necessary to change the measure itself. It is possible that market or other conditions may change such that a subsidy is no longer causing adverse effects or the measure is no longer a subsidy (*e.g.*, because it no longer confers a benefit).

28. The parties present divergent views with respect to the relevant marketing year to be considered by the panel in its analysis of Brazil's serious prejudice claims.

a. Could the parties explain what they consider to be the relevant legal considerations by which the Panel should be guided in determining whether MY 2005 or MY 2006 is the appropriate marketing year?

12. The United States considers that the present marketing year – MY 2006 – is the relevant period to consider whether the present "effect" of any subsidy "is . . . significant price suppression in the same market" within the meaning of Article 6.3(c) of the *SCM Agreement*. This is compelled by the use of the present-tense term "is" in that provision. "Is" means "that which exists, that which is; the fact or quality of existence."[11] "Is" comes from the verb "to be," which itself means, *inter alia*, "have place in the realm of fact, exist, live" "be the case or the fact; obtain."[12] To determine the effect (if any) of a subsidy that "exists" at present, it is plainly necessary to look at the present period (or marketing year). It is possible that certain data for MY 2006, the present marketing year, may not be available. In that circumstance, it is appropriate to look at historical data as a *proxy* for the "present" period.[13] However, where reliable data is available for MY 2006, or any part thereof, the Panel should consider that data in assessing Brazil's "present" serious prejudice claims. This is especially apt where the particular data for MY 2006 *is* available and complete, including, for example, futures data that would have been considered by U.S. producers at the time of planting for MY 2006 (*i.e.*, in the period January-March 2006).

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[10] *See* discussion of "appropriate" in response to Question 24 above.

[11] *The New Shorter Oxford English Dictionary* at 1421, Volume 1, (1993 Edition) (Exhibit US-129).

[12] *The New Shorter Oxford English Dictionary* at 195, Volume 1, (1993 Edition) (Exhibit US-130).

[13] *See* Brazil First Written Submission, para. 49 ("Full-year data on marketing loan and counter-cyclical payments to U.S. upland cotton farmers for MY 2006 – the first year in which Step 2 is not provided – will not be available until September 2007. *Nevertheless,* the compliance Panel can determine whether the repeal of the Step 2 program is sufficient to bring the new "basket of measures" supporting U.S. upland cotton farmers into conformity with the covered agreements, based on data covering the full 2005 marketing year.") (emphasis added)

b. Do the parties agree or disagree with the argument of the European Communities that in a dispute involving a claim of present serious prejudice the parties must provide the "most recent reasonably available" data? [Paragraphs 43 and 54-55 of the Third Party Submission of the European Communities]

13. As noted above, the United States agrees that, for a claim of "present" serious prejudice, the present marketing year and any (reliable) data relating to that marketing year are the most relevant.[14]

Questions to the United States

29. Does the United States contest the fact that a "strong positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production" exists?[15] In particular, does the US disagree with the following statements[16]:

- ***a very large proportion of farms with upland cotton base acres continue to plant upland cotton in the year of payment;***

- ***the overwhelming majority of farms enrolled in the programs which plant upland cotton also hold upland cotton base;***

14. To clarify, the United States considers "strong positive relationship" to be a characterization of facts, rather than facts themselves. The facts are the following.

- On farms that have upland cotton base acres (and thus may receive cotton counter-cyclical payments), the ratio of cotton *planted* acres to total upland cotton *base* acres was only 60 percent in MY 2002-2005. In other words, U.S. upland cotton farmers were planting only approximately 60 percent of the cotton acres that they planted in the historical period used to calculate base acres.

- Second, a significant portion of U.S. upland cotton planted acreage (over MY 2002-2005, an average of about 17 per cent) is on farms with cotton planted acreage that exceeds cotton base acres, or, indeed, on farms with no cotton base acres at all.

15. The debate between the parties is as to what these facts signify. In the view of the United States, these facts support a number of the U.S. arguments. For example, these facts confirm that U.S. farmers do, in fact, use the planting flexibility afforded by the direct and counter-cyclical payment programs. By contrast, Brazil argues that U.S. farmers are somehow induced to plant upland cotton simply because they hold base acres on which they may receive payments based on upland

[14] The United States does not necessarily endorse, however, all of the additional positions that the European Communities takes regarding the alleged "obligation" of a responding party to refer to the most recently-available data in its first written submission, regardless of what the complaining party argues. *See* European Communities' Third Party Submission, para. 55. These additional arguments appear to touch on the issue of burden of proof in an Article 21.5 proceeding. As the United States notes above, the burden in a DSU Article 21.5 proceeding is on *a complaining party* to prove a breach of the identified covered agreements; it does *not* fall in the first instance on the responding party.

[15] [ORIGINAL FOOTNOTE: See para. 131 of Brazil's first submission. The Panel clarifies that this phrase refers to the fact that "the recipients who hold upland cotton base acres" and "those who continue to plant upland cotton" overlap with each other to a great extent. (See para. 7.637 of the report of the original panel.) The Panel understands that Brazil uses this phrase in the same sense.]

[16] [ORIGINAL FOOTNOTE: These passages are reproduced from para. 7.636 of the report of the original panel.]

cotton payment rates. But Brazil has not explained why, if this is so, payment recipients are planting 40 percent fewer acres than they planted in the historical period used to calculate base acres.

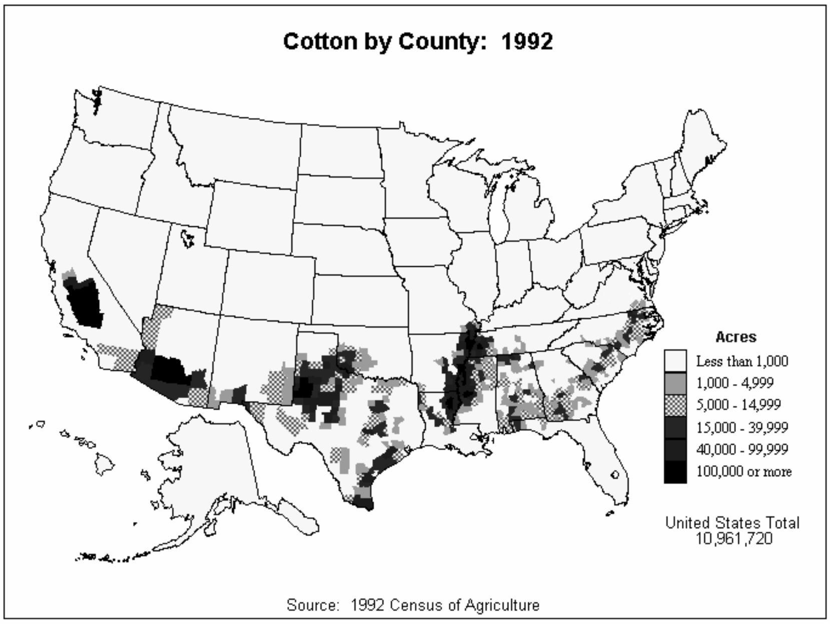
16. The second fact is also notable in the U.S. view. It shows that a significant – and growing percentage – of cotton is grown on farms that do not hold *any* upland cotton base acreage or on planted acreage that is in excess of the upland cotton base acreage held by a farm. That is, for these cotton farmers, there can be no link – even alleged – between cotton base counter-cyclical payments and current production because these farmers are growing cotton on acreage *beyond* their cotton base acreage, if any. This data reinforces other evidence submitted by the United States; for example, data regarding cost of production shows that most U.S. production (at least 92 per cent) market revenue not only covers variable costs of production but also *all* total costs of production. Thus, even on Brazil's own theory, counter-cyclical payments play no part in inducing continued cotton production for the vast majority of U.S. cotton production. And, as for the other 8 percent of U.S. production, Brazil has not even related its theory to them, to show any "significant" price suppression resulting from marketing loan and counter-cyclical payments.

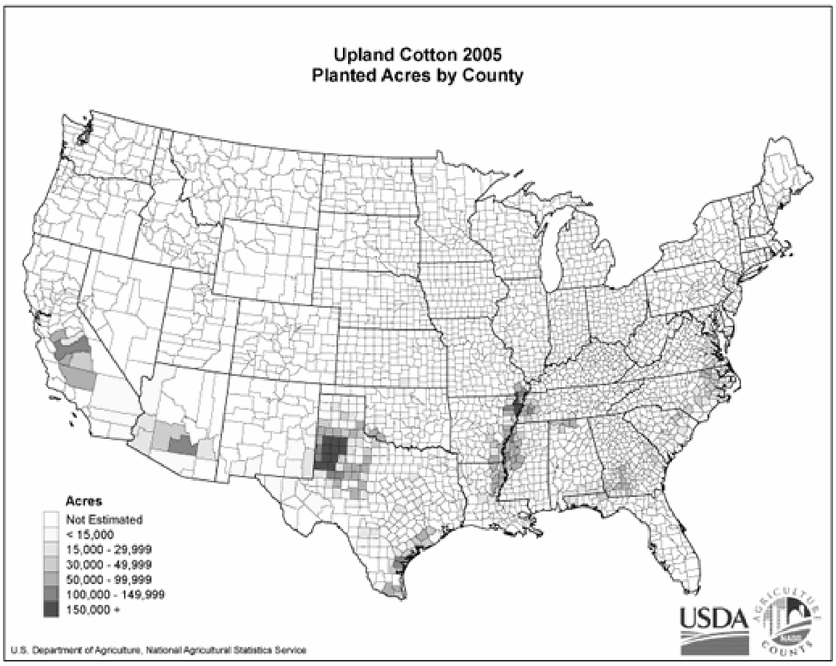
17. These are the facts that the United States considers to be the most relevant because they focus on the level of upland cotton *planting* and *production* and the relationship that these bear – if any – to payments. The United States recalls in this regard that Brazil's claim focuses on *precisely* this same relationship. Yet, inexplicably, Brazil seeks to dismiss these facts as "unimportant statistics."[17] Rather, Brazil argues that the focus should be on whether upland cotton is grown on farms that hold even one base acre of upland cotton. Brazil notes, in this regard, that "95 percent of actual U.S. upland cotton planted acreage was planted on farms that received upland cotton counter-cyclical payments in MY 2005."[18]

18. The United States does not contest this figure but strongly disagrees with the conclusions that Brazil asks the Panel to draw from this; namely, that this is somehow evidence of the allegedly production-inducing *effects* of the counter-cyclical payment program. In fact, Brazil appears to confuse cause and effects.

19. Upland cotton is grown in a limited number of areas in the United States, primarily in a few southern and western states, where the weather and other conditions are ideal for upland cotton production. Upland cotton was grown in these areas well before the counter-cyclical payment program came into effect and continues to be grown there now. Continued planting of upland cotton on this farmland is not the effect of any government payment; it is a function of the fact that upland cotton can be grown easily in these areas but cannot be grown in others (for example, cotton seedlings would likely freeze if planted in April in Montana but flourish in the warmer temperatures in Texas at that time). As shown in the maps below, cotton is grown in the same states and – in large part – the same counties in 2005 as it was in 1992, well before the counter-cyclical payments came into effect. The same would be true if one were to go back even decades earlier in time.

[17] Brazil Rebuttal Submission, para. 157.
[18] Brazil Rebuttal Submission, para. 157.





20. Base acres were assigned based on what U.S. farmers were producing in a historical period. If U.S. farmers were planting upland cotton in the historical period, they were able to enrol upland cotton base acres for purposes of the direct and counter-cyclical payment programs. Many farmers in the southern United States were planting upland cotton – often, as one in a rotation of crops – in the historical period because it made sense for them to do so as an agronomical matter. Many of the same farms produce *some* upland cotton today for the same reasons that they did so at the time that base acres were enrolled – farmers have experience and expertise growing upland cotton in those areas, they have equipment that they can use in that production, and they know they can grow upland cotton with good results given the particular growing conditions in the region.

21. Brazil seeks to claim whatever planting continuity exists as evidence that counter-cyclical payments cause U.S. producers to plant upland cotton where they would otherwise not have done so.

But there is no basis for such a conclusion. That is the equivalent of claiming as "evidence" of the effects of subsidies that wine grapes have historically been grown and continue to be grown today in certain regions of France, or that olives have been grown and are grown today in certain Mediterranean regions. The fact that some amount of farmland historically used to produce cotton continues to be good – from an agronomical standpoint – for the production of that crop and continues to be used to grow that crop is hardly remarkable and is *not* evidence of any production-inducing effects of the counter-cyclical payment program.

22. In short, Brazil has yet to establish either the relevance of the farm data it seeks to have the Panel consider or why the other – more relevant – acreage data presented by the United States should be ignored. Brazil's only argument appears to be that the original panel considered similar data to that pressed by Brazil in the panel's assessment of payments made in MY 1999-2002. But this argument does not withstand scrutiny. The original panel may have looked at how much upland cotton is grown on farms today that historically produced cotton. However, it could *not* have considered this to be persuasive evidence of any alleged production-inducing effects of the U.S. government payments because it did not find *direct* payments (or, in earlier years, the production flexibility contract payments) to have significant production and price effects. The exact same relationship exists between counter-cyclical payments and upland cotton base acreage as between direct payments and upland cotton base acreage. Indeed, the base acreage is exactly the *same* for both programs. If this relationship was strong evidence of production and price effects, as Brazil alleges, there would have been little basis for the original panel to find against the counter-cyclical/market loss assistance payments, but not direct/production flexibility contract payments, made in MY 1999-2002. The fact that the panel did not make the same finding of significant price suppression with respect to direct/production flexibility contract payments confirms that the relationship to base acreage is not persuasive evidence of any price-inducing effects of either program. It is simply evidence that certain regions in the United States are well-suited to growing upland cotton. Cotton was a viable crop for most farmers to include in their rotation before the counter-cyclical payment program (and direct payment program) came into effect and it continues to be a viable crop now.

23. Turning back to the question regarding the two statements above, for the reasons just explained, the United States considers that the relevant question for assessing the effects of counter-cyclical payments is not the percentage of farms, but the level of acreage planted to upland cotton (*vis-a-vis* upland cotton base acres). The data regarding such planted acreage are consistent with the fact that farmers use the planting flexibility afforded by the counter-cyclical payment program and make choices based on market considerations, not any "inducement" by counter-cyclical payments.

<u>Question to Brazil</u>

30. How does Brazil respond to the argument of the United States that "whether or not the marketing loan and counter-cyclical payment programs or payments under the programs cause significant price suppression is a question of first impression"? [Rebuttal Submission of the United States, paragraph 219]

2. The structure, design and operation of the countercyclical and marketing loan payment programs

<u>Question to the United States</u>

31. Brazil claims that the structure, design and operation of US counter-cyclical payments stimulate US upland cotton production. Both Brazil and the United States have referred to the Westcott (2005)[19] study to provide support for their

[19] [ORIGINAL FOOTNOTE: Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" (Exhibit US-35).]

opposing analysis of the possible production impact of counter-cyclical payments. In its rebuttal, Brazil quotes the following passage from Westcott:

> ***So where do CCPs fit compared with other farm commodity programs in the 2002 Farm Act? Marketing loans are fully coupled since they are available on all production and their link to market prices means they affect production decisions of farmers. Direct payments are mostly decoupled, since they are paid on a fixed, historically-based quantity rather than on current production and are not dependent on market prices or other factors that would affect production. …***
>
> ***CCPs fall in between these two programs, having some properties similar to mostly decoupled direct payments and other properties similar to fully coupled marketing loans. Like direct payments, CCPs do not depend on current production since they are paid on a fixed, historically-based quantity. However, similar to marketing loans, CCPs are linked to market prices so there may be some influence on current production decisions of farmers, which would potentially make CCPs at least partially or somewhat coupled.***

a. Does the United States agree with this characterization of the CCP?

24. The United States agrees that counter-cyclical payments differ from direct payments in one respect; namely, they are provided on the basis of historical base acres and payment yields *when the season-average farm price falls below a certain threshold*. Direct payments, by contrast, are paid *regardless of prices* on the basis of historical base acres and payment yields. The United States also agrees that, to the extent that payments under the counter-cyclical payment program are provided only when certain price conditions prevail, this conditionality is an aspect in which counter-cyclical payments are similar to marketing loan payments.

25. That said, the question under Articles 5 and 6.3(c) of the *SCM Agreement* is not on the form of subsidies but their *effects*. And, as the United States has explained, the possible effects of payments under the counter-cyclical payment program on acreage decisions are much closer to those of direct payments than marketing loan payments. As discussed below, marketing loan payments are paid in respect of actual production. By contrast, **"farmers retain nearly full planting flexibility and may receive CCPs for the base acreage crop regardless of whether that crop (or any crop) is planted on those acres."**[20] This is *precisely* the same as for direct payments.

26. Given that the only salient difference between the structure of direct payments and counter-cyclical payments is that the latter are only provided when certain market conditions prevail, rather than automatically in each year, the question is whether this fact somehow results in a production effect in the case of the latter that does not obtain in the case of the former. Some researchers – including Westcott – conclude that the link to prices may, in some circumstances result in indirect production effects stemming primarily from lowered risk of price volatility. The United States agrees. However, the United States also agrees with Westcott and others that the degree of any such production effects is likely to be minimal and mitigated by a number of factors. For example, Westcott notes in this regard that:

[20] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 202 (Exhibit US-35).

(a) where prices are expected to be above maximum threshold – counter-cyclical payments behave just like the fixed direct payments[21];

(b) "cross-commodity effect[s] suggest[] that CCPs may provide a general reduction in revenue risks rather than a crop-specific effect. Net returns among alternative crops would remain the primary consideration underlying production choices;"[22]

(c) "while a number of studies indicate that farmers are risk averse (Chavas and Holt, 1990, 1996, for example), other risk reduction instruments already exist to manage risks. Thus, with revenue risk reduction now provided by CCPs as part of farm programs, farmers may adjust their use of these other farm and nonfarm risk management strategies;"[23] and

(d) "a large portion of output in the U.S. agricultural sector is produced by a small share of large producers. . . . Evidence that risk aversion decreases as income rises (Chavas and Holt, 1990, 1996) suggests that risk aversion may also tend to decline as the size of farms increases. Thus, with larger farms that account for most production being less averse to facing risk, this lowers potential production effects of CCPs due to risk reduction. And while smaller farms may be more risk averse in their farm enterprise, off-farm income may reduce the overall level of household income risk."[24]

27. On the basis of these and other factors, Westcott concludes that "there are several mitigating factors which suggest that overall production effects of CCPs through revenue risk reduction are likely to be limited."[25] The United States agrees with that assessment. Other studies submitted by the United States examining the empirical evidence of production effects – for example, a 2007 study by Lin & Dismukes in which the authors found that "[t]he effect of CCPs on producers' planting decisions . . . appears to be *very negligible* – an increase in the acreage of major field crops of less than 1% . . . ."[26] – confirm that the effects of the counter-cyclical payments are, in fact, very limited.

b. How would the United States respond to the argument that, by design, counter-cyclical payments are in some measure coupled to production decisions because part of the payments is contingent on the actual realization of market prices?

28. The United States does not consider counter-cyclical payments to be "coupled to production decisions" at all because, as Westcott notes, "farmers retain nearly full planting flexibility and may receive CCPs for the base acreage crop regardless of whether that crop (or any crop) is planted on those acres."[27] A farmer simply does not have to produce upland cotton to get payments on upland cotton base acres. Indeed, the question reflects this because it notes that the contingency is realization

[21] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 203 (Exhibit US-35).

[22] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 204 (Exhibit US-35).

[23] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 204 (Exhibit US-35).

[24] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 204 (Exhibit US-35).

[25] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 205 (Exhibit US-35).

[26] Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter-cyclical Payments' Production Impacts," *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 83 (Exhibit US-85) (emphasis added).

[27] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 202 (Exhibit US-35).

of particular market *prices*, not the realization of any production by an individual producers. The market price is an independent trigger.

29. Nonetheless, as noted above, the United States agrees that counter-cyclical payments – like direct payments – may have some limited effects on risk and wealth which in turn translate into some limited effect on production. For example, the link between counter-cyclical payments and season-average farm prices may, in some circumstances, result in indirect production effects stemming from lowered risk of price volatility. This question of effects is the one that is important under Article 6.3(c) of the *SCM Agreement*. And, in that context, the question is one of *degree – i.e.*, whether any risk and wealth effects are such that they are substantially impacting production, and exports, and, ultimately, suppressing world market prices to a "significant" degree. The evidence before the Panel confirms that they are not. Indeed, as Westcott concluded, "there are several mitigating factors which suggest that overall production effects of counter-cyclical payments through revenue risk reduction are likely to be limited."[28] This is confirmed by recent empirical studies examining the effects of counter-cyclical payments.[29]

3. Economic simulation model

<u>Question to the United States</u>

> ***32. Brazil has presented a partial equilibrium model to simulate the effects of eliminating US upland cotton payments, particularly the marketing loan and counter-cyclical payments. In both its submission and rebuttal, the United States has provided reactions to the simulation model.***
>
> > ***a. Would it be accurate to describe the United States' response as constituting a general acceptance of the framework of analysis adopted by Brazil but contesting the assumptions made regarding the values of the parameters, the supply and demand elasticities and the "coupling factor", used in the model? (The coupling factor is the amount by which the expected price is increased by each dollar per unit of subsidy payments.)***

30. Before addressing the Panel's question, the United States clarifies that the coupling factor, as used in FAPRI models and the Sumner II model, are coefficients used in an effort to compare the effects of payments that are not coupled to any production (such as direct payments and counter-cyclical payments) with the effects of other payments (for example, market revenue), which are made directly in respect of production. In the case of direct payments and counter-cyclical payments, most of the coupling factors currently used have been based on the analyst's judgment. As more empirical data become available, the data provide a guide for analysts in determining the appropriate coupling factor to assign.

31. Turning to the Panel's question, although the United States considers that a partial equilibrium model may be an appropriate tool for conducting an assessment of the effects of the Step 2, marketing loan, and counter-cyclical payment programs on world market prices, the United States does not consider that Brazil's new model is appropriate. The United States has identified a number of important flaws in the model, including that the model:

- lacks cross-commodity impacts and cross-price elasticities, potentially leading to biased price effects;

[28] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 205 (Exhibit US-35).
[29] *See* U.S. First Written Submission, paras. 207-214; U.S. Rebuttal Submission, paras. 226-252.

- is static with no explicit relationships for changes in cotton stock levels and no stocks equation;

- contains foreign supply elasticities that are different from FAPRI that underestimate the response of foreign producers to changes in world prices;

- treats production flexibility payments and direct payments differently even though they operate in the same way;

- incorporates Step 2 payments directly into the producer revenue function as fully coupled payment, and

- appears to ignore statutory parameters, for example by including counter-cyclical payment rates in each of the various price expectations that sometimes exceed the statutory maximum.[30]

32. These are some of the problems that arise as a result of the general structure of the model itself, and the simplified, reduced nature of the assessment it attempts to conduct. Further, and even more substantial, biases result from the flawed econometric parameters used by the model. These have been addressed in detail in the U.S. submissions.

33. Not only does the United States not accept the particular model used by Brazil and the parameters and assumptions that it utilizes, but the United States disagrees with Brazil regarding the question that the model aims to address. Brazil appears to assume that the question before the Panel is the "short-run" impact of "shocking" the system with complete elimination of the marketing loan and counter-cyclical payment programs.[31] It is not. Under Article 6.3(c) the question is what, if any, degree of price suppression exists *presently* as a result of the marketing loan and counter-cyclical payments and whether this degree of price suppression is "significant." To the extent a counterfactual assessment is undertaken, it is only to assess what the price equilibrium would be at present if marketing loan and counter-cyclical payments had been lower, different, or did not exist. The question is not what prices will look like in the short-run adjustment period if the marketing loan and counter-cyclical payments are suddenly eliminated. Indeed, Members are not even required to eliminate measures found to be actionable subsidies; they are given a choice between "withdrawing" the subsidy or removing its adverse effects. Thus, in addition to the fact that the economic literature supports a long-term assessment, Brazil's argument that it is necessary to look at the short-run effects of total elimination of the programs is incorrect as a matter of textual interpretation.

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[30] The maximum counter-cyclical payments paid on 85 percent of base and program yields can not exceed 13.73 cents. Yet Dr. Sumner incorporates a value as high as 19.10 cents, which is 39 percent greater than the maximum allowed rate. Brazil attempts to explain this away at the Panel meeting are unavailing. Brazil explained that Dr. Sumner divided total counter-cyclical payments by production to determine a per-pound rate. But this does not track how farmers view counter-cyclical payments. The question if one of farmers' expectations and farmers do not enter the planting season with an assumption that the counter-cyclical payment rate could be as much as 30% above the statutory maximum. Moreover, all upland cotton base acres are not planted to upland cotton. Brazil's approach fails to take that fact into account. It should also be noted that Brazil chose not to adopt this approach in the cost-of-production analysis included in Brazil's oral statement. In that analysis, Brazil correctly used the statutory maximum rate for counter-cyclical payments.

[31] *See e.g.,* Brazil First Written Submission, Annex I, paras. 28-29. Brazil's economist attempts to justify, for example, the use of an unrealistic and disproportionately small rest-of-world supply elasticity on the basis that Brazil is seeking to assess the short-run effects of "the shock of removing U.S. cotton subsidies." *See* Brazil First Written Submission, Annex I, para. 28. It is puzzling, therefore, that Brazil's economist denied in the meeting with the Panel that Brazil had used such language or such an approach.

34. The total effect of all of these flaws in Brazil's model is to grossly overstate any possible effects of the marketing loan and counter-cyclical payments. The United States demonstrated that without changing the structural flaws in the model, but simply re-calibrating the "key elasticities" and some other basic assumptions to reflect FAPRI and other well-established parameters – many of which Brazil acknowledged and used in the original proceeding – the effects estimated by Brazil's new model decline sharply. *Complete* removal of the marketing loan and counter-cyclical payment programs results in world prices increasing by only 1.41 percent over baseline levels over the period MY 2002-2005 and 0.96 percent over the period MY 2006-2008. Long-run values for supply and demand elasticities taken from the UNCTAD-FAO ATPSM model shows removal of marketing loans and counter-cyclical programs resulting in an increase in world prices of 2.26 percent over the period MY 2002-2005 and 1.52 percent over the period MY 2006-2008. *These dramatically lower price impacts result from only some very basic, preliminary adjustments to Dr. Sumner's model*. More detailed analysis and re-calibration would reduce the price effects even more.

35. It is critical that the Panel understand the flaws in the Sumner II model and their significance to this dispute because Brazil has submitted virtually no valid empirical evidence to support its claims that the U.S. marketing loan and counter-cyclical payment programs are causing "present" significant price suppression. Rather, Brazil's claim depends, critically, on the new econometric modeling conducted for purposes this dispute. The fact that even this econometric modeling is fundamentally flawed confirms that Brazil has no basis for its claims.

b. In its First Written Submission and Rebuttal Submission, the United States uses the same value of 1 that Brazil adopts for the coupling factor assigned to marketing loan payments. Does this imply an acceptance by the United States that, by design, marketing loan payments provide a one-for-one incentive to upland cotton production?

36. The United States does not agree with the characterization that marketing loan payments provide a "one-for-one incentive to production." This may be understood to suggest that every dollar of marketing loan expenditures in a particular year can be assigned a production effect, which is not the case. As the United States has argued, whether or not the marketing loan creates any incentive to produce depends upon the expected prices that exist at planting time. Even Brazil, through its economic model, accepts – and ostensibly attempts to implement – this principle in this proceeding.[32]

37. Nonetheless, the fact that a coupling factor of 1 is attributed to marketing loan payments means that a dollar anticipated under the marketing loan program is expected to have the same effect in respect of production as a dollar anticipated in market revenue. As payments are made on a per-unit basis with respect to upland cotton that is ultimately produced, a common modeling convention is to assume a coupling factor of 1 for the marketing loan program. The United States has not disputed the use of this coupling factor by Brazil in this proceeding.

c. In its First Written Submission and Rebuttal Submission, the United States used a non-zero value of 0.25 (not much lower from the 0.4 that Brazil adopts) for the coupling factor assigned to counter-cyclical payments. Does this imply an acceptance by the United States that, by design, counter-cyclical payments are partially tied to upland cotton production, and of a

[32] *See* Brazil First Written Submission, Annex I, para. 36 ("U.S. cotton producers respond to the *expected* prices and *expected* rates of subsidy that apply at the time planting and other key decisions are made in the production cycle") (emphasis added) and Brazil First Written Submission, Annex I, para. 58 ("[t]he magnitude of the impact on incentives to produce cotton is equal to the *expected* difference between the loan rate, which is known at planting time, and the grower's *expectations* at the time of planting about the AWP for cotton that will apply when the grower makes that marketing loan transaction.") (emphasis added). Brazil Further Submission, Annex I, paras. 17-18.

> ***magnitude (25 cents to a dollar of counter-cyclical payments) not very far from Brazil's own estimate (of 40 cents to a dollar of counter-cyclical payments)?***

38. No. 0.25 percent was the coupling factor used in the FAPRI model, which was originally relied upon by Brazil itself and was lauded by Brazil as follows:

> The FAPRI model has been widely used for policy analysis in the United States and elsewhere for almost 20 years. U.S. commodity groups, including the U.S. cotton industry, have regularly used the FAPRI model to analyze farm commodity program options. The FAPRI model is also the key model used by the U.S. Congress in considering farm program options. For almost two decades the U.S. Congress has provided special appropriations to support the continued use and development of the FAPRI model. In both the 1996 and the 2002 Farm Bill processes, the FAPRI model provided the most influential projections of likely program impacts.[33]

> FAPRI is the most influential organization in the United States analyzing farm policy and its effects on U.S. and world commodity markets, i.e., that has the highest reputation and experience in answering the kind of "but for" questions faced by this Panel.[34]

39. FAPRI assumes a 0.25 coupling factor for counter-cyclical payments on the following basis:

> Because CCPs are made on a fixed base, they can be considered at least partially decoupled from production decisions (thus their inclusion in the decoupled payment term in the area equations). However, CCPs do depend on prices, and risk-averse producers may have a positive supply response to the price insurance offered by the program. The 0.25 parameter is based on analyst judgment, reflecting the notion that the crop-specific effect of CCPs on production is likely to be positive, but modest.[35]

40. The United States adopted the FAPRI coupling factor because of Brazil's express acknowledgment of the expertise and reputation of FAPRI researchers in assessing "likely program impacts" and "in answering the kind of 'but for' questions faced by this Panel."[36] But the United States considers that this coupling factor is high. In fact, the empirical research supports a lower coupling factor, closer to zero. For example, the United States has discussed a 2007 study by Lin & Dismukes in which the authors examined the following question: "[g]iven the market price scenario for major field crops [corn, wheat, and soybeans] perceived by producers at planting decision times, how would CCPs have affected plantings of 2005 major field crops in the North Central region.."[37] The authors found that "[t]he effect of CCPs on producers' planting decisions . . . appears to be *very negligible* – an increase in the acreage of major field crops of less than 1% . . . ."[38]

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[33] Brazil Further Submission, para. 214.

[34] Answers of Brazil to Questions from the Panel After 2nd Meeting, paras. 21-24 (22 December 2003).

[35] Westhoff, Patrick, Scott Brown and Chad Hart. "When Point Estimates Miss the Point: Stochastic Modeling of WTO Restrictions" FAPRI Policy Working Paper #01-05, December 2005, page 6 (Exhibit US-58).

[36] Answers of Brazil to Questions from the Panel After 2nd Meeting, paras. 21-24 (22 December 2003).

[37] Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter-cyclical Payments' Production Impacts," *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, (Spring 2007), p. 81 (Exhibit US-85). *See* U.S. Rebuttal Submission, para. 229-234.

[38] Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter-cyclical Payments' Production Impacts," *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 83 (Exhibit US-85) (emphasis added).

41. Similarly, the United States discussed a 2005 study by Goodwin & Mishra reported the results of a survey of farmers asking them to rate the factors important to their acreage decisions on a 5-point scale ranging from "not at all important" to "very important."[39] The study finds that almost half of farmers surveyed (44 per cent) – in a nationwide survey comprising about 4,125 observations – indicated that counter-cyclical payments were strongly "not at all important" to their acreage decisions. The other substantial percentage (43 per cent) indicated either ambivalence (that counter-cyclical payments were "neither important or unimportant") or that counter-cyclical payments were "unimportant" to their acreage decisions. This too confirms that counter-cyclical payments have minimal effects on production.

42. Although these studies and the others discussed in the U.S. submissions support a coupling factor much lower than 0.25, the United States has used that factor as a conservative measure and to illustrate the grossly exaggerated nature of Brazil's modeling results. Brazil does not even use this 0.25 factor, which may be too high in and of itself. Rather, Brazil has used a much higher 0.40 factor that finds *no support* in empirical research or the economic literature. The 0.40 factor is not – in the U.S. view – close to the 0.25 factor used by FAPRI, as suggested in the question above. Indeed, Brazil's coupling factor is more than 60 percent higher than the FAPRI factor, and it is without any legitimate basis in the economic literature or in empirical analysis. This, once again, confirms that the econometric modeling upon which much of Brazil's case depends is flawed and not capable of supporting Brazil's claims of significant price suppression.

E. EXPORT CREDIT GUARANTEES

1. Permissibility of an *a contrario* interpretation of item (j) of the Illustrative List

Questions to the United States

> ***33. Please discuss whether (and if so, how) the panel rulings in Korea – Vessels and Brazil – Aircraft (21.5) (I and II) affect the United States' approach to the interpretation of the relationship between item (j) of the Illustrative List and Article 3.1(a) of the SCM Agreement.***

43. As the Panel's questions 33 and 34 both deal with the question of the proper interpretation of item (j) and Articles 1.1 and 3.1(a) of the *SCM Agreement*, and the relationship between those provisions, the United States addresses the questions together here.

44. At the outset, the United States recalls that the issue is whether item (j) of the Illustrative List demonstrates definitively how the general definitional elements in Articles 1 and 3.1(a) of the *SCM Agreement* apply in the case of the export credit guarantees. The text of the *SCM Agreement* confirms that it does. As the United States has explained[40], item(j) "illustrates" the application of the general definition of "export subsidy" set out in Articles 1.1 and 3.1(a) to the specific context of export credit guarantees. "Illustrate," means, *inter alia*, "shed light on, light up, illumine" and "make clear, elucidate, explain; esp. clarify or support using examples, give an example or illustration of, exemplify."[41] According to the ordinary meaning of the term "illustrate," therefore, item (j) "makes clear" how the Article 1/3.1(a) definition applies in respect of each particular type of measure set out in the Illustrate List. It clarifies which export credit guarantees *do* provide export subsidies within the meaning of Article 1.1 and 3.1(a) and those that *do not*. The distinguishing factor – under item (j) – is

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[39] **Goodwin, B. and A. Mishra. "Another Look at Decoupling: Additional Evidence on the Production Effects of Direct Payments."** ***American Journal of Agricultural Economics*** **87(5):1200-1210, 2005 (Exhibit US-41).**

[40] U.S. First Written Submission, paras. 62-70

[41] *The New Shorter Oxford English Dictionary* at 1311, Volume 1, (1993 Edition) (Exhibit US-24).

whether the premium rates charged under the export credit guarantee program are inadequate to cover the long-term operating costs and losses of the program.

45. This interpretation of item (j) is supported not only by the ordinary meaning of the term "illustrate" but also by other provisions relating to the relationship between item (j) and the general definition in Articles 1.1 and 3.1(a) of the *SCM Agreement*. Thus, for example, Article 1 of the *SCM Agreement* provides that "*[f]or the purpose of this Agreement*, a subsidy shall be deemed to exist if . . . there is a financial contribution by a government . . . and a benefit is thereby conferred."[42] Moreover, Article 3.1(a) of the *SCM Agreement* expressly includes as subsidies "within the meaning of Article 1" any "subsidies contingent . . . upon export performance, *including those illustrated in Annex I*."[43] It is, therefore, plain that item (j) applies the general definition of "export subsidy" set out in 1.1 and 3.1(a) of the *SCM Agreement*. It does not establish any second or alternative standards for "export subsidy" as Brazil has argued in this dispute.

A. Footnote 5 of the SCM Agreement is entirely consistent with the U.S. interpretation

46. Brazil argues, nonetheless, that footnote 5 of the *SCM Agreement* somehow erases all of the textual guidance discussed above. Specifically, Brazil argues that the U.S. approach would require what Brazil terms an "*a contrario*" reading of item (j) and, according to Brazil, such an interpretation is "definitively foreclose[d]" by footnote 5.[44] This argument does not withstand scrutiny, as Brazil has itself recognized in other disputes.[45]

47. Footnote 5 – which modifies the prohibition on export subsidies contained in Article 3.1(a) – provides that "[m]easures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement." As such, Footnote 5 confirms two things – first, that Annex I is relevant in determining whether or not measures constitute "export subsidies" and, second, that where Annex I "refer[s] to" measures as not constituting export subsidies, no further analysis is necessary to determine whether the measures are prohibited subsidies under Article 3.1(a).

48. Brazil's argument – for purposes of this dispute – is that, under footnote 5, item (j) can only be understood to provide dispositive clarification as to what constitutes an "export subsidy" in the case of export credit guarantees if it were to include an "affirmative statement" about the conditions under which export subsidies do *not* exist.[46] However, footnote 5 says nothing about an "affirmative statement." Nor is an "affirmative statement" required under the ordinary meaning of the term "refer." Indeed, "refer" means, *inter alia*, "to make reference or allusion or direct the attention to something."[47] And "allusion," in turn, means "[a] covert, passing, or indirect reference (to); *popularly* any reference to."[48] It is, thus, clear that measures "referred to" in Annex I as not constituting export subsidies can include *both* measures that are *expressly* referred to as not constituting export subsidies (though there is actually only one such measure, described in the second paragraph of item (k))[49] and measures that are *implicitly* referred to as not constituting export

[42] Emphasis added.

[43] Emphasis added.

[44] Brazil Rebuttal Submission, para.563.

[45] *See e.g., Brazil – Aircraft (AB)*, paras. 14 and 19.

[46] *See* Brazil Rebuttal Submission, para. 465 and 467.

[47] *See The New Shorter Oxford English Dictionary* at 2520, Volume 1, (1993 Edition) (Exhibit US-116).

[48] *See The New Shorter Oxford English Dictionary* at 57, Volume 1, (1993 Edition) (Exhibit US-117) (emphasis in original).

[49] The second paragraph of item (k) provides that "if a Member is a party to an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members), or if in practice a Member applies the interest rates provisions of the relevant undertaking, an export credit practice

subsidies, such as the provision of export credit guarantee programs at premium rates which *are* adequate to cover the long-term operating costs and losses of the programs. Brazil confirmed to the Appellate Body in *Brazil – Aircraft (21.5)* that item (j) contains just such an implicit reference:

> Footnote 5 of the SCM Agreement specifies that Annex I contains not only a list of prohibited export subsidies, but also measures that do not constitute export subsidies, such as in items (b), (h), (i) and (k). Comparing the structure of item (j) and item (k), the two provisions share a similar structure in that they define practices that constitute prohibited export subsidies with *language that limits the scope of the definition. In the case of item (j) regarding export credit guarantee or insurance programs, the limiting language is "premium rates which are inadequate to cover the long-term operating costs and losses of the programs."*[50]

49. Because Brazil ultimately argued that its legal theory in that dispute was grounded "on an '*a contrario*' interpretation of the text of the first paragraph of item (k)," and not footnote 5, the Appellate Body did not end up interpreting that provision. Nonetheless, the Appellate Body did indicate that it accepted Brazil's argument that the first paragraph of item (k) could be read *a contrario* to determine when measures are "justified."[51] That result is equally appropriate here.

50. There are also other factors that undermine Brazil's interpretation of footnote 5 of the *SCM Agreement*. For example, Brazil's interpretation is undermined by the negotiating history of the provision. The negotiating history shows that Members agreed to delete from an earlier draft language that would have required an *express* reference in order for the provisions of the footnote to apply. Specifically, footnote 5 first appeared in the third draft agreement prepared by the Chairman of the Negotiating Group on Subsidies.[52] In that draft, footnote 5 read as follows: "[m]embers *expressly* referred to in the Illustrative List as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement."[53] The word "expressly" was not retained, however. In the very next draft, the word was deleted from the footnote,[54] demonstrating that the drafters intended to expand the scope of footnote 5 beyond those measures containing an "affirmative statement" that particular measures do not constitute export subsidies.

51. The U.S. interpretation of item (j) and the relationship between that provision and the general definition of "export subsidy" in Article 1.1 and 3.1(a) is not only textually sound and consistent with the negotiating history, it is the only logical interpretation.[55] There is no reason why drafters would have gone to the trouble of crafting in the Illustrative List specific and detailed rules for particular

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which is in conformity with those provisions shall not be considered an export subsidy prohibited by this Agreement."

[50] *Brazil – Aircraft (AB)*, para. 19 (emphasis added).

[51] *Brazil – Aircraft (21.5) (AB)*, para. 80 (arguing that, if Brazil had made the correct factual showing under paragraph 1, "we would have been prepared to find that the payments made under the revised PROEX are justified under item (k) of the Illustrative List.")

[52] MTN.GNG/NG10/W/38/Rev. 2 (2 November 1990).

[53] MTN.GNG/NG10/W/38/Rev. 2 (2 November 1990) (emphasis added).

[54] MTN.GNG/NG10/W/38/Rev. 3 (6 November 1990).

[55] The United States notes, in this regard, the principle of *generalia specialibus non derogant*, which holds that "a matter governed by a specific provision, dealing with it as such, is thereby taken out of the scope of the general provision dealing with the category of subject to which that matter belongs, and which otherwise might govern it as part of that category." Gerald Fitzmaurice, *The Law and Procedure of the Court of International Justice, 1951-4: Treaty Interpretation and Other Treaty Points*, 1957 British Y.B. Int'l L. 236; *see also Case Concerning Payment of Serbian Loans*, P.C.I.J. Ser. A, No. 20/21, page 30; and Grotius, *De Iure Belli Ac Pacis*, Lib. II, Cap. XVI, XXIX (Classics, 3, 1929). While the United States does not suggest that this principle applies directly here, the United States finds the logic of the principle compelling and notes that the U.S. interpretation of Articles 1, 3.1(a), and item (j), discussed above, is consistent with this logic.

types of measures, such as those for export credit guarantees in item (j), if those rules could be ignored in favour of more general rules elsewhere in the *SCM Agreement*.

52. By contrast, Brazil's interpretation ignores the textual guidance in the *SCM Agreement* regarding the relationship between Articles 1.1/3.1(a) and item (j), but it would – if applied – nullify or render redundant a number of provisions of the *SCM Agreement*. For example, under Brazil's interpretation, footnote 5 would become largely redundant. Specifically, Brazil's argument assumes that footnote 5 only exempts from the prohibition on export subsidies those measures that are *expressly* referred to in the Illustrative List as not constituting export subsidies. However, to the extent that measures *are* expressly referred to as not constituting export subsidies in the Illustrative List, they are not subject to the prohibition on "export subsidies" in any event. In other words, the language of Articles 1, 3.1(a), and the Illustrative List would be sufficiently clear – without footnote 5 – to establish that measures expressly identified as not constituting export subsidies will not be subject to prohibitions on export subsidies. If – as Brazil argues – the point of footnote 5 is simply to reiterate that point, footnote 5 would serve a purely redundant function. Such an interpretation is disfavoured under customary rules of treaty interpretation. As the Appellate Body has explained, "[a]n interpreter is not free to adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility."[56]

53. Similarly, Brazil's interpretation would call into question the need for item (d) of the Illustrative List.[57] Brazil contends that Articles 1 and 3.1(a) provide an independent basis to challenge as an export subsidy *any* export-contingent financial contribution that places the recipient in a better position than in the market. Item (d), however, establishes a two part test that requires *both* a showing of preferential treatment of products for export vis-a-vis products for domestic consumption *and*, in the case of goods, a showing that goods are being provided on terms and conditions more favourable than those available in the market. In the case of goods, the showing that would have to be made to satisfy the second part of the two-part test appears to be exactly the same showing that, under Brazil's interpretation, would – alone – be sufficient to demonstrate the existence of an export subsidy under Articles 1 and 3.1(a) of the *SCM Agreement*. Why would any rational complaining party choose to use the two-part test in item (d) if it could simply demonstrate the existence of an export subsidy under Articles 1.1 and 3.1(a) on the basis of one of the two parts? Again, Brazil's interpretation simply leads to manifestly absurd results.

54. For the reasons above, the more plausible textual interpretation is that there is only one definition of "export subsidy" in the *SCM Agreement* – its elements are laid out in Articles 1.1 and 3.1(a) – and item (j) of the Illustrative List controls on the question of how that definition applies in the case of export credit guarantees.

B. The panel reports in Korea – Ships and Brazil – Aircraft do not detract from the proper interpretation of item (j)

55. The panel reports in *Brazil – Aircraft* and *Korea – Ships* do not detract from the proper interpretation of item (j) of the Illustrative List discussed above. For one, all of these reports consider the relevant question to be whether the items of the Illustrative List are available as an "affirmative defense;" in other words, whether measures found to be "export subsidies" under the general definitional elements set out in Articles 1.1 and 3.1(a) can nonetheless be excused if the conditions in

[56] *United States – Gasoline (AB)*, p. 23.

[57] Item (d) of the Illustrative List identifies as an export subsidy "[t]he provision by governments or their agencies . . . of imported or domestic products or services for use in the production of exported goods, on terms or conditions more favourable than for provision of like or directly competitive products or services for use in the production of goods for domestic consumption, *if (in the case of products) such terms or conditions are more favourable than those commercially available on world markets to their exporters*." (Emphasis added)

the Illustrative List are satisfied.[58] The United States does not consider this to be the relevant question here. Indeed, the United States has never argued that item (j) constitutes an "affirmative defense." Rather, as explained above, the United States view is that item (j) "clarifies" dispositively how the elements of "export subsidy" in Articles 1.1 and 3.1(a) apply in the case of export credit guarantees. The suggestion that item (j) provides an "affirmative defense" suggests that the standard contained therein is different from the standard in Articles 1.1 and 3.1(a); an argument that Brazil – not the United States – has made in this proceeding. This is an argument with which the United States disagrees. And, in that limited sense, the U.S. position is consistent with that of the panels in *Brazil – Aircraft* and *Korea – Ships*.

56. The United States does not, however, consider that the panels in *Brazil – Aircraft* and *Korea – Ships* properly interpreted footnote 5 of the *SCM Agreement*. In particular, neither panel considered the full breadth of the ordinary meaning of the term "referred to" in footnote 5; namely, the fact that the term may well encompass both measures that are *expressly* referred to as not constituting export subsidies and measures that are *implicitly* referred to as not constituting export subsidies. Indeed, in *Korea – Ships*, even the European Communities – the complaining party in that dispute – agreed that "in law item (j) could be read to include a proviso, and thereby 'refer' to export credit guarantees as not constituting export subsidies to the extent that the premium rates cover the long-term operating costs and losses of the programs."[59] This is the same point made by Brazil in the *Brazil – Aircraft* dispute about the implicit reference in item (j) to measures that do not constitute prohibited export subsidies:

> Footnote 5 of the SCM Agreement specifies that Annex I contains not only a list of prohibited export subsidies, but also measures that do not constitute export subsidies, such as in items (b), (h), (i) and (k). Comparing the structure of item (j) and item (k), the two provisions share a similar structure in that they define practices that constitute prohibited export subsidies with *language that limits the scope of the definition. In the case of item (j) regarding export credit guarantee or insurance programs, the limiting language is "premium rates which are inadequate to cover the long-term operating costs and losses of the programs."*[60]

57. The United States agrees with Brazil's – and the European Communities' – assessment of item (j) and the implicit reference therein to the measures that do not constitute prohibited export subsidies.

58. The United States also considers that the panels in *Brazil – Aircraft* and *Korea – Ships* failed to give due consideration to the Appellate Body's analysis in *Brazil – Aircraft* in which it indicated that it accepted Brazil's argument that the first paragraph of item (k) can be read in an *a contrario* fashion.[61] Brazil concedes that the Appellate Body made this finding but argues that such an *a*

[58] *See e.g., Brazil – Aircraft (21.5 II – Canada),* paras. 5.272 ([t]he question before us is whether a measure which has been found to be a subsidy contingent upon export performance within the meaning of Article 3.1(a) of the *SCM Agreement* is nevertheless not prohibited if it is a 'payment' which is not 'used to secure a material advantage in the field of export credit terms' within the meaning of the first paragraph of item (k).") and 5.276 ("[w]e have concluded that . . . the first paragraph of item (k) cannot, as a legal matter, be invoked as an affirmative defence."); *Korea – Ships (21.5 – EC),* para. 7.193 ("[i]n light of out findings that certain [guarantees] constitute subsidies, and that such subsidies are contingent on export performance, we will be required to find that such [guarantees] are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement* unless we uphold Korea's claim that they benefit from a safe haven pursuant to item (j) of the Illustrative List.")

[59] *Korea – Ships (21.5 – EC),* para. 7.1299. The EC simply "reject[ed] the application of item (j) on the facts of [that] case." *Korea – Ships (21.5 – EC)*, para. 7.1299.

[60] *Brazil – Aircraft (AB)*, para. 19 (emphasis added).

[61] *Brazil – Aircraft (21.5) (AB),* para. 80 (arguing that, if Brazil had made the correct factual showing under paragraph 1, "we would have been prepared to find that the payments made under the revised PROEX are justified under item (k) of the Illustrative List.")

contrario reading must be limited to the first paragraph in item (k).[62] There is no legitimate or principled basis for that assertion and, in fact, Brazil expressly argued in the *Brazil – Aircraft* dispute that "[t]here is nothing in the text of either item (j) or (k) to support the conclusion that an *a contrario* argument is permitted in one but not the other."[63] If item (k) can be read *a contrario* – and Brazil has conceded that it can – then item (j) can be read *a contrario* as well.

> ***34. Does the United States considers that item (j) of the Illustrative List is one of the provisions to which footnote 5 of the SCM Agreement applies? What impact does this have for the United States' interpretation of the interaction between item (j) of the Illustrative List and Article 3.1(a) of the SCM Agreement?***

59. Please see response to Question 33 above.

> ***35. How does the United States address Brazil's argument that permitting an a contrario reading of item (j) would prevent a Member from challenging specific export credit guarantees or cohorts of such guarantees granted by a Member, as opposed to export credit guarantee programs [see paragraphs 472 ff. of Brazil's Rebuttal]***

60. Brazil appears to confuse the question of the measures that may be challenged as providing prohibited export subsidies and the standard for whether the measures are prohibited export subsidies in item (j). WTO Members agreed, in item(j), that a prohibited export subsidy would exist when premia under an export credit guarantee program are not adequate to cover the long-term operating costs and losses of the program. This is the test to apply in considering whether export credit guarantees are prohibited export subsidies or not. This test applies regardless of whether a Member chooses to challenge all guarantees under a program or particular guarantees. Indeed, the United States recalls, in this regard, that Brazil only successfully challenged those export credit guarantees in respect of exports of unscheduled products and rice in the original proceeding. Therefore, even the facts of this dispute undermine Brazil's assertion that a complaining Member could only challenge an export credit guarantee program as a whole, not any subset of guarantees. A complaining Member may challenge whatever guarantees it chooses, but to establish whether or not they are prohibited export subsidies, the relevant consideration is whether the program is being operated in such a way that the premiums collected are inadequate to cover the long-term costs and losses of the program.

61. Brazil suggests that the U.S. interpretation is "not compatible with Article 1.1(a)(1)(i)" because that provision identifies loan *guarantees* and not export credit guarantee *programs* as financial contributions.[64] Here, again, Brazil's argument incorrectly conflates the measures that can be challenged as conferring export subsidies and the standard for whether those measures do, in fact, do so. The fact that loan guarantees – or more specifically, export credit guarantees – constitute financial contributions does not change the analysis of the conditions under which those guarantees may be deemed to be prohibited export subsidies for purposes of the *SCM Agreement*.[65]

Questions to Brazil

> ***36. What is Brazil's reading of the Appellate Body's statement in paragraph 80 of its Report in Brazil – Aircraft (21.5) that it "... would have been prepared to find that***

[62] *See e.g.,* Brazil Oral Statement, para. 235 ("Brazil's position is not inconsistent with the Appellate Body's dicta, in *Brazil – Aircraft (Article 21.5 proceeding)*, that it 'would have been prepared,' in effect, to accept an *a contrario* reading of the first paragraph of item (k) of the Illustrative List.")

[63] *See Brazil – Aircraft (21.5 – Canada)*, para. 6.59, n. 58 (quoting Oral Statement of Brazil at the Meeting of the Panel, para. 34) (underlining added).

[64] Rebuttal Submission of Brazil, para. 473

[65] The same flaw is apparent in Brazil's arguments relating to Article 3.1(a) of the *SCM Agreement*.

the payments made under the revised PROEX are justified under item (k) of the Illustrative List"? Should the Panel take this statement into account in deciding whether item (j) can be interpreted a contrario?

2. Outstanding export credit guarantees / measures taken to comply

Questions to Brazil

37. Brazil relies on the panel and Appellate Body Reports in Brazil – Aircraft (21.5) in support of its arguments that the United States has not "withdrawn" the subsidy and is, "[a]t a minimum... prohibited from making 'payments' on claims against" any outstanding export credit guarantees [Paragraph 397 of Brazil's Rebuttal Submission]. Please discuss how the findings of the panel and Appellate Body in that case apply to the provision of the US export credit guarantees at issue.

3. "Benefit" under Articles 1 and 3.1(a) of the SCM Agreement

Question to the United States

38. Please discuss the relevance of the original panel's characterization, in paragraph 6.31 of its report, of Brazil's reliance on Articles 1 and 3.1(a) of the SCM Agreement as "not a separate claim, but merely another argument" on the United States' view in this respect (and notably the United States statement, in paragraph 67 of its First Written Submission, that "... the panel in the original proceeding specifically declined to address Brazil's alleged 'claim' under Articles 1 and 3.1(a) of the SCM Agreement")?

62. As reflected in the U.S. statement quoted by the Panel above, Brazil has erroneously alleged both in this proceeding and in the original proceeding that it presents separate "claims" under item (j) of the Illustrative List on the one hand and Articles 1 and 3.1(a) on the other, regarding whether the export credit guarantees at issue are prohibited export subsidies. The original panel disagreed. Instead, the original panel found that "Brazil's allegation invoking the elements of Articles 1 and 3.1(a) of the SCM Agreement is not a separate claim, but merely another argument, on a different factual basis, as to how the United States export credit guarantee programs would meet the definition of an export subsidy in Article 3.1(a) of the SCM Agreement."[66]

63. The original panel then went on to *decline* to address what Brazil had alleged was its "claim" – and what the panel properly re-classified as an "argument" – under Articles 1 and 3.1(a) of the *SCM Agreement*. The original panel explained that "[g]iven our finding in paragraphs 7.946-7.948 [regarding item (j)], we do not believe that it is necessary to address Brazil's additional arguments about how the Article 3.1(a) definitional elements would be fulfilled on another factual basis in order to resolve this dispute."[67] In other words, it was the original panel's view that this dispute could and should be resolved through implementation of the recommendations and rulings of the DSB based on the factual findings under item (j).

64. The same views were shared by the Appellate Body, which rejected Brazil's arguments that the "[original] Panel's failure 'to examine Brazil's claim [or, argument, according to the original panel] . . . leaves open a dispute and creates uncertainty concerning the scope of the United States' obligations, and the consistency of its existing measures with those obligations."[68] According to the Appellate Body, "[t]he Panel found that the United States' export credit guarantee programs constitute

[66] *Upland Cotton (Panel)*, para. 6.31.
[67] *Upland Cotton (Panel)*, para. 6.31.
[68] *Upland Cotton (AB)*, para. 727.

a prohibited export subsidy under Article 3.1(a) because they do not meet the criteria in item (j) of the Illustrative List of Export Subsidies. This finding, in our view, is sufficient to resolve the matter."[69]

65. The United States has implemented the DSB's recommendations and rulings relating to export credit guarantees; in particular, paying close attention to the guidance provided by the original panel regarding the standard in item (j) of the *SCM Agreement*. As the United States has shown, export credit guarantees under the GSM 102 program are provided at premium rates that are more than adequate to cover the long-term costs and losses of the program. The panel and Appellate Body properly found that this inquiry resolved the dispute in the original proceeding. The same result is appropriate here as well for all the reasons discussed above.

Questions to Brazil

39. The Panel understands the United States to argue that it has relied on the Panel's findings under item (j) to implement the DSB recommendations with respect to export credit guarantees. How would this, in Brazil's view, affect the compliance panel's role in this proceeding? Was the United States also expected to implement changes in order to make its export credit guarantee programs consistent with article 1.1 and 3.1(a) of the SCM Agreement, even though there were no findings of the original panel in this respect?

40. In paragraph 410 of its Rebuttal, Brazil refers to paragraph. 7.398 of the Panel Report in Canada – Aircraft II. The Panel notes, however, that in the same paragraph, the Canada -- Aircraft II panel also indicated that there would be a "'benefit' when the cost-saving for a Bombardier customer for securing a loan with an IQ loan guarantee is not offset by IQ's fees". Please discuss, in light of this sentence, whether the Panel should read the Canada – Aircraft II panel as having rejected the "total cost of funds" as the proper benchmark under Article 14(c) of the SCM Agreement.

Questions to both parties

41. What are the relevant considerations to guide the Panel in the selection of a market benchmark in this case?:

a. That the institution that provides the product is, on the whole, or on a program or product-specific basis, profitable? If so, is "any" profit sufficient to qualify an institution/ product/program as a relevant "market benchmark" or must the institution/product/program achieve a certain level of profit? Must the Panel conduct an examination of the level of profit achieved by commercial or private actors operating in the field?

b. Are the institution/program/products' stated goals relevant in assessing whether they can be used as a "market benchmark"?

c. Is the "governance" of the institution relevant?

d. What other factors are relevant?

66. The issue of what is an appropriate benchmark cannot be addressed in the abstract. It is necessary to determine, first, what the text of the *SCM Agreement* provides about the particular benchmark to be selected in the circumstances of the particular case. If the question presented is

[69] *Upland Cotton (AB)*, para. 732.

whether export credit guarantees provided prohibited export subsidies within the meaning of the *SCM Agreement*, the precise measure by which this is determined is set out in item (j) of the Illustrative List in Annex I. That provision clarifies that the relevant consideration is the long-term operating costs and losses of a program. Where the premiums collected are inadequate to cover the long-term operating costs and losses of a program, the export credit guarantees confer prohibited export subsidies. Where the premiums collected are *not* inadequate to cover the long-term operating costs and losses of a program, the export credit guarantees do *not* confer prohibited export subsidies.

67. Brazil argues that Article 1.1 and 3.1(a) establish a second, alternative benchmark for prohibited export subsidies. For the reasons discussed above, the United States strongly disagrees. Nonetheless, even under Brazil's (incorrect) argument, it is the text of the *SCM Agreement* from which one can draw guidance as to the particular "benchmark" to be used. Specifically, Article 14 of the *SCM Agreement* interprets and applies the definition of "benefit" set out in Article 1.1 and has been relied upon by the Appellate Body as important contextual guidance in interpreting "benefit" for purposes of Article 1.1 of the *SCM Agreement*.[70] Indeed, it has even been invoked by Brazil to justify its arguments in this proceeding.[71] Article 14 specifically identifies the different benchmarks that are relevant with respect to different types of government-provided measures.

68. Article 14(c) deals with loan guarantees and provides that the proper comparison – in assessing whether a benefit has been conferred (and the amount thereof) – is between "the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee." Under Article 14(c), the "market benchmark" that must be sought is, thus, a commercially-available loan that could be obtained without the government guarantee. A "benefit" is deemed to be conferred pursuant to Article 14(c) where there is a positive difference between "the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee."

69. The question, then, is how to identify a "comparable commercial loan" within the meaning of Article 14(c). As the text indicates, the focus of the analysis is on the loan itself – it is the loan that must be "commercial" and "comparable." The characteristics of the entity providing the loan are not necessarily determinative as to whether or not the loan itself is "commercial" and, therefore, appropriate for use as a benchmark under Article 14(c). While these characteristics may well be relevant considerations in assessing whether the loan itself is a "commercial" loan in a particular case, factors such as the overall profitability of a particular institution or its stated goals, or the manner of its governance, may not necessarily – and in all cases – correlate to whether the loan is "commercial." In short, the question of what constitutes an appropriate "market benchmark" – a "comparable commercial loan" under Article 14(c) – is a fact-specific question that looks to the (non-government guaranteed) loans that a particular obligor is actually able to obtain on the market.

70. Although Brazil bears the burden of proof, it has not even attempted to make the kind of particularized showing contemplated under Article 14(c) of the *SCM Agreement*; it has not shown that the overall cost, including fees, of each of the loans guaranteed by the government is less than overall cost of a comparable commercial loan that could actually be obtained without a government guarantee. Instead, Brazil has relied on sweeping and erroneous assertions that obligors on loans guaranteed under the GSM 102 program can *never* obtain any other financing of any kind and that the United States could *never* provide an export credit guarantee without also providing an export subsidy. These arguments simply do not square with the evidence submitted by the United States showing that such obligors are in fact able to obtain financing even without GSM 102 guarantees and on terms better than those available *with* GSM 102 guarantees. The declining level of use of the GSM 102 program in recent years is even further evidence of this.

[70] *Canada – Aircraft (AB)*, para. 155.
[71] Brazil First Written Submission, paras. 371-375

4. Claims under item (j) of the Illustrative List

Question to the United States

42. How does the United States address Brazil's arguments with respect to the MPRs under the OECD Arrangement?

71. There is no merit to Brazil's argument that GSM 102 export credit guarantees should be deemed to fail to meet the standard in item (j) of the Illustrative List because – allegedly – "the fees for GSM 102 [export credit guarantees] fall below the minimum premium rates ('MPRs') provided in the Organization for Economic Co-operation and Development's ('OECD') Arrangement on Officially Supported Export Credits . . ."[72] First, item (j) of the *SCM Agreement* clearly provides that the proper comparison is between the "premium rates" charged under the particular programs and "the long-term operating costs and losses" of the programs themselves. The text of the *SCM Agreement* does *not* provide that the Arrangement on Officially Supported Export Credits sets the standard by which to assess whether export credit guarantees constitute export subsidies under item (j) of the *SCM Agreement*.

72. Indeed, this is in contrast to the very next item in the Illustrative List – item (k), dealing with export credits – which *does* expressly refer to such an Arrangement[73] and *does* provide that it establishes a basis for determining whether or not a measure constitutes a prohibited export subsidy. It is, therefore, clear that when the drafters intended that a separate undertaking establish a standard for assessing WTO-consistency, they knew precisely how to reflect this in the text. The fact that no such reference is found in item (j) is clear evidence that the OECD Arrangement does not establish the standard for the fees that ought to be charged for export credit guarantees in order to meet the standard set in item (j).

Question to Brazil

43. What is Brazil's reaction to paragraph 25 of Japan's Third Party Submission?

[72] Brazil First Written Submission, para. 438.

[73] Item (k) refers to "an international undertaking on official export credits to which at least twelve original Members to this Agreement are parties as of 1 January 1979 (or a successor undertaking which has been adopted by those original Members)." The Appellate Body explained in *Brazil – Aircraft* that "[t]he OECD Arrangement is an 'international undertaking on official export credits' that satisfies the requirements of the proviso in the second paragraph in item (k).")

ANNEX D-10

BRAZIL'S COMMENTS ON THE RESPONSES OF THE UNITED STATES TO THE PANEL'S FIRST SET OF QUESTIONS

(16 March 2007)

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LIST OF ABBREVIATIONS

Arrangement	OECD Arrangement on Officially Supported Export Credits
AWP	Adjusted World Price
CCPs	Counter-Cyclical Payments
DSB	Dispute Settlement Body
DSU	Understanding on Rules and Procedures Governing the Settlement of Disputes
ECG	Export Credit Guarantee
EBRD	European Bank for Reconstruction and Development
FAIR Act	Federal Agricultural Improvement and Reform Act of 1996
FAPRI	Food and Agricultural Policy Research Institute
FSRI Act	Farm Security and Rural Investment Act of 2002
FY	Fiscal Year
GSM 102	General Sales Manager 102
GSM 103	General Sales Manager 103
IDB	Inter-American Development Bank
IFC	International Finance Corporation
MPRs	Minimum Premium Rates
MY	Marketing Year
OECD	Organization for Economic Co-operation and Development
SCGP	Supplier Credit Guarantee Program
SCM Agreement	*Agreement on Subsidies and Countervailing Measures*
U.S.	United States
USDA	U.S. Department of Agriculture
WTO	World Trade Organization

TABLE OF CASES

Short Title	Full Case Title and Citation
Australia – Salmon (Article 21.5 – Canada)	Panel Report, *Australia – Measures Affecting Importation of Salmon – Recourse to Article 21.5 of the DSU by Canada*, WT/DS18/RW, adopted 20 March 2000, DSR 2000:IV, 2031
Brazil – Aircraft	Appellate Body Report, *Brazil – Export Financing Programme for Aircraft*, WT/DS46/AB/R, adopted 20 August 1999, DSR 1999:III, 1161
Brazil – Aircraft (21.5)	Appellate Body Report, *Brazil – Export Financing Programme for Aircraft – Recourse by Canada* to Article 21.5 of the DSU, WT/DS46/AB/RW, adopted 4 August 2000, DSR 2000:VIII, 4067
Brazil – Aircraft (Article 21.5 – Canada)	Panel Report, *Brazil – Export Financing Programme for Aircraft – Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW, adopted 4 August 2000, modified by Appellate Body Report, WT/DS46/AB/RW, DSR 2000:IX, 4093
Canada – Aircraft (21.5)	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/AB/RW, adopted 4 August 2000, DSR 2000:IX, 4299
Canada – Aircraft Credits and Guarantees	Panel Report, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R and Corr.1, adopted 19 February 2002, DSR 2002:III, 849
EC – Bed Linen (Article 21.5 – India)	Appellate Body Report, *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by India*, WT/DS141/AB/RW, adopted 24 April 2003, DSR 2003:III, 965
EC – CVDs on DRAMs	Panel Report, *European Communities – Countervailing Measures on Dynamic Random Access Memory Chips from Korea*, WT/DS299/R, adopted 3 August 2005
EC – Selected Customs Matters	Appellate Body Report, *European Communities – Selected Customs Matters*, WT/DS315/AB/R, adopted 11 December 2006
Indonesia – Autos	Panel Report, *Indonesia – Certain Measures Affecting the Automobile Industry*, WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R and Corr.1, 2, 3 and 4, adopted 23 July 1998, DSR 1998:VI, 2201
Korea – Commercial Vessels	Panel Report, *Korea – Measures Affecting Trade in Commercial Vessels*, WT/DS273/R, adopted 11 April 2005
U.S. – Gasoline	Appellate Body Report, *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/AB/R, adopted 20 May 1996, DSR 1996:I, 3
U.S. – Shrimp (21.5)	Appellate Body Report, *United States – Import Prohibition of Certain Shrimp and Shrimp Products – Recourse to Article 21.5 of the DSU by Malaysia*, WT/DS58/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6481
U.S. – Softwood Lumber IV (21.5)	Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada – Recourse by Canada to Article 21.5 of the DSU*, WT/DS257/AB/RW, adopted 20 December 2005
U.S. – Upland Cotton	Appellate Body Report, *United States – Subsidies on Upland Cotton*, WT/DS267/AB/R, adopted 21 March 2005

Short Title	Full Case Title and Citation
U.S. – Upland Cotton	Panel Report, *United States – Subsidies on Upland Cotton*, WT/DS267/R, and Corr.1, adopted 21 March 2005, modified by Appellate Body Report, WT/DS/267/AB/R
U.S. – Wool Shirts and Blouses	Appellate Body Report, *United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India*, WT/DS33/AB/R and Corr.1, adopted 23 May 1997, DSR 1997:I, 323

TABLE OF EXHIBITS

Calculation of Total MY 2005 Counter-Cyclical Payments On Farms Growing Upland Cotton	Exhibit 670
U.S. Department of Agriculture's 2007 Farm Bill Proposal	Exhibit 671
Rangarajan Sundaram, *A First Course in Optimization Theory* (Cambridge Univ. Press, 1996) at Appendix A, Set Theory and Logic: An Introduction	Exhibit 672

A. General questions

Questions to both parties

1. Is Brazil/US of the view that a party to a dispute referred to a panel established under Article 21.5 of the DSU (a party in a compliance panel) can make the same legal argument as it did in the original Panel proceedings?

1. Generally Brazil agrees with the United States' view regarding the legal arguments that can be made in Article 21.5 proceedings. However, the United States suggests that Brazil's approach in these proceedings contradicts its approach in the original proceeding with respect of the Step 2 program and the appropriateness of the FAPRI approach to modeling. Brazil has explained that its Step 2-related arguments in these proceedings are consistent with its arguments in the original proceeding.[1] Moreover, Professor Sumner and Brazil have explained that the new model is more appropriate to assess the question before this compliance Panel.[2]

2. Could each party explain its view on the question of whether, and to what extent, this Panel must rely on the legal and factual analysis underlying the original panel's findings? What are the relevant provisions of the DSU in this regard?

2. Brazil refers the compliance Panel to its responses to questions 2 and 30, which address the relevant legal provisions of the DSU, applicable jurisprudence, as well as the application of those provisions and jurisprudence to the facts of this case. Contrary to the U.S. response, Appellate Body and panel rulings suggest that where a compliance panel examines the effects of one or more identical subsidies challenged in the original proceeding, it must rely on and accept any relevant findings of the original panel, as modified by the Appellate Body, absent a fundamental change in the underlying conditions of competition.

B. Questions with respect to Brazil's request under Article 13.1 DSU

Questions to the US

3. Is the United States arguing that Brazil must identify the subsidized product for each of the types of subsidies from which it claims serious prejudice? Is the United States arguing that payments which permit planting flexibility are not tied to the production of upland cotton, so that they must be allocated by Brazil across the total value of production of each recipient?

3. Brazil agrees with the United States that the subsidized product at issue in this dispute is upland cotton lint.[3] Brazil also agrees with the United States that, as a matter of fact, the challenged measures should subsidize the product at issue to support a finding that they cause the adverse effects claimed.[4] Finally, Brazil agrees with the United States that counter-cyclical subsidies benefit the production of upland cotton.[5]

4. The disagreement between the parties concerns two issues: first, the methodology by which to quantify the general order of magnitude of the counter-cyclical subsidies benefiting upland cotton; second, whether counter-cyclical subsidies paid on base other than upland cotton base are properly before the compliance Panel.

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[1] Brazil's Rebuttal Submission, paras. 48-90; Brazil's Oral Statement, paras. 135-144.

[2] Brazil's Rebuttal Submission, Annex I; Brazil's Oral Statement, paras. 92-121; Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments).

[3] U.S. 27 February response to question 3, paras. 7-9.

[4] U.S. 27 February response to question 3, para. 9.

[5] U.S. 27 February response to question 3, para. 9.

5. First, the United States continues to advocate the use of the methodology provided for in Annex IV of the *SCM Agreement* to allocate the amount of counter-cyclical subsidies benefiting upland cotton.[6] Both the original panel and the Appellate Body rejected the applicability of that methodology in the original dispute.[7] Indeed, Annex IV provides for a methodology to precisely quantify the magnitude of subsidies, in terms of their cost to the government, for the express purposes of the now expired rebuttable *presumption* of serious prejudice under Article 6.1(a) of the *SCM Agreement*. By contrast, under Articles 5(c) and 6.3 of the *SCM Agreement*, the compliance Panel is called to make an assessment of "the effect of the subsidy". This requires, to some extent, a more qualitatively and less quantitative assessment of the economic reality of how U.S. counter-cyclical subsidies support the production of upland cotton, not application of a one-size fits all methodology.[8] Indeed, the Appellate Body pointed out that these provisions "suggest that a panel has a certain degree of discretion in selecting the appropriate methodology for determining whether the 'effect' of a subsidy is significant price suppression".[9] In other words, Article 6.3 provides the necessary flexibility for a panel to take into account the economic reality of the measures, products and markets at issue.

6. As Brazil has explained in numerous instances, U.S. upland cotton production is economically viable only due to counter-cyclical subsidies. Moreover, as discussed in more detail in Brazil's comments to the U.S. response to question 29, there is a strongly positive correlation between upland cotton planting and holding upland cotton base. In fact, in MY 2005, 95 percent of U.S. upland cotton production took place on farms holding upland cotton base. This economic reality remains the same as the economic reality in MY 2002.

7. Any methodology to allocate counter-cyclical subsidies to upland cotton that serves as the basis for assessing "the effect of the subsidy" must take these economic realities into account. Brazil's methodology does so. Indeed, the original panel confirmed that it was "appropriate" and might even understate the real amount of support provided by counter-cyclical subsidies to upland cotton.[10] Brazil therefore maintains that the compliance Panel should adopt the Brazil's approach to determining the magnitude of the subsidies at issue.

8. Second, the United States asserts that the recommendations and rulings of the DSB related to counter-cyclical payments made only on upland cotton base. This is allegedly because the Appellate Body, in selecting a methodology for determining the amount of "support" "grant[ed]" in MY 2002 to upland cotton, within the meaning of Article 13(b)(ii) of the *Agreement on Agriculture*, relied on the amount of upland cotton counter-cyclical payments.[11] Again, the United States errs.

9. The findings of the original panel and the Appellate Body under Article 13(b)(ii) of the *Agreement on Agriculture* relate to the question whether support granted to upland cotton in MY 2002 exceeded support decided in MY 1992. The Appellate Body is clear that it applies a "methodology" for assessing whether U.S. measures are covered by Article 13(b)(ii).[12] While the *methodology* applied by the Appellate Body might have related to counter-cyclical payments with respect to upland cotton base only, the corresponding finding is that "support to" upland cotton exceeded support decided in 1992. In other words, any support for upland cotton was subject to the original panel's assessment under Part III of the *SCM Agreement*. Consequently, the original panel's findings and the recommendations and rulings of the DSB are not limited to counter-cyclical payments for upland

[6] U.S. 27 February response to question 3, paras. 9-11.
[7] *See* Panel Report, *U.S. – Upland Cotton*, paras. 7.1183-7.1190; Appellate Body Report, *U.S. – Upland Cotton*, paras. 461-467.
[8] Panel Report, *U.S. – Upland Cotton*, paras. 7.1183-7.1190.
[9] Appellate Body Report, *U.S. – Upland Cotton*, para. 436.
[10] Panel Report, *U.S. – Upland Cotton*, para. 7.646.
[11] U.S. 27 February response to question 3, para. 9 and footnote 16.
[12] Appellate Body Report, *U.S. – Upland Cotton*, paras. 377-380.

cotton base only. They cover any counter-cyclical payments that support the production of upland cotton, which are therefore properly before this compliance Panel.

10. Finally, Brazil corrects errors in the U.S. calculation, under the inapplicable Annex IV, of the amount of counter-cyclical subsidies allocated to upland cotton. First, rather than allocating all upland cotton base related counter-cyclical payments received by farms producing upland cotton, the United States only allocates those received up to the amount of upland cotton planted acres on the farm – in other words the basis for the Cotton-to-Cotton Methodology. The United States thus ignores a portion of upland cotton counter-cyclical payments received by farms producing upland cotton and that very likely supports the production of upland cotton. Brazil corrects this error in the table below, which otherwise reproduces the second U.S. table at paragraph 12 of its response.

Table 1. – Allocating Cotton Counter-Cyclical Payments

	2003	2004	2005
Total CCP payments (A)	$392 million	$1,375 million	$1,375 million
Upland cotton base acres on farms that plant upland cotton (B)[13]	NA	NA	13,470,412 acres
Total upland cotton base acres (C)[14]	NA	NA	18,474,000 acres
Ratio of upland cotton base acres on farms that plant upland cotton (D=B/C)	NA	NA	72.92%
CCP payments to farms that planted cotton (E=A*D)	$286 million	$1,003 million	$1,003 million
Cotton as percent of total on farms that harvested cotton (F)[15]	41.80%	53.90%	46.70%
CCP payments allocated based on cotton's share of total crop value (G=E*F)	$119 million	$540 million	$468 million
As percent of total CCPs (H= G/A)	30.48%	39.30%	34.05%

11. Second, Brazil uses the USDA base and planted acreage data provided for MY 2005 only to determine the amount of total counter-cyclical payments received by farms producing upland cotton and allocates them, under the inapplicable Annex IV methodology, to upland cotton based on the share of the value of the upland cotton crop of total farm production.[16]

[13] Exhibit Bra-625 (Calculation of MY 2005 Counter-Cyclical Payments Allocated to Upland Cotton)
[14] Exhibit Bra-639 (Commodity Estimates Book for FY 2008 President's Budget, p. 190)
[15] U.S. 27 February response to question 3, para. 12.
[16] Brazil notes that the data presented by the United States in the first table at paragraph 12 of its 27 February response to question 3 does not indicate whether it is applicable to all farms producing upland cotton. Brazil therefore has not means to determine the reliability of this data.

Table 2. – Allocating Total Counter-Cyclical Payments

	2005
Total cotton CCP payments (A)	$1,375 million
Cotton CCP payments on farms that plant cotton (B)[17]	$1,011 million
Other CCP payments on farms that plant cotton (C)[18]	$224 million
Total CCP payments on farms that plant cotton (D=B+C)	$1,235 million
Cotton as percent of total on farms that harvested cotton (E)	46.70%
CCP payments allocated based on cotton's share of total crop value (F=D*E)	$577 million
As percent of total CCPs (G= F/A)	41.95%

12. Brazil reiterates that, while pointing out these errors in the U.S. implementation of the inapplicable Annex IV methodology, it maintains that the compliance Panel should adopt the Brazil's approach to determining the magnitude of the subsidies at issue.

4. Does the United States contest the accuracy of the figures for 2003 – 2005 cited in "Table 6"[19] *of Brazil's first submission and "Table 5"*[20] *of Brazil's rebuttal submission? If so, please provide the accurate figures, or the figures the US deems to be more accurate.*

13. The United States' objections to the data in Table 6 of Brazil's First Written Submission and Table 5 of Brazil's Rebuttal Submission are inconsequential, and in many instances, incorrect.

14. First, the "actual outlays" presented by the United States are very similar to those in Table 6 of Brazil's First Written Submission. In fact, the United States reports greater marketing loan subsidy outlays in MY 2005 ($1,269 million)[21] than those reported in Table 6 of Brazil's First Written Submission ($1,257 million). In any event, USDA released updated budget information in February 2007.[22] The new marketing loan subsidy totals are very similar to those reported in Table 6 of Brazil's First Written Submission:

Figure 3. – Marketing Loan Payments in MY 2004-2005[23]

	MY 2004	**MY 2005**
LDP	$387	$256
MLG	$10	$8
CEG	$1,415	$1,005
TOTAL	**$1,812**	**$1,269**

[17] Sum of cotton counter-payments on category A and B farms, *see* Exhibit Bra-670 (Calculation of Total MY 2005 Counter-Cyclical Payments On Farms Growing Upland Cotton).

[18] Sum of non-cotton counter-cyclical payments on category A, B and C farms. *See* Exhibit Bra-670 (Calculation of Total MY 2005 Counter-Cyclical Payments On Farms Growing Upland Cotton).

[19] Immediately preceding para. 112 of Brazil's first submission.

[20] Immediately following para. 173 of Brazil's rebuttal submission.

[21] U.S. 27 February response to question 4, para. 14.

[22] Exhibit Bra-639 (Commodity Estimates Book for FY 2008 President's Budget, p. 190).

[23] Exhibit Bra-639 (Commodity Estimates Book for FY 2008 President's Budget, p. 190).

15. Contrary to what the Untied States "understands,"[24] Brazil does not intend that the figures in Table 6 of its First Written submission be superseded by the figures in Table 5 of its Rebuttal Submission. The figures in Table 6 of Brazil's First Written Submission are based on the ratio of counter-cyclical subsidies under "Brazil's allocation methodology" to total counter-cyclical subsidies in MY 2002.[25] By contrast, the figures in Table 5 of Brazil's Rebuttal Submission are based on the "Cotton-to-Cotton Methodology."[26]

16. Applying Brazil's Methodology to USDA's MY 2005 base and planted acreage data, the only data provided by the United States, results in MY 2005 counter-cyclical subsidies allocated to upland cotton in the amount of $868 million, about $45 million less than what was estimated in Table 6 of Brazil's First Written Submission. Brazil is not able to calculate counter-cyclical subsidies under Brazil's allocation methodology in MY 2003-2004 because the United States has still not provided data on planted acreage and base acreage.[27]

17. As the original panel pointed out, Brazil recalls that both the "Cotton-to-Cotton Methodology" and "Brazil's Methodology" are conservative.[28] Under both methodologies, million of dollars of counter-cyclical subsidies paid to upland cotton farmers are not counted as support to upland cotton. Consider a typical cotton farm with 2,000 acres planted to upland cotton. If a farmer has 2,500 upland cotton base acres, the counter-cyclical payments tied to those 500 "extra" base acres, up to $37,000 per year[29], are not allocated as support to upland cotton. In reality, it is very likely that some or all of these "extra" payments support the production of upland cotton.

18. Finally, the United States "test" of the calculations in Table 5 of Brazil's Rebuttal Submission is curious, considering that Table 5 is based directly on data submitted by the United States.[30] In any event, the amounts calculated by the United States are not significantly different from the figures in Table 5 of Brazil's Rebuttal Submission.

<u>Question to Brazil</u>

5. The Panel refers to Brazil's communication dated 22 January 2007 concerning its request in relation to Article 13.1 of the DSU. Is it correct for the Panel to understand that as far as data for 2005 is concerned, data included in Exhibit US-64 satisfies all of the requests Brazil made in Part A of Annex 1 of its 1 November communication?

C. QUESTIONS CONCERNING THE PRELIMINARY OBJECTIONS RAISED BY THE UNITED STATES

1. Preliminary objections of the United States in respect of claims of Brazil regarding export credit guarantees in respect of pig meat and poultry meat

<u>Question to both parties</u>

6. The parties disagree with respect to whether in a proceeding under Article 21.5 of the DSU a party may present a claim that was raised in the original proceeding but on which no finding of

[24] U.S. 27 February response to question 4, para. 15.
[25] Brazil's First Written Submission, para. 116-118.
[26] Panel Report, *U.S. – Upland Cotton*, para. 7.642.
[27] Brazil originally requested data on base and planted acreage for MY 2002-2006 on 29 June 2006. *See* Question 3 of Annex 2b of Brazil's data request submitted on 1 November 2006.
[28] Panel Report, *U.S. – Upland Cotton*, para. 7.646.
[29] 500 base acres * 634 pounds per acre * 0.1373 dollars per pound * 0.85 = $37,000, *see* U.S. 27 February response to question 4, para. 16.
[30] Table 5 of Brazil's Rebuttal Submission is directly based off of the information in the U.S. First Written Submission, para. 224.

WTO-inconsistency was made due to the fact that the Appellate Body was unable to complete the analysis.

a) *Could the parties explain the legal basis in the text of Article 21.5 of the DSU and other relevant provisions of the DSU for their position on this question?*

b) *Could the parties explain whether and how their position on this issue is consistent with prior panel and Appellate Body reports?*

19. The United States notes in its response that compliance panels are restricted to review of "measures taken to comply" and argues, more specifically, that such panels are limited to examining elements or aspects of "measures taken to comply" that are in some sense changed from the measure at issue in the original proceedings.

20. However, as Brazil noted in its own response to question 6, even assuming that the United States is correct, it does not mean that Brazil's claims concerning GSM 102 export credit guarantees ("ECGs") pig meat and poultry meat are outside the scope of this Panel's review.

21. In its claims concerning pig meat and poultry meat, Brazil is indeed challenging a "measure taken to comply". While the United States describes the "measure" subject to Brazil's claim as "pig meat and poultry meat GSM 102 guarantees"[31], no such measure has ever existed, either in the original proceedings or following the implementation deadline. While Brazil's claims of inconsistency are product-specific with respect to scheduled products, the measure subject to those claims is not product-specific, as the United States asserts. Instead, the measure subject to Brazil's claims of WTO-inconsistency, "in its totality"[32], is the GSM 102 program as amended by the United States' "measures taken to comply", in particular the modified GSM 102 fee schedule (including the removal of certain risk categories from eligibility).[33]

22. As Brazil noted in its response to question 6, there is no factual basis for the United States to characterize the measure subject to Brazil's claims of inconsistency as "the pig meat and poultry meat GSM 102 guarantees".[34] Neither the amended GSM 102 program in its totality, nor the individual amendments, set out terms or conditions that differ as between different eligible products.[35] The measure does not apply on a product-specific basis; the terms and conditions for ECGs under the GSM 102 program as amended by the modified GSM 102 fee schedule are the same for pig meat, poultry meat, and all other eligible scheduled as well as unscheduled products.

23. Thus, Brazil's challenge concerning pig meat and poultry meat relates to a new aspect of a new measure – the modified fee schedule that is part of the amended GSM 102 program. In that situation, none of the limits on the scope of Article 21.5 proceedings discussed by the United States in its response (or, indeed, any other limits) apply.

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[31] U.S. Rebuttal Submission, para. 10 ("In other words, as Brazil expressly concedes, there have *never* been any findings of WTO inconsistency against the pig meat and poultry meat GSM 102 guarantees, and consequently there were no DSB recommendations and rulings against these measures with which the United States was obligated to comply.") (emphasis added). *See also Id*., paras. 14, 15.

[32] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 67; Appellate Body Report, *U.S. – Shrimp (21.5)*, para. 87.

[33] *See* WT/DS267/30, paras. 8 ((ii) and (iii)), 26. Throughout its response, Brazil will refer to the measure subject to its claims as "the GSM 102 program as amended by the modified GSM 102 fee schedule".

[34] U.S. Rebuttal Submission, para. 10.

[35] Brazil's 26 February response to question 6, para. 29. The same can be said of the "old" GSM 102, before it was amended on 1 July 2005.

24. A similar situation arose in *Canada – Aircraft (21.5)*. In that dispute, Canada amended the terms and conditions of an export subsidy program.[36] The Appellate Body held that the "measure taken to comply" was "a new measure, the *revised* TPC program", which was "separate and distinct" from the *original* TPC program.[37] Similarly, in this dispute, the United States also amended the terms and conditions of an export subsidy program. The "measure taken to comply" is, therefore, "a new measure, the *revised* [GSM 102] program".

25. With respect to a new measure, the Appellate Body held that a compliance panel operating under the authority of Article 21.5 "is not confined to examining the 'measures taken to comply' from the perspective of the claims, arguments and factual circumstances that related to the measure that was the subject of the original proceedings."[38] Thus, a compliance panel can assess any claims made with respect to the new measure.

Questions to Brazil

7. Is Brazil of the view that it is only in the circumstances identified by the Appellate Body in EC – Bed Linen (Article 21.5 – India) that the scope of Article 21.5 proceedings is limited by the scope of the original proceedings? [Paragraphs 11-15 of Submission of Brazil to the Panel Regarding US Requests for Preliminary Ruling]

8. How does Brazil respond to the arguments of the United States that Brazil "incorrectly assumes that the standard is one of whether there has been a 'final resolution' of the issue in the original proceeding" and that Brazil misreads the Appellate Body report in EC – Bed Linen (Article 21.5 – India) and confuses the issue of "the scope of a compliance proceeding pursuant to Article 21.5 of the DSU" and the distinct issue of "when a claim against a specific measure or aspect of a measure can be considered to be 'finally resolved' for purposes of WTO dispute settlement"? [Paragraphs 8 and 12 of the Rebuttal Submission of the United States]

9. What are the comments of Brazil on the arguments in footnote 22 of the United States' rebuttal submission?

Question to the US

10. Could the United States explain why it considers that what it describes as the "final resolution" standard is not the correct standard to decide whether Brazil's claims regarding export credit guarantees for pig meat and poultry meat are within the scope of this proceeding?

26. Brazil refers to compliance Panel to its comment on the U.S. response to question 6, above.

2. Preliminary objections of the United States with respect to claims of Brazil regarding marketing loan and counter-cyclical payment programmes

Questions to Brazil

11. Is Brazil of the view that a finding under Article 6 of the SCM Agreement that a "subsidy" is causing serious prejudice necessarily always applies to both the subsidy "payments" and the subsidy "programme"? [Paragraphs 31-35 of Submission of Brazil Regarding US Requests for Preliminary Ruling and paragraph 38 of the Rebuttal Submission of Brazil]

12. In paragraph 44 of its Rebuttal Submission, Brazil states:

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[36] Appellate Body Report, *Canada – Aircraft (21.5)*, para. 34.
[37] Appellate Body Report, *Canada – Aircraft (21.5)*, para. 36 (italics in original, underlining added).
[38] Appellate Body Report, *Canada – Aircraft (21.5)*, para. 41.

> "*Accordingly, there is no need for Brazil to challenge per se the FSRI Act of 2002*. Nor does it assert an 'as applied' challenge to the FSRI Act of 2002. Rather, Brazil challenges the counter-cyclical and marketing loan programs in the FSRI Act of 2002 and the payments that such programmes require to U.S. upland cotton farmers, as they cause adverse effects." (emphasis added)

Could Brazil please explain:

a) *How its claims against "programmes and payments... as they cause adverse effects" differ from claims against programmes as such?*

b) *How these claims differ from claims against programmes as applied?*

13. *In paragraph 45 of its Rebuttal Submission, Brazil refers to the failure of the United States "to implement the original recommendation of the DSB requiring the United States to take actions concerning its present statutory and regulatory framework providing for marketing loan and counter-cyclical payments".*

a) *Does Brazil consider that the statement in paragraph 7.1501 of the original panel report that "the United States is obliged to take action concerning its present statutory and regulatory framework..." forms an integral part of the recommendation made by the original panel in paragraph 8.3(d) of its report?*

b) *Does Brazil consider that the absence of actions by the United States "concerning its present statutory and regulatory framework providing for marketing loan and counter-cyclical payments" is in itself a sufficient basis for this Panel to find that the United States has not complied with the DSB recommendation under Article 7.8 of the SCM Agreement?*

c) *Is there any difference, in Brazil's view, between, on the one hand, the nature of the action the United States was obliged to take with respect to its statutory and regulatory framework as a consequence of the recommendation in paragraph 8.3(d) of the original panel report and, on the other, the nature of the action the United States would have been obliged to take if the original panel had found that the relevant provisions of this statutory and regulatory framework were WTO-inconsistent as such?*

14. *Could Brazil please explain how this Panel should interpret the relationship between the three categories of measures identified in paragraph 3.1(v),(vii) and (viii) of the original panel report? Is it the view of Brazil that "subsidies provided" or "subsidies mandated to be provided" must be interpreted to encompass both payments of subsidies and the regulatory provisions pursuant to which such payments were "provided" or "mandated to be provided"?*

15. *Does Brazil agree or disagree with the United States that the listing of certain legislative and regulatory provisions in paragraph 7.1107 of the original panel report reflects the original panel's view that "payments under a programme constitute programmes 'as applied'"? [Paragraphs 46-47 of the Rebuttal Submission of the United States]*

16. *Could Brazil clarify whether or not its claim in this Article 21.5 proceeding regarding a threat of serious prejudice caused by marketing loan and counter-cyclical payments is a claim with respect to the marketing loan and counter-cyclical payment programmes as such? [Paragraphs 237-314 of the First Written Submission of Brazil]*

Questions to the United States

17. The United States argues in paragraph 16 of its Rebuttal Submission that "[a]ccording to Brazil, its claims apply not only to the marketing loan and counter-cyclical payment programs, as such, but to the programs in addition to all payments authorized under the programs" (original emphasis). The United States also argues in this respect that "it is abundantly clear that the original panel did not make any finding under Article 5(c) and 6.3(c) of the SCM Agreement against the marketing loan and counter-cyclical payment programs, as such, whether alone or in addition to payments". [Paragraph 43 of Rebuttal Submission of the United States]

a) How does the United States respond to the argument of Brazil that the United States mischaracterizes Brazil's claims in these proceedings in that Brazil is not challenging the subsidy programmes at issue as such? [Paragraph 31 of Submission of Brazil to the Panel Regarding US Requests for Preliminary Ruling; paragraph 33 of Rebuttal Submission of Brazil]

b) Could the United States also comment in this regard on the arguments in paragraph 31 of the Third Party Submission of Chad? Does the United States agree or disagree with the proposition that statutory or regulatory provisions can be challenged on an as applied basis and that Brazil's claims in the original proceeding "were as applied claims regarding measures that included legislative and regulatory provisions"?

27. Brazil has addressed the United States' arguments in its 26 February 2007 replies to Questions 11 and 15. In addition, Brazil disagrees with the United States continued efforts to label and compartmentalize Brazil's claims in this Article 21.5 proceeding as "as applied" or "per se." These terms are not found in the compliance Panel's terms of reference. Nor did the original Panel use these terms in making its "present" (as opposed to "threat") findings, conclusions and recommendations. The Appellate Body recently relied upon the U.S. assertion that certain claims under the covered agreements are "not readily classifiable in the categories of 'as such' and 'as applied.'"[39] Indeed, claims under Articles 5 and 6 of the *SCM Agreement* are just the type of WTO provisions that are not readily classifiable into such arbitrary classifications.

28. Claims under Article 5(c) and 6.3 deal with the "effects" of "subsidies."[40] These provisions oblige subsidizing Members not to cause serious prejudice to the interests of another Member through the "use of any subsidy." Nowhere does Article 5 or 6.3 require "subsidies" to be broken down into "legislative and regulatory" subsidies and "payment subsidies", nor do these provisions require that these subsidies be assessed separately. When a legislative and regulatory program of subsidies mandates payments – such as the marketing loan and CCP provisions of the FSRI Act of 2002 – an examination of the "effects" of the "program" subsidy necessarily includes an assessment of the circumstances in which mandatory subsidy payments are made, the nature and operation of the payment subsidies, the recipients and magnitude of the subsidy payments, and the impact of those subsidy payments in the marketplace.[41] In this dispute, Brazil's claims have always extended to the subsidy programs and subsidy payments.

29. Nor do Articles 5 and 6.3 of the *SCM Agreement* anticipate that the operation of legislative and regulatory subsidy frameworks must be challenged in "as applied" or "per se" claims. As the United States itself has argued, these Articles require panels to address "present" – as opposed to "threat" – serious prejudice caused by the effects of any subsidy.[42] Assessment of "present" serious

[39] Appellate Body Report, *EC – Selected Customs Matters*, para. 165 (quoting U.S. argument).
[40] Brazil's 16 January Response to U.S. Request for Preliminary Rulings, paras. 31-34.
[41] Brazil's 26 February response to question 11, paras. 83-84.
[42] U.S. 6 March response to question 28, para. 12.

prejudice requires the use of a historical "reference period" to assess the causal connection between subsidies and adverse effects. When adverse effects findings, conclusions, and recommendations are made, affirmed on appeal, and adopted by the DSB, they remain "present" serious prejudice findings, conclusions and recommendations. After the six month period anticipated by Article 7.9 of the *SCM Agreement*, the adverse effects subject to the findings, conclusions, and recommendations continue to be "present" adverse effects . This means the appropriate steps under Article 7.8 must fully withdraw the "present" and "ongoing" adverse effects caused by the subsidies. That includes effects caused by subsidy legislation and regulatory provisions as well as subsidy payments mandated by such provisions.

30. Such ongoing "present" serious prejudice findings were made by the original Panel. It described its findings in June 2004 as "present serious prejudice."[43] (The *Indonesian Autos* panel made similar findings in using the term "*actual* serious prejudice" to distinguish a claim of "*threat* of serious prejudice."[44]) The original panel's serious prejudice conclusions, also made in June 2004, did *not* include any timeframe and used the present tense phrase to describe the effects of the contested subsidies: "is significant price suppression. . . ."[45] The adverse effect that the United States was required to remove under Article 7.8 of the *SCM Agreement*, by 21 September 2005, "is significant price suppression", *i.e.*, present serious prejudice.

31. Thus, the original panel's "present" serious prejudice findings – not framed in terms of "as applied" or "per se" – were entirely consistent with an assessment of "effects" in serious prejudice claims under Articles 5 and 6.3 of the *SCM Agreement.* The original panel's "present" serious prejudice findings fully explains why it found that the United States was obligated to make changes to its statutory and regulatory framework.[46] As explained in Brazil's 26 February reply to Question 11 and its earlier submissions, this is because the original panel considered that the U.S. statutory and regulatory framework, which would last until the end of MY 2007[47], were found to cause present serious prejudice, and because those findings reflect *ongoing present* serious prejudice. The original panel correctly concluded that the only way to remove adverse effects from *ongoing* mandatory, price-contingent subsidies that continue to cause "present" serious prejudice is to change the statutory and regulatory framework.[48]

18. The United States submits that the only measures subject to the DSB's recommendation under Article 7.8 of the SCM Agreement are payments made under the Step 2, marketing loan, and counter-cyclical payment programmes in 1999-2002. The United States also asserts, in this regard, that Brazil fails to submit evidence "as to the present effects, if any, of the measures that were subject to the original panel's actionable subsidy finding".

a) Do these statements mean that the United States considers that the DSB recommendation under Article 7.8 of the SCM Agreement only obliged the United States to ensure that payments made in 1999-2002 would no longer have any adverse effects?

b) Could the United States comment on the argument of New Zealand in paragraph 4.08 of the Third Party Submission of New Zealand?

32. Brazil notes that the United States answer to these questions are premised on the incorrect view that the original Panel found only that the subsidies causing "present" serious prejudice were

[43] Panel Report, *U.S. – Upland Cotton*, para. 7.1499-7.1503.
[44] Panel Report, *Indonesia – Autos*, para. 14.257.
[45] Panel Report, *U.S. – Upland Cotton*, para. 8.1(g)(i).
[46] Panel Report, *U.S. – Upland Cotton*, para. 7.1499-7.1503.
[47] Panel Report, *U.S. – Upland Cotton*, para. 7.1500.
[48] Panel Report, *U.S. – Upland Cotton*, para. 7.1501.

payments made within a defined period. In fact, as Brazil explained in reply to Question 11, in its earlier submissions, and at the meeting with the Panel, the original panel found that the subsidy programs and the subsidy payments mandated by those programs were causing serious prejudice. The United States' arguments that its implementation obligations pertain solely to past payments are, therefore, misplaced.

19. Regarding the argument of the United States that the marketing loan and counter-cyclical payments programmes are not measures "taken to comply", is it the view of the United States that Article 21.5 of the DSU only applies to measures actually taken by a party to comply and does not apply to measures that a Member should have taken to comply?

33. The United States agrees that Article 21.5 proceedings concern either measures taken to comply or the absence of such measures. In this dispute, the original panel found that marketing loan and counter-cyclical payments programs, and mandatory payments made under these programs, were part of the "basket of measures" that causes "present" serious prejudice. The United States "measures taken to comply" – *i.e.*, the repeal of the Step 2 program and the continuation of the marketing loan and counter-cyclical payments programs – continue to cause "present" serious prejudice. Hence, the United States has failed (1) to withdraw the subsidy or (2) to take appropriate steps to remove the present adverse effects found to exist.

20. How does the United States respond to the argument in the Third Party Submission of Japan that the Appellate Body report in EC – Bed Linen (Article 21.5 – India) does not support the argument of the United States that the marketing loan and counter-cyclical payments programmes are not within the scope of this Article 21.5 proceeding?

34. Brazil refers to its comments on the United States' answer to Question 19. Brazil also notes that, in paragraph 44 of its answers, the United States quotes from the panel in EC – Bed Linen (India – Article 21.5) to the effect that Members do not have a second chance, in Article 21.5 proceedings, to raise claims that could have been raised in the original proceedings. The United States mistakenly attributes this quote to the Appellate Body. In fact, the Appellate Body merely included the Panel's statement in its summary of those findings.[49] However, the Appellate Body's own ruling in that dispute was considerably narrower than the panel's. The Appellate Body ruled that the complainant does not have a second chance, in Article 21.5 proceedings, to raise claims that were *finally resolved* in the original proceedings.[50]

3. Claim of Brazil regarding the failure of the United States to comply with the DSB recommendations between 21 September 2005 and 1 August 2006

<u>Questions to Brazil</u>

21. Could Brazil please explain whether its request for a finding that the United States failed to comply with the DSB recommendations between 21 September 2005 and 1 August 2006 is supported by prior panel practice in Article 21.5 proceedings? [Paragraph 68 of the Rebuttal Submission of the United States]

22. How does Brazil respond to the argument of the European Communities that "the lack of positive action taken by the United States to comply with the panel and Appellate Body's findings and recommendations between the implementation date of 21 September 2005 and 31 July 2006 is not necessarily fatal to its defence"? [Paragraph 48 of the Third Party Submission of the European Communities]

[49] Appellate Body Report, *EC – Bed Linen (21.5)*, para. 74.
[50] Appellate Body Report, *EC – Bed Linen (21.5)*, para. 96.

Question to the United States

23. Does the United States consider that the text of Article 21.5 of the DSU should be interpreted to mean that a compliance panel may only review the "existence" or "consistency" with a covered agreement of measures taken to comply as of the date that the matter was referred to the panel and not as of the date of the end of the implementation period? [Paragraph 68 of the Rebuttal Submission of the United States]

35. In its 27 February response, the United States reiterates its position that the compliance Panel is legally precluded from making a finding that the United States failed to comply with the recommendations and rulings of the DSB between 21 September 2005 and 31 July 2006.[51] As support, the United States refers to the panel reports in *U.S. – Shrimp (21.5)* and *EC – Bed Linen (21.5)*.[52]

36. Brazil notes, first, that the circumstances in this dispute are distinct from the circumstances in the two disputes cited: while there was no Article 22.6 arbitration pending in these two disputes, there are two DSU Article 22.6 arbitrations pending in the present dispute – one in connection with the recommendations under Article 4.7 of the *SCM Agreement* and one in connection with the recommendation under Article 7.8 of the Agreement. The circumstances of this dispute, therefore, resemble the circumstances faced by the panel in *Australia – Salmon (21.5)*. That panel made a finding with respect to past non-compliance.[53] This compliance Panel should do the same.

37. The United States refers to the concept of judicial economy, relied on by the panels in *U.S. – Shrimp (21.5)* and *EC – Bed Linen (21.5)*, as allegedly supporting its position that the compliance Panel should refrain from making such a finding.[54] However, the basis cited by the United States for the exercise of judicial economy does not exist. Brazil explained, in its response to Panel question 21, that a finding by the compliance Panel regarding the U.S. failure to implement between 21 September 2005 and 31 July 2006 will assist the arbitrator in the pending arbitration under Article 7.10 of the *SCM Agreement* and Article 22.6 of the DSU in performing their assessment of the countermeasures requested by Brazil.[55] A finding of non-compliance is therefore "necessary to resolve the particular matter."[56]

38. The United States points out that there is no disagreement between the parties as the failure of the United States to comply with the recommendations and rulings of the DSB between 21 September 2005 and 31 July 2006. In these circumstances, it is puzzling that the United States argues against a finding by the compliance Panel to this effect – a finding that will assist the parties in their pending arbitration and, thus, serves to the goal of "prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired," within the meaning of Article 3.3 of the DSU.

D. CLAIMS OF BRAZIL REGARDING PRESENT SERIOUS PREJUDICE

1. General

Questions to both parties

24. Could the parties explain how they interpret the phrases "take appropriate steps to remove the adverse effects" and "withdraw the subsidy" in Article 7.8 of the SCM Agreement?

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[51] U.S. 27 February response to question 23, para. 45.
[52] U.S. 27 February response to question 23, para. 46.
[53] Panel Report, *Australia – Salmon (Article 21.5 – Canada)*, paras. 7.30, 8.1(i).
[54] U.S. 27 February response to question 23, para. 46.
[55] Brazil's 26 February response to question 21, paras. 154-157.
[56] Appellate Body Report, *U.S. – Shirts and Blouses*, p. 18.

39. In paragraphs 4 and 5 of its response, the United States states that an "appropriate step" under Article 7.8 is one involving the "removal of the adverse effects found to exist in the panel and Appellate Body reports." This implies that the "removal of adverse effects" language in Article 7.8 only addresses *past* adverse effects, not *present, ongoing* and *future* adverse effects. Such an erroneous interpretation of Article 7.8 follows logically from the equally erroneous U.S. interpretations that (a) "present" (as opposed to "threat") Article 6.3 claims are necessarily "as applied" claims that involve adverse effects occurring in a historical period of time, and (b) only "per se" challenges to subsidies can result in any prospective relief from the effects of subsidies. From this logic, the United States implies that the "appropriate steps" of subsidizing Member need only involve an appropriate period of time for the effects of *past* subsidies to dissipate.

40. Brazil refers the Panel to its 26 February answer to Question 11, as well as its comments on the U.S. 27 February 2007 responses to Question 17 set out above. Brazil's earlier submissions demonstrated the fallacy of the U.S. assertions as well as their inconsistency with the findings and conclusions of the original panel, as affirmed by the Appellate Body and adopted by the DSB.[57] In these findings and conclusions, the original panel held that the U.S. subsidy programs, together with the payments mandated by these programs, cause serious prejudice, and the original panel expressly stated that the United States was obliged to take appropriate steps to change its "present statutory and regulatory framework."[58]

25. How do the parties interpret the relationship between Article 7.8 of the SCM Agreement and Article 21.5 of the DSU?

41. Brazil refers the Panel to its response to Question 25 while noting that the more limited response of the United States does not appear to conflict with the interpretation of Articles 21.5 and Article 7.8 advanced by Brazil.

26. Could the parties explain whether they agree or disagree with the arguments of New Zealand in its Third Party Submission that Article 7.8 of the SCM Agreement has certain consequences for the burden of proof in an Article 21.5 proceeding? [Paragraphs 5.04-5.06 of the Third party Submission of New Zealand]

42. Brazil refers the Panel to its response to Question 26 while noting that the more limited response of the United States is consistent with paragraphs 20-21 of Brazil's response. Brazil also notes that the United States does not address the hypothetical set out in paragraph 22 of Brazil's response which appears to be relevant to the point raised by New Zealand.

27. Could the parties comment on the following statement of the European Communities:

> "The text of Article 7.8 of the *SCM Agreement* does not state expressly that a Member that has been requested by the DSB to implement its recommendations and rulings under Article 7.8 of the *SCM Agreement* has to *do* anything" (original emphasis)

43. Brazil disagrees with the United States, and refers the Panel to its 26 February answer to Question 22, which addresses a similar statement made by the European Communities. In sum, Article 7.8 requires action, not inaction, no later than the end of the six-month implementation period following adoption by the DSB of the panel or Appellate Body report contemplated by Article 7.9 of the *SCM Agreement.* Doing nothing is not undertaking action. Having taken *no* action whatsoever by 21 September 2005, the United States had "not taken appropriate steps to remove the adverse effects

[57] Brazil's 26 February response to question 11, para. 99-108; 134-150; Brazil's Rebuttal Submission, paras. 33-45; Brazil's 16 January Response to U.S. Requests for Preliminary Rulings, paras. 31-34.
[58] Panel Report, *U.S. – Upland Cotton*, para. 7.1501.

of the subsidy or withdraw the subsidy within six months from the date when the DSB adopts the panel report and the Appellate Body report". Further, with respect to the specific action required under Article 7.8 in this case, Brazil refers the Panel to its comments above on the U.S. responses to Questions 17(a) and (b).

28. The parties present divergent views with respect to the relevant marketing year to be considered by the panel in its analysis of Brazil's serious prejudice claims.

a) Could the parties explain what they consider to be the relevant legal considerations by which the Panel should be guided in determining whether MY 2005 or MY 2006 is the appropriate marketing year?

b) Do the parties agree or disagree with the argument of the European Communities that in a dispute involving a claim of present serious prejudice the parties must provide the "most recent reasonably available" data? [Paragraphs 43 and 54-55 of the Third Party Submission of the European Communities]

44. Both Brazil and the United States appear generally to agree that the Panel should examine data from both MY 2005 and MY 2006 in assessing Brazil's claims of serious prejudice as well as Brazil's claims of threat of serious prejudice. Because MY 2006 data will remain incomplete throughout the Panel's consideration of Brazil's claims, it is necessary for the Panel to rely *primarily* on MY 2005 data.

45. Brazil notes that the United States does not refer to the methodological tool of a "reference period" in its response to this question. This is the tool used by the original panel in assessing Brazil's "present" (as opposed to "threat") serious prejudice claims.[59] The U.S. argument in paragraph 12 of its answer to question 28 implies that only effects of marketing loan and counter-cyclical payment programs and payments existing in MY 2006 would be subject to any implementation obligation of the United States in this proceeding. However, the necessary use of a particular time period to assess the existence of serious prejudice does not limit or otherwise circumscribe the *measures* at issue before a panel. Nor does it limit the implementation obligations of a subsidizing Member to removing the adverse effects caused during the reference period.

Questions to the United States

29. Does the United States contest the fact that a "strong positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production" exists?[60] *In particular, does the US disagree with the following statements*[61]*:*

- *a very large proportion of farms with upland cotton base acres continue to plant upland cotton in the year of payment;*

- *the overwhelming majority of farms enrolled in the programs which plant upland cotton also hold upland cotton base?*

46. To begin, Brazil disagrees with the United States' assertion that the existence of a "strong positive relationship between cotton (base acre) producers receiving annual payments and upland

[59] Brazil's 6 March 2007 response to question 28.

[60] See para. 131 of Brazil's first submission. The Panel clarifies that this phrase refers to the fact that "the recipients who hold upland cotton base acres" and "those who continue to plant upland cotton" overlap with each other to a great extent. (*See* para. 7.637 of the report of the original panel.) The Panel understands that Brazil uses this phrase in the same sense.

[61] These passages are reproduced from para. 7.636 of the report of the original panel.

cotton production" is a characterization of facts.[62] As the compliance Panel's question suggests, it is a fact. Moreover, it is a fact that the United States cannot make vanish by pointing out two other facts. Indeed, Brazil welcomes that the United States does not contest, as it cannot, that 95 percent of U.S. upland cotton acreage was on farms holding upland cotton base.[63] The parties disagreement relates to the relative importance of certain facts, including the "strong positive relationship between cotton (base acre) producers receiving annual payments and upland cotton production", and their relevance for Brazil's arguments.

47. Brazil's claims in this dispute relate, *inter alia*, to the effect of counter-cyclical subsidies in sustaining – not necessarily inducing additional acreage, as the United States erroneously claims[64] – current U.S. upland cotton production. In other words, Brazil looks to current producers of upland cotton and the relationship between current upland cotton production and upland cotton counter-cyclical subsidies. The facts show that the overwhelming majority of current U.S. upland cotton production is undertaken by historic upland cotton producers receiving upland cotton counter-cyclical payments. By contrast, the U.S. arguments focus solely on facts regarding this relationship from the perspective of historic, not current, producers of upland cotton, pointing out that some historic upland cotton producers receiving upland cotton counter-cyclical payments do no longer produce upland cotton.[65] This different focus explains much of the divergence between the parties.

48. In particular, the United States argues that a "significant portion" of upland cotton planted acreage was not on upland cotton base acreage. Viewed from the relevant perspective of current upland cotton production, the relevant figures tell a very different story. In MY 2005, <u>83 percent</u> of cotton planted acreage was on cotton base acreage. This is the more significant portion of U.S. upland cotton acreage. Moreover, of the remaining 17 percent, <u>12 percent</u> was on farms that "overplanted" their cotton base acreage and <u>5 percent</u> was on farms that did not have any upland cotton base acreage.[66] In other words, 95 percent of U.S. upland cotton acreage is on farms that hold upland cotton base. These facts demonstrate that there continues to be a "strong positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production."[67] Indeed, these percentages remain essentially unchanged from the same ratios that the original panel assessed for MY 2002 and based on which it made this finding.[68] The "growing" percentage of historic upland cotton farms that exit upland cotton production – referred to by the United States[69] – simply does not exist.

49. The United States makes a great deal of the fact that 40 percent of upland cotton base acres are not currently planted to upland cotton.[70] First, Brazil notes that at no time in recent history has U.S. upland cotton acreage been 18.4 million acres – the amount of upland cotton base. The high level of upland cotton base relative to production reflects the fact that with consecutive base updates, U.S. farms elected to update only if that would increase their high payment upland cotton base. In case an update would have decreased high payment upland cotton base in favour of lower payment crop base, U.S. farms declined to update. Thus, U.S. upland cotton base acres are not a reliable measure to compare to annual U.S. upland cotton acreage.

[62] U.S. 6 March response to question 29, para. 14.
[63] U.S. 6 March response to question 29, para. 18.
[64] It is telling that the United States does not footnote to any of Brazil's submissions. As Brazil has clarified, it is not arguing that counter-cyclical subsidies induce production. Rather, Brazil argues that it maintains production by keeping current producers of upland cotton in business.
[65] U.S. 6 March response to question 29, para. 14.
[66] Exhibit US-64 (2005 Crop Year Subcategories).
[67] Panel Report, *U.S. – Upland Cotton*, para. 7.1302.
[68] Brazil's Rebuttal Submission, paras. 153-163.
[69] U.S. 6 March response to question 29, para. 16.
[70] *See, e.g.*, U.S. 6 March response to question 29, paras. 14-15.

50. Brazil has never disputed that some farmers have used their planting flexibility and collect upland cotton counter-cyclical subsidies without growing upland cotton. The same basic percentage of use of planting flexibility (40 percent) was the situation before the original panel. Contrary to the U.S. assertions, this is irrelevant to Brazil's adverse effects claims. Brazil claims are that counter-cyclical subsidies received by current producers of upland cotton are critical to ensure a profit for those farms that currently do produce upland cotton. The fact that there are other farms that decide to put these funds to other uses is irrelevant to Brazil's claim today, exactly as it was irrelevant to Brazil's claims in 2003 before the original panel.

51. Moreover, the United States asserts out that it is not surprising that much of U.S. upland cotton production continues to be on farms that hold upland cotton base because growing upland cotton is possible only in certain regions.[71] It may not be surprising to the United States, but it is strong evidence of a strongly positive relationship. Despite the U.S. claims that these subsidies are "decoupled," the fact that 95 percent of U.S. upland cotton is grown on farms that hold upland cotton base shows just how coupled these subsidies, as well as direct payments, are.

52. The U.S. Congress provided for counter-cyclical payments rates for historic producers of upland cotton for exactly the same reason that the United States notes here: historic producers of upland cotton would be current producers of upland cotton; and those continuing producers would have high costs requiring counter-cyclical subsidies to grow upland cotton profitably (and avoid bankruptcy). Thus, counter-cyclical subsidies are a means to support current upland cotton production. As the United States argues, given climatic and other conditions, historic producers are likely to continue to grow upland cotton. As Brazil has argued and established throughout these proceedings, U.S. upland cotton producers "can grow upland cotton with good results given the particular growing conditions in the region"[72] only in light of mandated marketing loan and counter-cyclical payments. Historically, U.S. producers were able to do so in light of at least 70 years of U.S. subsidization of U.S. upland cotton production with federal funds.

53. Finally, Brazil notes that the compliance Panel's question refers to the proportion of <u>farms</u> with upland cotton base acres that continue to plant cotton. In MY 2005, the only year for which the United States produced data, this proportion was 73 percent.[73] Instead of presenting the figure in question, the United States provides "the ratio of cotton planted acres to total planted acres"[74] on farms that have upland cotton base acres. This ratio, calculated under the "Cotton-to-Cotton Methodology," allocates counter-cyclical payment on a one base acre to one planted acre basis.[75] The "Cotton-to-Cotton Methodology" does not cover 13 percent of counter-cyclical subsidies – $179 million – in MY 2005 that are paid to currently upland cotton producing farms, but relate to base acres in excess of planted acres. These payments could be considered to support upland cotton production.

54. With respect to the U.S. direct payment related arguments, Brazil refers the compliance Panel to its comments on the U.S. answer to question 31, below.

<u>Question to Brazil</u>

30. How does Brazil respond to the argument of the United States that "whether or not the marketing loan and counter-cyclical payment programs or payments under the programs cause significant price suppression is a question of first impression"? [Rebuttal Submission of the United States, paragraph 219]

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[71] U.S. 6 March response to question 29, para. 19-21.
[72] U.S. 6 March response to question 29, para. 20.
[73] *See* Table 2, above.
[74] U.S. 6 March response to question 29, para. 14.
[75] *See* Panel Report, *U.S. – Upland Cotton*, para. 7.641.

2. The structure, design and operation of the countercyclical and marketing loan payment programs

Question to the United States

31. Brazil claims that the structure, design and operation of US counter-cyclical payments stimulate US upland cotton production. Both Brazil and the United States have referred to the Westcott (2005)[76] *study to provide support for their opposing analysis of the possible production impact of counter-cyclical payments. In its rebuttal, Brazil quotes the following passage from Westcott:*

> So where do CCPs fit compared with other farm commodity programs in the 2002 Farm Act? Marketing loans are fully coupled since they are available on all production and their link to market prices means they affect production decisions of farmers. Direct payments are mostly decoupled, since they are paid on a fixed, historically-based quantity rather than on current production and are not dependent on market prices or other factors that would affect production. …
>
> CCPs fall in between these two programs, having some properties similar to mostly decoupled direct payments and other properties similar to fully coupled marketing loans. Like direct payments, CCPs do not depend on current production since they are paid on a fixed, historically-based quantity. However, similar to marketing loans, CCPs are linked to market prices so there may be some influence on current production decisions of farmers, which would potentially make CCPs at least partially or somewhat coupled.

a) Does the United States agree with this characterization of the CCP?

55. The United States understandably continues to downplay the significance of the direct link between upland cotton prices and counter-cyclical subsidies, arguing that any production effects are mitigated by a number of factors.[77] Brazil has already responded to a number of these arguments, including the incorrect assertion that counter-cyclical subsidies behave like direct payments when prices are "expected" to be above 65.73 cents per pound.[78] The past four years (MY 2002-2005) illustrate that expectations are not good indicators of actual outcomes.[79] Farmers recognize this, and assign some probability that prices will be lower, or higher than they expect.

56. The second mitigating factor cited by the United States, that "net returns among alternative crops would remain the primary consideration underlying production choices," ignores the importance of planting restrictions and the potential for base acre updates as well as the effect of risk reduction on expected net returns. As discussed further below, planting the base crop, in this case upland cotton, significantly reduce uncertainty about revenue. This is because market revenue and counter-cyclical subsidies are inversely related for upland cotton, whereas there is no such relationship between upland cotton counter-cyclical subsidies and the planting of other crops. In that case, farmers risk low market prices for the crop planted and high upland cotton prices, resulting in low or no counter-cyclical subsidies. The risk reduction effect, thus, has a significant impact on the expected net returns from planting the base crop or alternative crops. Further, the empirical literature confirms that the 2002

[76] Exhibit US-35 (Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited").

[77] U.S. 6 March response to question 31(b), para. 26.

[78] Brazil's Rebuttal Submission, para. 131.

[79] As Brazil explained in its Rebuttal Submission, expectations were significantly wrong in both MY 2003 and 2004. *See* Brazil's Rebuttal Submission, para. 131.

base acre update and the potential for future base acre updates sustains and even increases program crop acreage.[80]

57. Brazil further recalls that counter-cyclical subsidies are part of a structured basket of policies that guarantee holders of upland cotton base (and 83 percent of cotton acres) an institutional price of 72.4 cents per pound of upland cotton. There are, of course, important caveats to this policy, such as the fact that direct and counter-cyclical subsidies are made on 85 percent of historic acreage and fixed yields. However, the compliance Panel should not lose sight of the fact that upland cotton counter-cyclical subsidies are based on a target price for *upland cotton*, not some other crop, or some measure of a farmer's income. The original panel observed that "in the price range from the loan rate up to the target price minus the DP payment rate, changes in producer revenues due to changes in market prices are partly offset by the countercyclical payments if the base acreage crop is planted, thereby reducing total revenue risk associated with price variability."[81] Throughout this proceeding, the United States has attempted to divorce counter-cyclical subsidies from their direct link to the market for upland cotton.

58. The United States also argues that counter-cyclical subsidies might simply replace other risk management instruments employed by farmers.[82] Brazil notes that farmers will naturally use risk reduction tools that are the most cost effective. By providing a risk reduction tool for free, *i.e.*, counter-cyclical subsidies, farmers plant more of the program crop for two reasons. First, they are allowed to achieve lower risk than would be accepted with other costly risk reduction instruments (such as diversification or more conservative use of credit). Farmers therefore plant more than they otherwise would because one of the risk management instruments, a required "input" into upland cotton production, is cheaper. Second, with risk for upland cotton mitigated by upland cotton counter-cyclical subsidies, farmers face less risk than they otherwise would if they had to resort to other risk management tools. Therefore, risk averse farmers plant more upland cotton and their bankers and landlords encourage planting upland cotton because this reduces their risk of default by the farmer.

59. Next, the United States argues that upland cotton farms are large and that large farms are less risk averse than small farms, suggesting that, therefore, upland cotton counter-cyclical subsidies have no appreciable effects.[83] However, the notion that large commercial growers of upland cotton are less risk averse in the their upland cotton enterprises is not established by any data or other sources. In fact, there are a few facts that would tend to suggest otherwise. Large upland cotton growers are more likely to have more of their total resource base tied to upland cotton and, thus, have a stronger incentive to mitigate against revenue losses from low prices. This is precisely the benefit that the counter-cyclical subsidies provide. Furthermore, large growers are more likely to use substantial debt in financing their operation than small growers. Lenders in turn are more likely to limit the credit line available unless a grower can assure repayment even when market prices are low. Again, this is precisely the benefit that counter-cyclical subsidies provide. Thus, the notion that large upland cotton growers will exhibit less risk aversion than smaller growers has no factual basis and seems inconsistent with certain facts characterizing U.S. upland cotton production.

60. Aside from these more specific points, Brazil notes that Westcott and the United States accept the fact that counter-cyclical subsidies reduce the risk of upland cotton production and that this risk

[80] *See* Exhibit Bra-565 (McIntosh, Christopher R., Jason F. Shogren and Erik Dohlman, "Supply Response to Counter-Cyclical Payments and Base Acre Updating under Uncertainty: An Experimental Study," forthcoming paper in the American Journal of Agricultural Economics, November 2006) and Exhibit Bra-568 (O'Donoghue, Erik J. and James Whitaker, "How distorting are direct payments?," Paper prepared for presentation at the 2006 American Agricultural Economics Association in Long Beach, CA, p. 2-3, accessed December 2006 at http://agecon.lib.umn.edu/cgi-bin/pdf_view.pl?paperid=21797).

[81] Panel Report, *U.S. – Upland Cotton*, para. 7.1302.

[82] U.S. 6 March response to questions 31, paras. 26-27.

[83] U.S. 6 March response to questions 31, paras. 26-27.

reduction provides incentive to grow more upland cotton than in their absence. The U.S. attempts to minimize this effect are off the mark. Rather, the evidence supports Brazil's argument that the risk-mitigating benefits of counter-cyclical subsidies are significant, and that they provide a substantial additional incentive to maintain upland cotton acreage.

61. The United States asserts that counter-cyclical payments have effects closer to those of direct payments than marketing loan payments. For the reasons set out above, Brazil does not agree with this characterization. Yet, contrary to the U.S. assertion, the original panel did not find that direct payments were decoupled from production. It found that, because they were not price-contingent, they did not contribute to significant price suppression in the same manner as the price-contingent U.S. subsidies.[84] Moreover, it held that they can have production effects when

> considered in conjunction with the market loss and countercyclical component, respectively. We incorporate our description of the measure in Section VII:C, including the requirement to use the land for an agricultural use or conserving use. These [direct] payments provide an incentive to maintain land in agricultural use. Moreover, while a producers has the ability to vary production among crops, the strongly positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production shows that they are, to a certain degree, an incentive for continuity. We also refer to and incorporate our findings on these measures in Section VII:D.[85]

62. In others words, the original panel found that these payments have production effects and maintain farmers in the production of upland cotton. This is consistent with the evidence that direct payments contribute significantly to covering upland cotton producers' cost of production and that over 90 percent of upland cotton production takes place on farms that hold upland cotton base.[86]

63. In commenting on the original panel's finding regarding direct payments, the Appellate Body held that "subsidies that are not price-contingent … could have some effect on production and exports and contribute to price suppression."[87] Thus, direct payments are capable of contributing and do contribute to serious prejudice. Westcott concedes this point, finding "direct payments may still have some influence on production, reflecting general wealth effects, changes in risk attitudes, and providing liquidity to farmers."[88] However, Westcott does not fully consider the production effects of counter-cyclical subsidies, as he does not consider two of the most important factors contributing to their production effects: (i) planting restrictions and (ii) the potential for base updates.[89]

64. In this context, Brazil recalls the survey results of Goodwin and Mishra (2005), that questioned what farmers intend to do with direct payments. If direct payments were truly "decoupled" and did not affect production decisions, one would expect that they would be used toward family savings, consumption and other non-farm uses. This is not what the survey results reveal. Instead, 68 percent of farmers reported that they intend to use direct payments on the farm. Even more

[84] Panel Report, *U.S. – Upland Cotton*, para. 7.1307.

[85] Panel Report, *U.S. – Upland Cotton*, footnote 1417.

[86] Panel Report, *U.S. – Upland Cotton*, Attachment to Section VII:D.

[87] Appellate Body Report, *U.S. – Upland Cotton*, footnote 589.

[88] Exhibit US-35 (Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited").

[89] Brazil notes that, in 2002 for example, farmers were allowed to update not only program acres for both the direct and counter-cyclical payment program, but also program yields for the counter-cyclical payment program only.

troubling, 34 percent indicated that they intend to devote direct payments to covering their operating costs of production.[90]

65. USDA's 2007 farm bill proposal sheds further light on the importance of direct payments for upland cotton as opposed to other program crops. The proposal calls for an immediate 66 percent increase in direct payments for upland cotton, with much more modest increases in direct payments for other program crops. The USDA explains the rational for drastically increasing cotton direct payments by explaining that

> While program crop prices are generally expected to remain firm or increase over the next few years, upland cotton is an exception. The combination of increases in upland cotton yields per acre and declining U.S. upland cotton textile production is expected to limit price gains and result in substantial cotton program expenditures, compared to other commodities.[91]

66. This explanation of the "problem" facing upland cotton farmers clearly demonstrates that the proposed large increase in upland cotton direct payments are designed to support upland cotton production. As USDA's data demonstrates and as the United States admits, historic producers are often current producers of upland cotton. If direct payments were truly decoupled, and did not affect production, why would USDA propose to drastically increase direct payments for upland cotton and not other program crops? The reason is, of course, that USDA proposes to compensate for possible income losses of current upland cotton producers that may result from proposed changes in other programs. The fact that USDA considers compensating them by increasing the direct payments paid to historic producers of upland cotton is further demonstration of the "strong positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production." That strong positive relationship is not likely to change simply because future legislation may change the name of the payments from "counter-cyclical" to "direct."

67. The 2007 USDA farm bill proposal also calls for an increase in direct payments for beginning farmers. The rational for this proposal once again sheds light on how direct payments, and presumably counter-cyclical payments, are used to expand production. USDA explains that "to better prepare beginning farmers to face the initial financial burdens associated with entering production agriculture, the Administration recommends that beginning farmers receive an increased direct payment rate."[92] This USDA explanation is yet another fact demonstrating that direct payments are not decoupled from production. Instead, direct payments are designed to help farmers finance capital investments in "equipment, including planting, cultivation and harvest machinery, [which] exemplifies the financial barriers to entering production agriculture."[93]

68. In sum, unlike direct payments, counter-cyclical subsidies are dependent on the price of upland cotton. This makes counter-cyclical subsidies more coupled to the production of upland cotton than direct payments. The fact that counter-cyclical subsidies have other attributes similar to direct payments does not diminish their ability to affect production.

[90] Exhibit US-41 (Goodwin B.K. and Mishra A. "Another Look at Decoupling: Additional Evidence on the Production Effects of Direct Payments." *American Journal of Agricultural Economics* 87(5):1200-1210 (2005), Table 3 at p. 1206).

[91] Exhibit Bra-671 (U.S. Department of Agriculture's 2007 Farm Bill Proposal, p. 14, accessed March 2007 at http://www.usda.gov/documents/07finalfbp.pdf).

[92] Exhibit Bra-671 (U.S. Department of Agriculture's 2007 Farm Bill Proposal, p. 16, accessed March 2007 at http://www.usda.gov/documents/07finalfbp.pdf).

[93] Exhibit Bra-671 (U.S. Department of Agriculture's 2007 Farm Bill Proposal, p. 16, accessed March 2007 at http://www.usda.gov/documents/07finalfbp.pdf).

b) *How would the United States respond to the argument that, by design, counter-cyclical payments are in some measure coupled to production decisions because part of the payments is contingent on the actual realization of market prices?*

69. The United States asserts that "the market price is an independent trigger" for counter-cyclical subsidies.[94] This is a remarkable assertion in view of the structure, design and operation of counter-cyclical subsidies. Brazil recalls that counter-cyclical subsidies are made with respect to a particular commodity on the basis of an institutional target price. When the market price of that commodity falls below the trigger price, counter-cyclical subsidies result. Far from being independent, market prices directly link counter-cyclical subsidies to upland cotton production. As explained above, this link is crucial for the risk reduction function of counter-cyclical subsidies. The notion that market price are an "independent trigger" is inconsistent Westcott's finding that "CCPs are linked to market prices so there may be some influence on current production decisions of farmers."[95]

70. Contrary the U.S. assertion[96], however, the evidence demonstrates that counter-cyclical subsidies not only have the potential to cause adverse effects, but that they do cause adverse effects. Brazil has addressed the alleged "mitigating factors" in its comments on the U.S. response to the previous question.

3. Economic simulation model

<u>Question to the United States</u>

32. Brazil has presented a partial equilibrium model to simulate the effects of eliminating US upland cotton payments, particularly the marketing loan and counter-cyclical payments. In both its submission and rebuttal, the United States has provided reactions to the simulation model.

a) *Would it be accurate to describe the United States' response as constituting a general acceptance of the framework of analysis adopted by Brazil but contesting the assumptions made regarding the values of the parameters, the supply and demand elasticities and the "coupling factor", used in the model? (The coupling factor is the amount by which the expected price is increased by each dollar per unit of subsidy payments.)*

71. In its response, the United States identifies a number of "important flaws" in Professor Sumner's model.[97] These are the same criticisms raised in the U.S. Oral Statement[98] and the U.S. Rebuttal Statement.[99] Professor Sumner addressed each of these issues in Brazil's Comments on the U.S. Oral Statement.[100] Brazil will not repeat these arguments here.

72. The United States also criticizes the counter-factual question that Professor Sumner's model was designed to address, *i.e.*, what would happen if marketing loan and counter-cyclical subsidies were eliminated? The United States incorrectly asserts that "to the extent that a counterfactual assessment is undertaken, it is only to assess what the price equilibrium would be at present if marketing loan and counter-cyclical payments had been *lower*, *different*, or *did not exist*."[101] First, Article 6.3 requires an counterfactual examination of effects *but for* "the subsidy." This does not

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[94] U.S. 6 March response to question 31(b), para. 28.
[95] Exhibit US-35 (Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited").
[96] U.S. 6 March response to question 31(b), para. 29.
[97] U.S. 6 March answer to question 32(a), para. 31.
[98] U.S. Oral Statement, Statement of Dr. Glauber, para. 3.
[99] U.S. Rebuttal Submission, Annex I, para. 4.
[100] Brazil's 16 January Comments on the U.S. Oral Statement, paras. 35-56.
[101] U.S. 6 March answer to questions 32(a), para. 33 (emphasis added).

involve assessing effects of a "lower" or "changed" subsidy, but "effects" of "*the* subsidy." Article 6.3 also requires assessing whether "the effect of the subsidy" "is" "significant price suppression." From a textual point of view, this requires assessment of the existence of *present* "significant price suppression" under market conditions during the reference period – not those that would exist over a sufficiently long time for any shock to result in a new equilibrium. Thus, the assessment of the effects of a subsidy is short-term and does not involve a long-term analysis.

73. These general principles are even more applicable in an Article 21.5/Article 7.8 proceeding. Any Member that makes changes to reduce or limit the subsidy still maintains the "subsidy." Articles 7.8 and 7.9 of the *SCM Agreement* require the *full* removal of all adverse effects (assuming no withdrawal of the subsidy) within only six months. This short time period also reflects the fact that the complaining Member has already endured years of market distortions through adverse effects. As a textual matter, it is thus entirely appropriate for the compliance Panel to examine the adverse effects of "the subsidy" through a counter-factual that assesses the present effects of eliminating the subsidy.

74. Finally, the United States concludes that Professor Sumner's model "grossly overstate[s] any possible effects of the marketing loan and counter-cyclical payments,"[102] and are considerably higher than the U.S. estimates applying Professor Sumner's model to others sets of parameters.[103] As explained in Brazil's Closing Statement, Professor Sumner's findings are consistent with the academic literature. The United States simulation results, on the other hand, are smaller than any other study that has examined the effects of U.S. upland cotton subsidies on world market prices.[104]

b) In its First Written Submission and Rebuttal Submission, the United States uses the same value of 1 that Brazil adopts for the coupling factor assigned to marketing loan payments. Does this imply an acceptance by the United States that, by design, marketing loan payments provide a one-for-one incentive to upland cotton production?

75. Brazil welcomes the United States acceptance of a coupling factor of 1 for marketing loan subsidies. Brazil agrees with the United States that expectations of marketing loan subsidies are what ultimately drives their production effects.[105] Brazil recalls that upland cotton farmers have expected to receive marketing loan subsidies in every year under the FSRI Act of 2002.[106] Even if farmers did not "expect" to receive marketing loan subsidies (*i.e.*, farmers expected the AWP to be above the loan rate), the marketing loan program would still provide a benefit to upland cotton farmers by eliminating the risk of lower than expected prices.[107]

76. Furthermore, as explained by Professor Sumner in his Annex I analysis[108], the impact of a reduction in expected marketing loan subsidies is at least as large as a decrease in the expected market price. In addition to the direct incentive effect, marketing loan subsidies function as a hedge against a fall in market prices. Farmers generally respond to less risk by expanding output. By this logic, it would be appropriate to assign marketing loan payments a coupling factor of greater than 1.

c) In its First Written Submission and Rebuttal Submission, the United States used a non-zero value of 0.25 (not much lower from the 0.4 that Brazil adopts) for the

[102] U.S. 6 March answer to question 32(a), para. 34.
[103] U.S. 6 March response to question 32(a), para. 34.
[104] Brazil's Closing Statement, para. 23. *See also* Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments).
[105] U.S. 6 March answer to question 32(b), para. 36.
[106] Brazil's Rebuttal Submission, paras. 106-107.
[107] *See* Brazil's Oral Statement, paras. 80-82. *See also* Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments, paras. 48-56).
[108] *See* "Analysis of Effects of U.S. Upland Cotton Subsidies on Upland Cotton Prices and Quantities by Daniel Sumner," Brazil's First Written Submission, Annex I, para. 58.

coupling factor assigned to counter-cyclical payments. Does this imply an acceptance by the United States that, by design, counter-cyclical payments are partially tied to upland cotton production, and of a magnitude (25 cents to a dollar of counter-cyclical payments) not very far from Brazil's own estimate (of 40 cents to a dollar of counter-cyclical payments)?

77. In its response, the United States asserts that "the empirical research supports a lower coupling factor, closer to zero."[109] Brazil disagrees.

78. The study cited by the United States to support this assertion examines corn, wheat and soybean acreage in the North Central region. Upland cotton is not produced in the North Central region. Most upland cotton producing regions, including the Southeast, Delta and Far West, are suitable for a number of substitute crops, such as soybeans, rice, peanuts, corn, sorghum, hay, fruits, nuts and vegetables. By contrast, the North Central region grows almost exclusively three crops – wheat, corn and soybeans. In addition, the simulation conducted by Lin and Dismukes does not examine removing the counter-cyclical subsidies for a single crop, but examines the simultaneous removal of counter-cyclical subsidies for all crops. Under these circumstances, it is not surprising that Lin and Dismukes find small acreage impacts from counter-cyclical subsidies.[110]

79. As in other studies that examine field crops in U.S. Midwest, the low acreage response to counter-cyclical subsidies is most likely driven by low elasticities of supply for wheat, corn and soybeans. This study does not examine whether counter-cyclical subsidies are decoupled from production. Instead, it examines whether counter-cyclical subsidies increase acreage for corn, wheat and soybeans in the North Central Region. This question has two parts. First, how coupled to production are counter-cyclical subsidies (*i.e.*, what is the coupling factor)? Second, what is the elasticity of supply for soybeans, wheat and corn in this region? The impact of counter-cyclical subsidies on acreage is a product of these two effects. Goodwin and Mishra's 2005 study, also cited by the United States, confirms that the elasticities of supply for soybeans, wheat and corn are low. Therefore, the effect of counter-cyclical subsidies on acreage is bound to be low, independent of whether or not counter-cyclical subsidies are coupled to production.

80. Finally, Brazil notes that this study examines only a few of the many mechanisms through which counter-cyclical subsidies might effect production. As explained by Professor Sumner, it focuses on the truncation of the effective price distribution and how an increase in wealth might reduce risk aversion, and, increase quantity supplied. The study does not examine how increased wealth might increase on-farm investment, or how counter-cyclical subsidies constrain planting choices and increase incentives to plant because of potential base updating.

81. The United States next cites the survey results in a 2005 study by Goodwin and Mishra to support its assertion that the CCP coupling factor is "closer to zero."[111] The United States seizes on the results that show that 44 percent of farmers think counter-cyclical subsidies are "not at all important" to acreage decisions.[112] As Professor Sumner explained in Exhibit Bra-659, this result is unremarkable. This is because, as the United States fails to mention, the exact same percentage of farms surveyed, 44 percent, did not have any base acres. In other words, they were not entitled to receive counter-cyclical subsidies.[113]

[109] U.S. 6 March answer to question 32(c), para. 40.

[110] Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments, para. 20).

[111] U.S. 6 March response to question 32(c), para. 40.

[112] U.S. Rebuttal Submission, para. 235.

[113] Exhibit US-41 (Goodwin B.K. and Mishra A. "Another Look at Decoupling: Additional Evidence on the Production Effects of Direct Payments." *American Journal of Agricultural Economics* 87(5):1200-1210 (2005), Table 3 at p. 1206).

82. Yet, the survey does allow a comparison of the relative importance of different variables that may affect production decisions. In this regard, Brazil notes that 23 percent of farmers also thought that expected commodity prices were "not at all important" and 20 percent thought that the cost of inputs were "not at all important." In relation to these findings, the survey results show that variable factors like counter-cyclical and direct payments are about half as important as the cost of inputs and the expected commodity price. That suggests a coupling factor of about 0.5, higher that what Professor Sumner uses in his model.

83. Brazil also notes that the survey is based on a national sample of farms. In 2002 and 2003, the years in which the survey was conducted, counter-cyclical subsidies were only made for rice, upland cotton and peanut base acres, a small subset of U.S. base acreage. Given that most farmers had not received counter-cyclical subsidies, it is reasonable that many of them indicated that counter-cyclical subsidies were "neither important nor unimportant." The fact that even some of those farmers thought that counter-cyclical subsidies were important to acreage decisions suggests their potential supply effects for crops like cotton, where the payments are large, made on a consistent basis and necessary to cover costs of production.

84. The importance of counter-cyclical subsidies in the sub-sample of upland cotton farms would be much higher than the national average, given that they are the ones who actually received the payments. Brazil recalls that when arguing for the institutionalization of counter-cyclical subsidies, the former Chairman of the National Cotton Council of America testified that "during the past three years, many cotton farmers have avoided bankruptcy only because Congress has authorized emergency relief to supplement the FAIR Act's inadequate fixed payments."[114] Emergency market loss assistance subsidies were the predecessor to counter-cyclical subsidies.

85. Contrary to United States arguments, the empirical literature does not support a coupling factor below 0.25. As Brazil has long maintained, even a coupling factor for upland cotton of 0.4 is decidedly conservative. Brazil refers the Panel to the ample evidence provided in its written submissions[115] and those of its economic expert, Professor Sumner[116], to support this position.

E. EXPORT CREDIT GUARANTEES

1. Permissibility of an *a contrario* interpretation of item (j) of the Illustrative List

Questions to the United States

33. Please discuss whether (and if so, how) the panel rulings in Korea – Vessels and Brazil – Aircraft (21.5) (I and II) affect the United States' approach to the interpretation of the relationship between item (j) of the Illustrative List and Article 3.1(a) of the SCM Agreement.

86. Brazil refers the compliance Panel to its comment on the U.S. response to question 34, below.

34. Does the United States considers that item (j) of the Illustrative List is one of the provisions to which footnote 5 of the SCM Agreement applies? What impact does this have for the United States' interpretation of the interaction between item (j) of the Illustrative List and Article 3.1(a) of the SCM Agreement?

[114] Panel Report, *U.S. – Upland Cotton*, footnote 1471, referring to Exhibit Bra-109 (Testimony (Full) of Robert McLendon, Chairman, NCC Executive Committee, Before the House Agricultural Committee. National Cotton Council (NCC)).

[115] Brazil's First Written Submission, paras. 128-131; Brazil's Rebuttal Submission, paras. 111-166; and Brazil's Opening Statement, paras. 40-53.

[116] Annex I to Brazil's First Written Submission, paras. 59-66; Annex I to Brazil's Rebuttal Submission, paras. 30-39; Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments, paras. 17-41).

87. Brazil has already explained in some detail its understanding of the interrelationship among, and proper reading of, Articles 1.1 and 3.1, the Illustrative List, and footnote 5 of the *SCM Agreement*.[117] Brazil has explained that the United States seeks an *a contrario* reading of the Illustrative List, and of item (j) in particular, and that that reading is not only incorrect, but has been rejected by both of the panels that have directly considered the United States' argument. Brazil will not repeat those arguments here, but rather incorporates them by reference, and focuses instead on aspects of the U.S. argument that have been articulated for the first time in these proceedings in the United States' answers to the Panel's questions.

88. The United States' position that item (j) "demonstrates definitively how the general definitional elements in Articles 1 and 3.1(a) of the *SCM Agreement* apply in the case of export credit guarantees"[118] rests on a textually and logically flawed understanding of the Illustrative List.

89. First, the United States maintains that each "type" of measure identified in an item – apparently any item – on the Illustrative List is defined as an export subsidy (or not) by the terms of that item's description in the Illustrative List. For example, according to the United States, item (j) "'makes clear' how the Article 1/3.1(a) definition applies in respect of each particular type of measure set out in the Illustrative List."[119]

90. This reading, however, imports into Article 3.1(a) terms that are nowhere to be found there. Article 3.1(a) specifies that subsidies contingent upon export performance "including those [export-contingent subsidies] illustrated in Annex 1" are prohibited. It does *not* say "those types [of export-contingent subsidies] defined in Annex 1" are prohibited. Yet the United States would have this Panel read such additional, and different, terms into the *SCM Agreement*. Instead of understanding the Illustrative List to comprise illustrations, or examples, of prohibited export subsidies, the United States wishes the Illustrative List to be read as definitions of types of prohibited export subsidies. That wish is without textual foundation.

91. Second, while the United States asserts that its reading of footnote 5 and the Illustrative List "is the only logical interpretation,"[120] in setting out that reading, the United States commits an elementary mistake of logic.

92. The Panel will recall that while Article 3.1(a) describes Annex I as illustrating measures that are export-contingent subsidies, footnote 5 indicates that Annex I may under certain conditions refer to measures that are not export subsidies. The United States collapses these two principles, assuming that when an item in the Illustrative List describes the circumstances in which a type of measure is an export subsidy, by automatic implication it also describes the circumstances in which that type of measure is not an export subsidy, *i.e.*, where the circumstances set out in the item are not met. For example, the United States argues that item (j) "clarifies which export credit guarantees *do* provide export subsidies within the meaning of Article 1/3.1(a) and those that *do not*"[121], and that "Annex I is relevant in determining whether or not measures constitute 'export subsidies'".[122] In other words, on the United States' view, *every* item in the Illustrative List not only identifies measures that are export subsidies, but also simultaneously identifies, by negative implication, measures that are not export subsidies.

[117] *See, e.g.,* Brazil's Rebuttal Submission, paras. 451-481; Brazil's Oral Statement, paras. 233-238; Brazil's 6 March response to question 36, paras. 37-43.
[118] U.S. 6 March response to question 33, para. 44.
[119] U.S. 6 March response to question 33, para. 44.
[120] U.S. 6 March response to question 33, para. 51.
[121] U.S. 6 March response to question 33, para. 54 (italics in original, underlining added).
[122] U.S. 6 March response to question 33, para. 47 (underlining added).

93. The premise to the United States' argument – that a statement of circumstances in which a measure constitutes an export subsidy also automatically illustrates circumstances in which a measure does not constitute an export subsidy – involves a serious logical flaw. Assume two propositions – P and Q. The statement "If P, then Q" means that if proposition P is true, then proposition Q is also true. On its own, the statement "If P, then Q" says nothing about the situation in which P is not true; where P is not true, Q is not necessarily false.[123] Consider a simple illustration. The statement that a cow is a quadruped ("If cow, then quadruped") is true. But it would be incorrect to assume that because an animal is not a cow, it is not a quadruped ("If not cow, then not quadruped").

94. Footnote 5 is consistent with this fundamental logical principle, by specifying that the Illustrative List only identifies measures that are not export subsidies where a measure is "referred to . . . as not constituting" an export subsidy ("If not P, then not Q"). Otherwise, an item in the Illustrative List does nothing more than identify circumstances under which a measure is an export subsidy ("If P, then Q").

95. Along with being logically invalid, the United States' view leaves no role at all for footnote 5 of the *SCM Agreement.* If every item of the Illustrative List can be interpreted *a contrario*, it is the United States, and not Brazil, that would have this Panel "adopt a reading that would result in reducing whole clauses or paragraphs of a treaty to redundancy or inutility".[124] Footnote 5 serves no purpose if a type of measure will always be deemed to be "*implicitly* referred to as not constituting [an] export subsid[y]"[125] whenever the definitional elements of an item on the Illustrative List covering that type of measure are not met.

96. In its response, the United States argues that if footnote 5 is read consistent with its ordinary meaning – *i.e.* as labelling "not prohibited" measures that are "referred to . . . as not constituting export subsidies" – then it would be redundant and ineffective because a measure that is not an export subsidy already would not be prohibited under Articles 1 and 3.1(a).[126]

97. The United States fails to recognize, however, that this argument is answered by its own proposition – that the term "referred to" in footnote 5 could be read to encompass more than affirmative statements that a measure is not an export subsidy.[127] The phrase "referred to" may potentially encompass less explicit references than that of the second paragraph of item (k), such as items (h) and (i)'s "provided that" clauses or the first and last sentences of Footnote 59. The panel in *Brazil – Aircraft (21.5)* also embraced that possibility.[128] Where Brazil parts ways with the United States is at the U.S. suggestion that *all* measures of the types referred to in items on the list are "implicitly referred to" whenever they fall short of the items' terms. This renders the action verb "refer" completely passive. The U.S. position reads out any requirement whatsoever that the text of an item in the Illustrative List contain an actual "reference", *i.e.*, a positive or deliberate signal by WTO Members that a measure is being characterized as not being an export subsidy.

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[123] *See, e.g.,* "Critical Thinking and Argumentation" (Identifies one of the "most common logical errors" as "If A then B, then it is not the case that If Not A then Not B".), available at http://www.staffs.ac.uk/schools/humanities_and_soc_sciences/philosophy/.resource/critthink.html. *See also* Exhibit Bra-672 (Rangarajan Sundaram, *A First Course in Optimization Theory* (Cambridge Univ. Press, 1996) at Appendix A, Set Theory and Logic: An Introduction, p. 245) ("Given two propositions P and Q, the statement 'If P then Q" is interpreted as the statement that if the proposition P is true, then the statement Q is also true. ... We stress the point that ['If P then Q] only says that if P is true, then Q is also true. It has nothing to say about the case where P is *not* true; in this case, Q could be either true or false.").

[124] Appellate Body Report, *U.S. – Gasoline*, p. 23.

[125] U.S. 6 March response to question 33, para. 48.

[126] U.S. 6 March response to question 33, para. 52.

[127] U.S. 6 March response to question 33, para. 48.

[128] Panel Report, *Brazil – Aircraft (21.5)*, para. 6.36.

98. The same observation, that footnote 5 potentially extends beyond item (k), second paragraph, also answers a U.S. assertion regarding the negotiating history of footnote 5.[129] According to the United States, the negotiating history leads to the conclusion that "referred to" requires no "reference" at all – *i.e.* no affirmative statement or indication that a measure is not an export subsidy. The United States rests this conclusion on the fact that an earlier text of Footnote 5 included the word "expressly" before "referred to", while the final version uses only "referred to".

99. But the panels in both *Brazil – Aircraft (21.5)* and *Korea – Vessels* considered this very same argument, and the very same negotiating history, and rejected the reading that the United States here puts forward.[130] Those panels concluded that although the change may have broadened the scope of footnote 5, perhaps to reach provisions like items (h) and (i)'s proviso clauses, it cannot be read as broadly as the United States proposes. The panels considered that the negotiating history was at most inconclusive, and that it could not drive them to disregard the plain meaning of footnote 5's "referred to" requirement.

100. As Brazil has explained, the items on the Illustrative List offer claimants a *per se* evidentiary path to establish that a measure is an export subsidy prohibited under Articles 1 and 3.1(a). The United States has objected that on this approach, item (d) would be rendered inutile; according to the United States, claimants would never use item (d) to prove the existence of an export subsidy, because item (d) requires not only proof of the same "benefit" that would have to be established under Articles 1 and 3.1(a), but also further proof of preferential treatment of exports relative to products for domestic consumption.

101. The United States' view rests on too narrow a reading of Articles 1 and 3.1(a), however. In fact, *both* parts of item (d) track the showing that would need to be made under Articles 1 and 3.1(a) directly: the preferential treatment requirement that the United States claims is additive can rather be seen as the parallel to Article 3.1(a)'s export contingency requirement, but without the specific Article 1 elements of proof such as "financial contribution." Thus, item (d) does still provide a useful *per se* evidentiary path for establishing a violation of Articles 1 and 3.1(a).

102. For the reasons above, and those set forth in Brazil's earlier submissions, the United States' advocacy of an *a contrario* reading of item (j) should be rejected.

35. How does the United States address Brazil's argument that permitting an a contrario reading of item (j) would prevent a Member from challenging specific export credit guarantees or cohorts of such guarantees granted by a Member, as opposed to export credit guarantee programs [see paragraphs 472 ff. of Brazil's Rebuttal]

103. The United States has advanced the remarkable proposition that the only measure of an ECG's consistency with the *SCM Agreement* is whether the ECG program under which that guarantee is issued charges premia that cover its long-term operating costs and losses. Thus, the United States maintains that a complaining Member can only succeed in establishing that individual ECGs are contrary to the prohibited subsidy disciplines of the *Agreement* if those ECGs were granted under an ECG program that does not break even.[131]

104. Brazil has explained that this interpretation conflicts with the text of Articles 1 and 3.1, and that it is not plausible that the U.S. approach reflects the Members' intent in this regard.[132] Brazil

[129] U.S. 6 March response to question 33, para. 50.
[130] Panel Report, *Brazil – Aircraft (21.5)*, paras. 6.39-6.41; Panel Report, *Korea – Vessels*, paras. 7.200-7.201.
[131] U.S. 6 March response to question 35, para. 60.
[132] Brazil's Rebuttal Submission, paras. 472-476.

would only note here that the U.S. approach is inconsistent with the United States' own position regarding the proper application of item (j) of the Illustrative List.

105. The United States has explained its view that for "each particular type of measure set out in the Illustrate [*sic*] List", the item constitutes the exclusive and definitive means for determining whether the measure is or is not a prohibited export subsidy within the meaning of Articles 1 and 3.1(a).[133]

106. Even accepting that an item in the Illustrative List fully occupies the field for the "type" of measure addressed in the item (a proposition that Brazil rejects), the "type" of measure identified in item (j) is "export credit guarantee or insurance programmes" or "exchange risk programmes". Thus, by the United States' own reasoning, challenges to individual ECGs should not be governed by item (j) at all, as that item deals only with the "programmes." In support of its product-specific circumvention claims under Article 10.1 of the *Agreement on Agriculture*, Brazil has established the existence of an export subsidy in several ways. For instance, Brazil has demonstrated that under a country-by-country, tenor-by-tenor benchmarking analysis, GSM 102 ECGs constitute export subsidies because they are export-contingent financial contributions offered on terms that confer "benefits".

107. Even if item (j) occupies the field, by the terms of the U.S. argument, it does so only with respect to the measures it addresses – "export credit guarantee or insurance programmes" and "exchange risk programmes". It says nothing about the circumstances under which, for example, individual ECGs constitute export subsidies, and thus does not address the demonstration described by Brazil in the previous paragraph. Specifically, Brazil's approach under Articles 1/3.1(a) proves that GSM 102 ECGs are export subsidies, *country-by-country*, and *tenor-by-tenor*. Brazil's approach under item (j) proves that the GSM 102 ***program*** is an export subsidy.

Questions to Brazil

36. What is Brazil's reading of the Appellate Body's statement in paragraph 80 of its Report in Brazil – Aircraft (21.5) that it "... would have been prepared to find that the payments made under the revised PROEX are justified under item (k) of the Illustrative List"? Should the Panel take this statement into account in deciding whether item (j) can be interpreted a contrario*?*

2. Outstanding export credit guarantees / measures taken to comply

Questions to Brazil

37. Brazil relies on the panel and Appellate Body Reports in Brazil – Aircraft (21.5) in support of its arguments that the United States has not "withdrawn" the subsidy and is, "[a]t a minimum... prohibited from making 'payments' on claims against" any outstanding export credit guarantees [Paragraph 397 of Brazil's Rebuttal Submission]. Please discuss how the findings of the panel and Appellate Body in that case apply to the provision of the US export credit guarantees at issue.

3. "Benefit" under Articles 1 and 3.1(a) of the *SCM Agreement*

Question to the United States

38. Please discuss the relevance of the original panel's characterization, in paragraph 6.31 of its report, of Brazil's reliance on Articles 1 and 3.1(a) of the SCM Agreement as "not a separate claim, but merely another argument" on the United States' view in this respect (and notably the United States statement, in paragraph 67 of its First Written Submission, that "... the panel in the original

[133] U.S. 6 March response to question 35, para. 44.

proceeding specifically declined to address Brazil's alleged 'claim' under Articles 1 and 3.1(a) of the SCM Agreement")?

108. The lack of precision in the United States' response is alarming. To be precise, Brazil is making two claims. First, Brazil claims that the United States applies export subsidies in a manner that results in circumvention of its export subsidy commitments for unscheduled products, and for rice, pig meat and poultry meat, in contravention of Articles 10.1 and 8 of the *Agreement on Agriculture*. Second, and as a result of the first violation, Brazil claims that the United States maintains export subsidies, in contravention of Articles 3.1(a) and 3.2 of the *SCM Agreement*.

109. As one element of these claims, Brazil must demonstrate the existence of an export subsidy. It has done so in two ways. First, invoking the elements of Articles 1 and 3.1(a) of the *SCM Agreement*, Brazil has demonstrated that GSM 102 ECGs are export subsidies because they are export contingent financial contributions provided to recipients on below-market terms. Second, invoking the elements of item (j) of the Illustrative List in the alternative, Brazil has demonstrated that the GSM 102 program is an export subsidy because the Commodity Credit Corporation fails to charge premia sufficient to meet its long-term operating costs and losses.

110. Whether these are separate *claims*, or instead separate *arguments*, is irrelevant in the circumstances of these Article 21.5 proceedings. In *Canada – Aircraft (21.5)*, the Appellate Body concluded that the claims and arguments at issue in Article 21.5 proceedings will naturally differ from the claims and arguments at issue in the original proceedings:

> *[I]n carrying out its review under Article 21.5 of the DSU, a panel is not confined to examining the "measures taken to comply" from the perspective of the claims, arguments and factual circumstances that related to the measure that was the subject of the original proceedings*. Although these may have some relevance in proceedings under Article 21.5 of the DSU, Article 21.5 proceedings involve, in principle, not the original measure, but rather a new and different measure which was not before the original panel. In addition, the relevant facts bearing upon the "measure taken to comply" may be different from the relevant facts relating to the measure at issue in the original proceedings. It is natural, therefore, that *the claims, arguments and factual circumstances which are pertinent to the "measure taken to comply" will not, necessarily, be the same as those which were pertinent in the original dispute*. Indeed, the utility of the review envisaged under Article 21.5 of the DSU would be seriously undermined if a panel were restricted to examining the new measure from the perspective of the claims, arguments and factual circumstances that related to the original measure, because an Article 21.5 panel would then be unable to examine fully the "consistency with a covered agreement of the measures taken to comply," as required by Article 21.5 of the DSU.[134]

111. If invoking the elements of Articles 1 and 3.1(a), on the one hand, and of item (j), on the other, are separate *claims*, Brazil has demonstrated that none of the limits subsequently imposed by the Appellate Body on the claims properly subject to Article 21.5 review apply.[135]

112. As argued on appeal in the original proceedings, Brazil considers that invoking the elements of Articles 1 and 3.1(a), on the one hand, and of item (j), on the other, are indeed separate claims. Among other reasons, Brazil notes that the approaches involve the proof of separate things. As noted in Brazil's comment on the U.S. response to question 35, Brazil's approach under Articles 1 and 3.1(a) proves that GSM 102 ECGs are export subsidies, country-by-country, and tenor-by-tenor.

[134] Appellate Body Report, *Canada – Aircraft (21.5)*, para. 41 (emphasis added).
[135] Brazil's 26 February response to question 6, paras. 10-62.

Nonetheless, if, as the United States insists[136], invoking the elements of Articles 1 and 3.1(a), on the one hand, and of item (j), on the other, are separate *arguments*, the Appellate Body's statements in *Canada – Aircraft (21.5)* leave Brazil free to pursue both arguments in these Article 21.5 proceedings, and no subsequent jurisprudence holds otherwise.

113. The United States' proposition that because the recommendation and ruling of the DSB to "withdraw the subsidy" was based on a finding by the original panel and the Appellate Body that the GSM 102 program constitutes an export subsidy under item (j), the compliance Panel's assessment should both start[137] and, indeed, end[138] with an assessment of the GSM 102 program under item (j), should be rejected. The U.S. view enjoys no support in the covered agreements or the jurisprudence.

114. To leave not a shadow of doubt, Brazil has requested review by the compliance Panel of Brazil's evidence and argument under item (j) solely if the compliance Panel does not consider sufficient the evidence and argument raised by Brazil under Articles 1 and 3.1(a).[139] As previously noted by Brazil, this position applies whether or not the Articles 1/3.1(a) and the item (j) approaches are separate *claims*, or instead separate *arguments*.[140]

115. First and foremost, Brazil seeks a finding that GSM 102 ECGs constitute export contingent financial contributions provided to recipients on below-market terms. Given the low cost of funds enjoyed by the CCC and the backing offered the GSM 102 program by the U.S. Treasury, merely charging premia sufficient to break even is insufficient.[141] Recipients of GSM 102 ECGs are receiving guarantees on terms that are well below market. By arguing item (j) strictly in the alternative, Brazil seeks to avoid a repeat of the original proceedings, where the dispute was evidently not, as the United States' alleges, "resolved".[142]

116. The United States asserts that "this dispute could and should be resolved through *implementation* of the recommendations and rulings of the DSB *based on the factual findings under item (j)*."[143] This assertion reflects a fundamental misunderstanding of the nature of Article 21.5 proceedings. As Brazil has noted elsewhere, the United States cannot escape its obligations by arguing that it relied on the factual and legal basis for the original panel's finding that the GSM 102 program constitutes an export subsidy – item (j) of the Illustrative List. The question in these compliance proceedings is not limited to whether the United States has cured the basis on which the original panel found a violation. Instead, the Appellate Body has emphasized that the question for a compliance panel is whether the "new measure" is consistent with all obligations in the covered agreements.[144]

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[136] U.S. 6 March response to question 38, paras. 62-63. *See also* U.S. First Written Submission, para. 64 (footnote 97).

[137] U.S. First Written Submission, paras. 66, 67.

[138] U.S. 6 March response to question 38, para. 65.

[139] Brazil's Oral Statement, paras. 225-227; Brazil's First Written Submission, para. 363.

[140] Brazil's First Written Submission, para. 363.

[141] Brazil's Oral Statement, para. 228 ("The CCC enjoys a low cost of funds, by virtue of the fact that it borrows from the U.S. Treasury and benefits from the full faith and credit of the U.S. government. It is entirely possible that the GSM 102 program could charge fees that meet its costs and losses, but that are, at the same time, below what would be charged by a market-based entity.")

[142] U.S. 6 March response to question 38, para. 65.

[143] U.S. 6 March response to question 38, para. 63 (emphasis added).

[144] Appellate Body Report, *Canada – Aircraft (21.5)*, para. 40. *See also Id.*, para. 41 (In Article 21.5 proceedings, "a panel is not confined to examining the 'measures taken to comply' from the perspective of the claims, arguments and factual circumstances that related to the measure that was the subject of the original proceedings.").

117. In any event, the Panel will recall that "full *withdrawal* of a prohibited subsidy within the meaning of Article 4.7 of the *SCM Agreement* cannot be achieved by a 'measure taken to comply' that replaces the original subsidy with yet another subsidy found to be prohibited."[145]

118. Even had the United States withdrawn the elements of the GSM 102 program that made it an export subsidy under item (j), it would not have achieved full withdrawal of the subsidy in the present circumstances, since it has "replace[d] the original subsidy with yet another" prohibited subsidy – the provision of export-contingent GSM 102 ECGs at below-market fees. It has, therefore, failed to achieve "full withdrawal" of the subsidy, consistent with the Article 4.7 recommendation. In urging the Panel not to examine whether its compliance measure confers export-contingent "benefits", the United States seeks precisely to escape its obligation to <u>fully</u> withdraw the prohibited subsidy.

<u>Questions to Brazil</u>

39. The Panel understands the United States to argue that it has relied on the Panel's findings under item (j) to implement the DSB recommendations with respect to export credit guarantees. How would this, in Brazil's view, affect the compliance panel's role in this proceeding? Was the United States also expected to implement changes in order to make its export credit guarantee programmes consistent with article 1.1 and 3.1(a) of the SCM Agreement, even though there were no findings of the original panel in this respect?

40. In paragraph 410 of its Rebuttal, Brazil refers to paragraph. 7.398 of the Panel Report in Canada – Aircraft II. The Panel notes, however, that in the same paragraph, the Canada – Aircraft II panel also indicated that there would be a "'benefit' when the cost-saving for a Bombardier customer for securing a loan with an IQ loan guarantee is not offset by IQ's fees". Please discuss, in light of this sentence, whether the Panel should read the Canada – Aircraft II panel as having rejected the "total cost of funds" as the proper benchmark under Article 14(c) of the SCM Agreement.

<u>Questions to both parties</u>

41. What are the relevant considerations to guide the Panel in the selection of a market benchmark in this case?:

a) That the institution that provides the product is, on the whole, or on a program or product-specific basis, profitable? If so, is "any" profit sufficient to qualify an institution/ product/program as a relevant "market benchmark" or must the institution/product/program achieve a certain level of profit? Must the Panel conduct an examination of the level of profit achieved by commercial or private actors operating in the field?

b) Are the institution/program/products' stated goals relevant in assessing whether they can be used as a "market benchmark"?

c) Is the "governance" of the institution relevant?

d) What other factors are relevant?

[145] Appellate Body Report, *U.S. – FSC (21.5 II)*, para. 83 (italic emphasis in original; underlining supplied).

119. In its response, as elsewhere in these proceedings, the United States asserts that the only way to assess the WTO consistency of an ECG program is under the "cost to government" standard in item (j).[146] Brazil has rebutted this assertion elsewhere, and will not repeat those arguments here.[147] As noted above in comments on the U.S. response to question 35, however, even if item (j) satisfies the terms of footnote 5 to the *SCM Agreement*, it would serve as no defense to Brazil's demonstration that GSM 102 ECGs (rather than the GSM 102 program) constitute export subsidies.

120. The United States also asserts that even if the "cost to government" standard under item (j) is not determinative, the only way to determine the existence of a "benefit" from an ECG in an export subsidy case is through a quantitative assessment under what it deems the "total cost of funds" approach in Article 14(c).[148] Again, Brazil has rebutted this assertion elsewhere, given the circumstances of this dispute, and will not repeat those arguments here.[149]

121. Brazil notes, however, that the United States grossly misrepresents the findings of two panels that have applied a fee-based comparison as an expression of the standard in Article 14(c). In describing the analysis in *EC – DRAMS*[150], the United States ignores a critical passage from the panel report:

> One possible approach … would be to compare the guarantee provided by the government with a comparable guarantee provided by the market. *If the government charges less than a market fee for its guarantee in light of the specific circumstances of the case, there would be a benefit to the recipient.*[151]

122. Moreover, the United States misrepresents the finding of the panel in *Canada – Aircraft Credits and Guarantees*. The panel in that dispute indeed concluded that "it is safe to assume that such cost difference would not be covered by [guarantee] fees if it is established that [the guarantee] fees are not market-based."[152] The panel did not, as the United States asserts, "*require[]* Brazil, as the complaining party, to provide 'arguments or information regarding what the [airline] might have had to pay on a *comparable commercial loan* absent the *IQ* loan guarantee.'"[153] Rather, the panel found that Brazil had not made a showing either that the airline secured better terms on a commercial loan with the government guarantee, or that "IQ's fee for its loan guarantee to [the airline] is not market based."[154] The panel report does not support the conclusion drawn by the United States – that the "total cost of funds" approach suggested by the United States is "required" as the sole, determinative standard. In fact, the panel report supports Brazil's position, which is that in light of the

[146] U.S. 6 March response to question 41, para. 66.

[147] Brazil's Closing Statement, para. 24; Brazil's Oral Statement, paras. 225-238; Brazil's Rebuttal Submission, paras. 454-481.

[148] U.S. 6 March response to question 41, paras. 67-70; U.S. Opening Statement (Check against delivery version), paras. 31-39; U.S. Rebuttal Submission, paras. 137-144; U.S. First Written Submission, paras. 107, 133-134, 138.

[149] Brazil's Closing Statement, paras. 28-29; Brazil's Oral Statement, paras. 193-208; Brazil's Rebuttal Submission, paras. 400-413.

[150] U.S. Comments on Brazil's Oral Statement, para. 17.

[151] Panel Report, *EC – CVDs on DRAMs*, para. 7.189 (emphasis added). Under its fee-based approach, the panel continued to find a *per se* basis on which to establish that a government guarantee confers a "benefit". *See Id*. ("We note in this respect, that none of the parties (...) before us in the course of the panel proceedings has argued that a private market operator would have provided an export guarantee similar to the one that was provided by the KEIC so that the fees could be compared. This implies that, if one opts to examine benefit by looking at the difference between the government providing a financial contribution, and the market doing so, *then it would be clear that a benefit was provided, as no private market operator was even argued to have been willing to provide such a guarantee*.") (emphasis added).

[152] Panel Report, *Canada – Aircraft Credits and Guarantees*, para. 7.345.

[153] U.S. Comments on Brazil's Oral Statement, para. 18 (emphasis in original).

[154] Panel Report, *Canada – Aircraft Credits and Guarantees*, para. 7.399.

circumstances, a fee-based comparison is one acceptable means of showing the "benefit" from a government guarantee.

123. Turning to the remainder of the U.S. response, Brazil notes its general agreement with the United States' observation that "factors such as the overall profitability of a particular institution or its stated goals, or the manner of its governance, may not necessarily – and in all cases – correlate to whether the loan is 'commercial'".[155] However, this observation is considerably more muted than the United States' categorical observation, when measures other than its own were at issue, that evidence regarding an entity's profitability is "irrelevant" to the assessment of "benefit" under Article 1.1(b).[156] Brazil tends to agree with this latter, stronger sentiment, for the reasons stated in its own response to question 41.[157]

124. Brazil turns to comments on the "evidence" offered by the United States in an attempt to rebut Brazil's showing that GSM 102 ECGs are unique financing instruments with no parallel at market, and that the entire purpose of the GSM 102 program is to facilitate credit for foreign obligors that do not enjoy other options at market. In these circumstances, Brazil argues that GSM 102 ECGs confer "benefits" and constitute subsidies *per se*. (Brazil has also demonstrated, country by country, and tenor by tenor, that GSM 102 fees are dramatically below even non-market benchmarks, and therefore confer "benefits" on U.S. exporters.[158])

125. **First**, the Panel will recall Professor Sundaram's conclusion that there is no commercial credit protection product available in the marketplace that is comparable to a GSM 102 ECG.[159] The Panel will note that the United States has not provided a single example of a product offered by a market-based entity that imparts the essential qualities of a GSM 102 ECG cited by Professor Sundaram.

126. The United States attempts to draw support from *Brazil – Aircraft* for its position that government guarantees cannot confer "benefits" *per se*, just because they are unique financial instruments with no parallel at market. The United States argues that this position must be correct, because in *Brazil – Aircraft*, "[t]he panel did not consider whether PROEX payments were a 'unique financial instrument'."[160] As is evident from a cursory review of the report, however, the panel did not undertake this consideration because the complaining Member, Canada, did not make such a claim. In those circumstances, it is not surprising that the panel did not consider it. Indeed, in those circumstances, it would have constituted reversible error for the panel to have done so.

127. In any event, Brazil finds the U.S. position most surprising. The United States has recently argued that unique support without any parallel at market, provided to recipients who are not otherwise creditworthy, should not only be considered a subsidy, but should be a *prohibited* subsidy *per se*. The United States has argued that prohibited subsidies should include "… egregious government intervention such as … lending to … companies with poor financial prospects unable to attract commercial financing or other funding of companies or projects that would not otherwise receive conventional commercial financing."[161] Moreover, in *Canada – Aircraft Credits and*

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[155] U.S. 6 March response to question 41, para. 69.

[156] Response of the United States to Questions from the Parties, *Korea – Measures Affecting Trade in Commercial Vessels*, 22 March 2004, paras. 6-7, accessed February 2007 at http://www.ustr.gov/assets/Trade_Agreements/Monitoring_Enforcement/Dispute_Settlement/WTO/Dispute_Settlement_Listings/asset_upload_file769_5561.pdf.

[157] Brazil's 6 March response to question 41, paras. 58-66.

[158] Brazil's First Written Submission, paras. 381-406. *See also Id.*, Annexes III (Statement of Professor Rangarajan Sundaram) and IV (Methodology for Comparison of GSM 102 Fees with Fees for ExIm Bank Products), and Exhibits Bra-536 and Bra-537.

[159] Brazil's First Written Submission, paras. 377-378, and Annex III (Statement of Professor Rangarajan Sundaram), para. 7.

[160] U.S. Comments on Brazil's Oral Statement, para. 22.

[161] TN/RL/GEN/94 (16 January 2006).

Guarantees, the United States similarly argued that where the government offers a unique product that can not be replicated at market, a benefit is conferred *per se*.[162]

128. **Second**, the Panel will recall the statement in the GSM 102 regulations that the program operates "where U.S. financial institutions would be unwilling to provide financing without CCC's guarantee," and "where the guarantee is necessary to secure financing of the export."[163] Similarly, in a self-assessment of the program, USDA's Foreign Agriculture Service ("FAS") repeatedly notes that "[t]he program is primarily targeted to countries not considered to be investment grade", and that it is in place to "make commercial credit available at a reduced cost to higher risk markets."[164] In fact, GSM 102 administrators consider the program to be successful if, among other things, foreign obligors in countries that have improved their financial standing and reached investment grade stop using the program.[165]

129. In these circumstances, where no financing would be available without a government guarantee, the guarantee confers a "benefit" *per se*. As noted by the panel in *EC – DRAMS*, where no commercial loan could be secured by a recipient in the absence of a government guarantee, a benefit exists *per se*.[166]

130. To support its *per se* claim, Brazil has relied on Professor Sundaram's statement[167] and the types of normative statements made by the U.S. government concerning the GSM 102 program, quoted above. Nonetheless, the United States considers that "[t]hese arguments do not square with the **evidence** submitted by the United States showing that **such** obligors are in fact able to obtain financing even without GSM 102 guarantees and on terms better than those available *with* GSM 102 guarantees."[168]

131. In this sentence, the United States employs a sleight of hand with its use of the words "evidence" and "such" – meaning presumably GSM 102 – obligors.

132. The United States does not cite to the "evidence" it has offered in this regard. The United States may be referring to the three examples of syndicated loans described in a letter from [[ ]], a U.S. bank and significant participant in the GSM 102 program.[169] This letter and these loans hardly meet the standard of "evidence", for a number of reasons.

[162] Panel Report, *Canada – Aircraft Credits and Guarantees*, Annex C-2 (para. 7) ("If the commercial market does not offer a particular borrower the exact terms offered by the government, then the government is providing a benefit to the recipient whenever those terms are more favourable than the terms that are available in the market.").

[163] Exhibit Bra-519 (7 C.F.R. § 1493.10(a)(2), GPO Access Online, January 2006, accessed July 2006 at http://www.gpoaccess.gov/cfr/index.html) (emphasis added).

[164] Exhibit Bra-588 (Agricultural Export Credit Guarantee Programs Assessment, ExpectMore.gov, Section 5.1, accessed January 2007 at http://www.whitehouse.gov/OMB/expectmore/detail.10002020.2005.html). For other similar excerpts, *see* Brazil's Rebuttal Submission, para. 418.

[165] Exhibit Bra-588 (Agricultural Export Credit Guarantee Programs Assessment, ExpectMore.gov, pg. 10 (section regarding "Program Performance Measures"), accessed January 2007 at http://www.whitehouse.gov/OMB/expectmore/detail.10002020.2005.html) ("measures how much export credit guarantee use declines per year in countries that reach investment grade and how much U.S. agricultural exports increase to those countries").

[166] Panel Report, *EC – CVDs on DRAMs*, para. 7.190.

[167] Brazil's First Written Submission, Annex III (Statement of Professor Rangarajan Sundaram), para. 7.

[168] U.S. 6 March response to question 41, para. 70 (bold and underline added; italics in original).

[169] U.S. Rebuttal Submission, paras. 146-153; U.S. First Written Submission, paras. 119-131; Exhibit US-22.

133. The United States has not provided any documentary evidence at all to establish any of the facts of these alleged transactions; in Exhibit US-22, it relies instead on a single secondary source, a brief statement by an [[ ]] to characterize them. The absence of such documentary evidence deprives the compliance Panel of the opportunity to examine the validity, much less the representativeness, of the only three data points that the United States offers. In contrast, Brazil has offered exhaustive analyses of GSM 102 and ExIm fees based on over one thousand data points, all of which are transparent and readily replicable by the United States and this compliance Panel.

134. What little we know about the three examples offered by the United States does not inspire confidence in the quality of the "evidence". One of the three examples, that of the [[ ]] bank, shows that GSM 102 places the bank in a <u>better</u> position than it would have been in the market.[170] This "evidence" quite evidently does not establish, as the United States asserts in its response to question 41, that GSM 102 foreign obligors are able to obtain commercial financing without GSM 102 guarantees, "on terms better than those available *with* GSM 102 guarantees."[171] The second of the three examples, concerning the [[ ]] banks, is not a real example at all, since [[ ]] tells us it "[[ ]]."[172]

135. That leaves precisely one data point, the example concerning the [[ ]] bank. Apparently on the basis of this <u>one data point</u>, the United States remarkably believes that it has demonstrated that a "<u>large number of</u> investment-grade participants" can obtain financing at lower annualized costs than under GSM 102.[173]

136. This one data point does not, as the United States asserts, constitute "<u>**evidence**</u>" that "<u>**such**</u> [*i.e.*, GSM 102 foreign] obligors are in fact able to obtain financing even without GSM 102 guarantees and on terms better than those available *with* GSM 102 guarantees."[174] The United States has not demonstrated that the [[ ]] bank – or, indeed, the banks in the other two examples – are GSM 102 foreign obligors.[175] The United States has not identified the bank (much less provided the loan documents[176]), to allow Brazil and the Panel to determine whether the bank indeed features on the list of CCC-approved foreign obligors published on the GSM 102 website.[177] Thus, while the United States asserts that it has provided "evidence" regarding "such" GSM 102 foreign obligors, it has done no such thing.

137. What is more, the United States has failed to show that the banks in its examples are even <u>similar</u> to GSM 102 foreign obligors. The United States has stated that the [[ ]] and [[ ]] banks are investment grade.[178] As noted above, the entire objective of the GSM 102 program is to

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[170] Brazil's Rebuttal Submission, para. 426.

[171] U.S. 6 March response to question 41, para. 70.

[172] Exhibit US-22.

[173] U.S. Comments on Brazil's Oral Statement, para. 15 (emphasis added).

[174] U.S. 6 March response to question 41, para. 70 (bold and underline added; italics in original).

[175] For similar reasons, it is false for the United States to assert that it has provided evidence "showing that commercial lenders regularly involved in both the GSM-102 program and other lending ... do provide – and have provided – unsecured financing to foreign banks <u>that are CCC-approved obligors</u> ...." U.S. Comments on Brazil's Oral Statement, para. 12 (emphasis added).

[176] By refusing to provide the loan documents, the United States has deprived Brazil and the Panel of the opportunity to test the many assertions made by the United States regarding factual elements of the loans in paragraphs 119-130 of its First Written Submission, and paragraphs 146-153 of its Rebuttal Submission. In fact, in its Rebuttal Submission, the United States fails to offer even *indirect* evidence to support its assertions; while it appears to quote from a second [[ ]] communication, it does not even provide that communication (though as noted above, the communication in itself would be insufficient). U.S. Rebuttal Submission, paras. 149, 150.

[177] *See* <u>http://www.fas.usda.gov/excredits/foreignbanks.html</u>.

[178] U.S. Rebuttal Submission, para. 150.

provide cover for, and therefore to enable credit in, countries that are below investment grade. In its self-assessment of the program, USDA goes out of its way to emphasize, in passage after passage, that the program is primarily targeted to non-investment grade countries.[179] The examples provided by the United States do not prove anything about the ability of foreign obligors like those targeted by GSM 102 "to obtain financing even without GSM 102 guarantees."[180]

138. Moreover, the United States inaccurately asserts that Brazil "acknowledges" that the [[ ]] examples show lower annualized costs than under GSM-102[181], Brazil recalls that it has heavily criticized the [[ ]] examples, both for lack of evidentiary veracity and as not offering a valid comparison.[182]

139. In addressing Professor Sundaram's critique of the U.S. "average life" approach, the United States asserts that short- and long-term ratings are the same; as a result, the United States argues that if it shows that the short-term borrowing cost is lower than some threshold amount, it follows that the long-term borrowing costs are also lower.[183] This is false. For the "same" rating category, borrowing rates vary substantially based on maturity.[184] The correlation between short- and long-term rates for borrowers in a single rating category is not as suggested by the United States.

140. The United States erroneously argues that in its critique of the [[ ]] examples, Brazil ignores "the pricing of risk inherent in the transactions".[185] The United States mischaracterizes Brazil's critique. Brazil's critique is simple: that bullet loans (such as those in the [[ ]] examples) and amortizing loans (such as those backed by GSM 102 ECGs) are not comparable, because they involve different patterns of default exposure.[186] The United States' comments are not responsive to this critique. Rather, the United States asserts that bullet loans and amortizing loans are comparable, because in an amortizing loan, one third of the principal gets paid earlier, and one third gets paid later, than the bullet loan.[187] This argument merely reinforces Brazil's critique – the patterns of exposure in these two different types of loans are different, making the comparison the United States seeks to make invalid.

4. Claims under item (j) of the Illustrative List

Questions to the United States

42. How does the United States address Brazil's arguments with respect to the MPRs under the OECD Arrangement?

141. The United States' response fails to address the purpose for which Brazil offered the comparison between OECD MPRs and GSM 102 fees. As noted in its response to question 43, Brazil does not contend that the OECD MPRs constitute a strict quantitative benchmark for analysis of the U.S. upland cotton ECG fees. Rather, this comparison offers the compliance Panel a *qualitative* reference point for appreciating the degree to which GSM 102 fees fall below internationally-accepted

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179 *See* Brazil's Rebuttal Submission, para. 418.
180 U.S. 6 March response to question 41, para. 70 (bold and underline added; italics in original).
181 U.S. Comments on Brazil's Oral Statement, para. 12.
182 Brazil's Closing Statement, para. 26; Brazil's Oral Statement, paras. 209-223; Brazil's Rebuttal Submission, paras. 420-432.
183 U.S. Comments on Brazil's Oral Statement, para. 14.
184 S. Trück et al, "The Term Structure of Credit Spreads and Credit Default Swaps – an empirical investigation", September 2004, available at http://www.pstat.ucsb.edu/research/papers/spreads200904.pdf (finding a positive relationship between maturity and spreads could be observed for investment grade debt).
185 U.S. Comments on Brazil's Oral Statement, para. 15.
186 Brazil's Oral Statement, paras. 211-215, 219-222.
187 U.S. Comments on Brazil's Oral Statement, para. 15.

standards for ECG programs that are, according to the OECD, structured and designed to break even.[188]

142. The United States asserts that use of any external reference point, like the OECD MPRs, to determine whether an ECG program breaks even is not permitted. According to the United States, use of any such external reference point is only allowed if the particular reference point is specifically mentioned in "[t]he text of the *SCM Agreement* . . ."[189]

143. The U.S. position is untenable. The original panel noted that "item (j) does not set forth, or require us to use, any one particular methodological approach nor accounting philosophy in conducting our examination."[190] Despite this fact, the original panel referred to, and the Appellate Body confirmed, reliance on a number of different external reference points, including one supported by the United States in these Article 21.5 proceedings – the net present value methodology required by the U.S. Federal Credit Reform Act of 1990 ("FCRA"). The FCRA is not, of course, referred to in the text of the *SCM Agreement*.

144. Panels and the Appellate Body have frequently relied on reference points and benchmarks external to and not specified in the text of the *SCM Agreement*. Virtually every benchmark used for the purposes of assessing the "benefit" flowing from a government financial contribution will be drawn from sources external to the *SCM Agreement*. The U.S. position notwithstanding, the Appellate Body has even relied on reference points or benchmarks drawn from the OECD Export Credit Arrangement, even where the provision of the *SCM Agreement* at issue did not specifically direct the interpreter to do so. In interpreting the phrase "used to secure a material advantage in the field of export credit terms", from paragraph 1 to item (k) of the Illustrative List, the Appellate Body concluded that

> the *OECD Arrangement* can be appropriately viewed as one example of an international undertaking providing a specific market benchmark by which to assess whether payments by governments, coming within the provisions of item (k), are "used to secure a material advantage in the field of export credit terms".[191]

145. Here, as in *Brazil – Aircraft*, the context suggests that the OECD Arrangement is an appropriate reference point. Paragraph 1 of item (k) – like item (j) – speaks to export credits, which are, after all, covered by the OECD Arrangement. In that circumstance, the Appellate Body found that paragraph 2 of item (k), and the reference therein to the OECD Arrangement, formed relevant context for the identification of a benchmark for the purposes of paragraph 1 of item (k), even if paragraph 1 did not specifically mention the Arrangement. Similar considerations could apply to item (j), which similarly addresses export credits covered by the OECD Arrangement.

146. The OECD Arrangement does not establish *the only* standard for the fees that ought to be charged for export credit guarantees in order to meet the standard set in item (j). This, however, does not invalidate the use of the OECD MPRs as useful reference points for a showing that GSM 102 fees are not designed to cover long-term operating costs and losses of the program. The United States'

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[188] Brazil's 6 March response to question 43, para. 69; Brazil's Oral Statement, para. 51.

[189] U.S. 6 March response to question 42, para. 71.

[190] Panel Report, *U.S. – Cotton Subsidies*, para. 7.804.

[191] Appellate Body Report, *Brazil – Aircraft*, para. 181. *See also* Appellate Body Report, *Brazil – Aircraft (21.5)*, paras. 61, 64.

assertion that reference points or benchmarks external to the *SCM Agreement* – including the OECD Export Credit Arrangement – are irrelevant unless they are specifically mentioned, is in error and should be rejected.

<u>Question to Brazil</u>

43. What is Brazil's reaction to paragraph 25 of Japan's Third Party Submission?

ANNEX D-11

UNITED STATES' COMMENTS ON THE RESPONSES OF BRAZIL TO THE PANEL'S FIRST SET OF QUESTIONS

(16 March 2007)

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1. The United States provides comments on certain of Brazil's responses to the first set of questions from the Panel below. The absence of a comment with respect to any particular response by Brazil should not be understood to imply that the United States agrees with Brazil's response.

A. GENERAL QUESTIONS

<u>Questions to both parties</u>

1. Is Brazil/US of the view that a party to a dispute referred to a panel established under Article 21.5 of the DSU (a party in a compliance panel) can make the same legal argument as it did in the original Panel proceedings?

2. Could each party explain its view on the question of whether, and to what extent, this Panel must rely on the legal and factual analysis underlying the original panel's findings? What are the relevant provisions of the DSU in this regard?

2. The United States agrees to the extent that Brazil acknowledges that where the claim in a proceeding pursuant to Article 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") is one of the consistency of a measure taken to comply with the recommendations and rulings of the Dispute Settlement Body ("DSB"), the prior adopted panel and Appellate Body reports in the dispute "should be taken into account where they are relevant."[1] However, the United States strongly disagrees with any suggestion by Brazil that this consideration applies any differently – or more strongly – in Article 21.5 proceedings that in original proceedings.[2] Contrary to Brazil's assertions, the Appellate Body has never stated that "the objective of 'security and predictability' applies with particular force in Article 21.5 proceedings.'"[3] As an initial matter, the United States notes that "security and predictability" is not the objective of the DSU in the sense of interpreting a treaty in light of the treaty's object and purpose. Rather security and predictability are the result of the correct operation of the DSU. Furthermore, it is clear why the Appellate Body would not make such a statement, since it would elevate Article 21.5 proceedings above all others. Moreover, Brazil's citation to *U.S. – Softwood Lumber IV (21.5*) in support of this proposition is misplaced.

3. *U.S. – Softwood Lumber IV (21.5*) involved an Article 21.5 panel's review of a redetermination of injury by the U.S. International Trade Commission ("ITC"). The Appellate Body considered, there, the extent to which the Article 21.5 panel would need to rely on the findings of the original panel regarding the ITC's original determination. Both the ITC's original determination and its redetermination related to *the exact same factual situation – i.e.,* the impact of the *same* subsidized imports in the *same* period on the *same* industry. The question in the Article 21.5 proceeding was whether the ITC's *reassessment* of the evidence in regard to that factual situation was consistent with the WTO provisions cited by Canada.

4. The Appellate Body noted that Canada's arguments "seem to assume that a panel is *required* to evaluate the facts in an Article 21.5 proceeding in exactly the same way as it evaluated those facts in the original panel proceedings, and to hold an investigating authority making a redetermination to the inferences that it drew from the same evidence in the original determination."[4] The Appellate Body explained that this was *not* the case. It noted that the ITC had provided additional reasoning and explanation and had also reopened the record to collect more information about the impact of the

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[1] *United States – Shrimp (21.5 – Malaysia) (AB),* para. 108 (citing *Japan – Alcoholic Beverages (AB)* at 108).

[2] Brazil Responses to Panel Section A-C Questions, para. 4 (February 26, 2007).

[3] Brazil Responses to Panel Section A-C Questions, para. 4 (February 26, 2007).

[4] *U.S. – Softwood Lumber (21.5),* para. 101 (emphasis in original).

subsidized imports. The Appellate Body explained that "in these circumstances, *we do not see why the Panel would be bound by the findings of the original panel*."[5]

5. Brazil neglects to note this primary reasoning of the Appellate Body and, instead, cites (selectively) to the Appellate Body's clarification that "[t]his does not mean that a panel operating under Article 21.5 of the DSU should not take account of the reasoning of an investigating authority in an original determination, or of the reasoning of the original panel."[6] The language cited by Brazil is simply an application of the general principle that prior adopted panel and Appellate Body reports in the dispute "should be taken into account where they are relevant."[7]

6. Further, contrary to Brazil's assertions, the Appellate Body did *not* state in *U.S. – Softwood Lumber IV (21.5*) that "[i]f a compliance panel 'deviate[d] from the original panel's findings on a 'specific issue,' without a fundamental change in the domestic legal framework and/or facts warranting this deviation, it would suggest that the compliance panel is acting in an arbitrary fashion that does not meet the requirements of an 'objective assessment."[8] To the contrary, if such reasoning had been applied in *U.S. – Softwood Lumber IV (21.5*), it would have directly undermined the Appellate Body's analysis therein. The ITC's injury redetermination in that dispute did not – and could not – involve any "fundamental change in the domestic legal framework and/or facts." Both the ITC's original determination and redetermination (and, thus, the original panel proceeding and Article 21.5 proceeding) related to the impact of the *same* subsidized imports in the *same* period on the *same* industry. Thus, the reasoning asserted by Brazil would have, in fact, bound the compliance panel to the original panel's findings, in direct contradiction to the Appellate Body's clarification that the compliance panel was not so bound.

7. Moreover, the contrast between the facts of the *U.S. – Softwood Lumber IV (21.5*) dispute and this one illustrates the unreasonableness of Brazil's efforts to bind this Panel's hands in its assessment of the issues before it. Unlike in *U.S. – Softwood Lumber IV (21.5*), the present dispute does *not* involve a redetermination of the impact of the *same* subsidized imports in the *same* period on the *same* industry. Rather, Brazil is attempting to advance claims in this proceeding against measures that were *not* subject to recommendations and rulings in the original dispute. Further, Brazil is asserting here price suppressive and world market share effects in a time period, and under market conditions, *never* assessed by the original panel. The reasoning asserted by Brazil – that an Article 21.5 panel is allegedly not permitted to 'deviate from the original panel's findings on a 'specific issue,' without a fundamental change in the domestic legal framework and/or facts"[9] – makes even less sense in the circumstances of this dispute (where there is a change in the relevant measures and in the relevant facts) than in *U.S. – Softwood Lumber IV (21.5*) (where there was no such change). By its nature, a serious prejudice claim will depend on the facts applicable to a particular period, such as the existence of displaced sales or price undercutting. Accordingly, an Article 21.5 panel will need to assess the facts applicable to the period at issue in the Article 21.5 proceeding and will not necessarily be able to rely on the original panel's findings.

B. QUESTIONS WITH RESPECT TO BRAZIL'S REQUEST UNDER ARTICLE 13.1 DSU

Questions to the US

3. Is the United States arguing that Brazil must identify the subsidized product for each of the types of subsidies from which it claims serious prejudice? Is the

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[5] *U.S. – Softwood Lumber (21.5),* para. 102 (emphasis added).

[6] *U.S. – Softwood Lumber (21.5)*, para. 102.

[7] *United States – Shrimp (21.5 – Malaysia) (AB),* para. 108 (citing *Japan – Alcoholic Beverages (AB)* at 108).

[8] Brazil Responses to Panel Section A-C Questions, para. 5 (February 26, 2007).

[9] Brazil Responses to Panel Section A-C Questions, para. 5 (February 26, 2007).

United States arguing that payments which permit planting flexibility are not tied to the production of upland cotton, so that they must be allocated by Brazil across the total value of production of each recipient?

4. ***Does the United States contest the accuracy of the figures for 2003 – 2005 cited in "Table 6" of Brazil's first submission and "Table 5" of Brazil's rebuttal submission? If so, please provide the accurate figures, or the figures the US deems to be more accurate.***

Question to Brazil

5. ***The Panel refers to Brazil's communication dated 22 January 2007 concerning its request in relation to Article 13.1 of the DSU. Is it correct for the Panel to understand that as far as data for 2005 is concerned, data included in Exhibit US-64 satisfies all of the requests Brazil made in Part A of Annex 1 of its 1 November communication?***

C. QUESTIONS CONCERNING THE PRELIMINARY OBJECTIONS RAISED BY THE UNITED STATES

1. Preliminary objections of the United States in respect of claims of Brazil regarding export credit guarantees in respect of pig meat and poultry meat

Question to both parties:

6. ***The parties disagree with respect to whether in a proceeding under Article 21.5 of the DSU a party may present a claim that was raised in the original proceeding but on which no finding of WTO-inconsistency was made due to the fact that the Appellate Body was unable to complete the analysis.***

   a. ***Could the parties explain the legal basis in the text of Article 21.5 of the DSU and other relevant provisions of the DSU for their position on this question?***

   b. ***Could the parties explain whether and how their position on this issue is consistent with prior panel and Appellate Body reports?***

8. Rather than responding to the specific questions asked by the Panel above, Brazil expounds over 15 pages on why its claims with respect to GSM 102 export credit guarantees in respect of pig meat and poultry meat are within the scope of this proceeding. Leaving aside that Brazil's response is not, in fact, directly responsive to the question posed, it also fails to withstand scrutiny.

A. *Specific Export Credit Guarantees Are Measures And Those Guarantees Provided In Support of Exports of Pig Meat, Poultry Meat, And Other Scheduled Products (Other that Rice) Have Never Been Subject to Any DSB Recommendations and Rulings*

9. Brazil argues, first, that (a) "no such 'measure' [as export credit guarantees in respect of exports of pig meat and poultry meat] exists;" (b) the only "measure" capable of being subject to Brazil's claims of WTO-inconsistency is the GSM 102 *program* in its entirety; and (c) it is simply Brazil's *claims* under Articles 10 and 8 of the *Agreement on Agriculture* and 3.1(a) and 3.2 of the *SCM Agreement* that are limited to specific products. These arguments lack merit.

10. First, it is surprising to find Brazil arguing now that specific GSM 102 guarantees – in this case, those guarantees issued in support of export transactions involving pig meat and poultry meat – do not constitute "measures." This argument is at odds with Brazil's arguments elsewhere that an *a contrario* reading of item (j) would prevent a Member from challenging specific export credit guarantees (*i.e.*, as opposed to the export credit guarantee *programs* generally).[10] If specific guarantees cannot even constitute "measures," as Brazil now asserts, Brazil's complaints about being able to make claims against specific guarantees would be entirely moot.[11]

11. In any event, Brazil provides no basis for its assertion that export credit guarantees in respect of exports of pig meat and poultry meat are not "measures." Certainly, Brazil makes no effort to reconcile its argument with the clarification by the Appellate Body that a "measure" for purposes of WTO dispute settlement may encompass "[i]n principle, any act or omission attributable to a WTO Member. . . ."[12] The provision of specific guarantees would certainly seem to fit within this broad scope of "measure."

12. Second, Brazil's assertion that its export subsidy-related claims in the original and present proceeding apply with respect to the GSM 102 program, as such, rather than to the *application* of the program in particular cases (*i.e.*, particular export credit guarantees) is inconsistent with Brazil's prior arguments and the original panel's resolution of Brazil's claims. The United States recalls that, in order to avoid the mandatory-discretionary distinction in the original panel proceeding, Brazil expressly stated that its claims of actual circumvention under the *Agreement on Agriculture* were "akin to . . . 'as applied' claim[s]" with respect to the export credit guarantees themselves, and were not against the programs under which they were provided.[13] The scope of measures subject to Brazil's claims under the *SCM Agreement* was necessarily circumscribed to the same extent because, by virtue of the Peace Clause[14], only those export subsidies inconsistent with the circumvention provisions of the *Agreement on Agriculture* would even be *subject* to claims under the *SCM Agreement*.

13. Consistent with this, the original panel found that:

> in respect of exports of upland cotton and other unscheduled agricultural products supported under the programmes, and in respect of one scheduled product (rice) . . . United States export credit *guarantees* under the GSM 102, GSM 103 and SCGP export credit guarantee programmes are export subsidies applied in a manner which results in circumvention of United States' export subsidy commitments, within the

[10] *See* Panel's Question 35 to Brazil below and Brazil Rebuttal Submission, para. 472.

[11] Article 6.2 of the DSU requires that a request for panel establishment identify both the "specific measures at issue" and provide "a brief summary of the legal basis of the complaint" (i.e., the claim). If specific guarantees cannot even be measures, as Brazil alleges, no claim could *ever* be made with respect to them in WTO dispute settlement.

[12] *United States – Corrosion-Resistant Steel (AB)*, para. 81.

[13] *See* Brazil's Answers to Additional Questions Following Second Panel Meeting, para. 11 (according to Brazil "it is therefore not relevant to this claim whether the CCC programs are mandatory or discretionary.") Indeed, had Brazil's claims been with respect to the programs, they would have failed because the programs themselves are clearly *not* mandatory. If they had been, the United States certainly could not have ceased issuing GSM 103 and SCGP guarantees – as it has done – nor could the United States have removed from eligibility obligations in certain higher-risk countries under the GSM 102 program.

[14] Under the Peace Clause of the *Agreement on Agriculture*, "export subsidies that conform fully to the provisions of Part V of this Agreement . . . shall be . . . exempt from actions based on Articles XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement." Article 13(c)(ii) of the *Agreement on Agriculture*. An export subsidy found to be inconsistent with Articles 10 and 8 of the *Agreement on Agriculture* would not "conform fully to the provisions of Part V of this Agreement" and, thus, would not be "exempt from actions based on Articles XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement."

meaning of Article 10.1 of the Agreement on Agriculture and they are therefore inconsistent with Article 8 of the Agreement on Agriculture.[15]

14. As is clear from the language cited above, the original panel considered *guarantees* to constitute export subsidies. And it was only those guarantees "in respect of exports of upland cotton and other unscheduled agricultural products supported under the programmes, and in respect of one scheduled product (rice)" to which the finding of actual circumvention applied. Because the panel found that these measures did not "conform fully to the provisions of Part V of the Agreement on Agriculture," the guarantees were also subject to – and ultimately found to be inconsistent with – the prohibition on export subsidies in the *SCM Agreement*.[16]

15. Brazil has no basis to assert now that its claims in the original proceeding, and the original panel's findings, were actually against the export credit guarantee programs themselves and that the particular application of the programs to certain export transactions (*i.e.*, particular guarantees) does not even constitute a "measure." This even contradicts Brazil's own clarification in its rebuttal submission that "*Brazil does not assert that the GSM 102 program itself circumvents the United States' export subsidy commitments, within the meaning of Article 10.1 of the Agreement on Agriculture*."[17] Rather, according to Brazil, its claim is that "the United States has *applied* the GSM 102 program in a manner that circumvents U.S. export subsidy commitments with respect to unscheduled products, and with respect to three scheduled products – rice, pig meat and poultry meat."[18] The United States regrets that, even at this late stage, Brazil continues to shift its arguments on such fundamental issues as the measures subject to its claims.

16. Third, Brazil's assertion that its *claims* are product-specific does not alter the analysis. That just means that Brazil's claims relate to guarantees provided in respect of exports of particular products. Calling these claims "product-specific" does not change the fact that only particular guarantees – those provided in respect to the particular "product" at issue – are the subject of the claims. Where those guarantees were not the subject of any DSB recommendations and rulings and are not measures taken to comply with any DSB recommendations and rulings, there is no basis for a claim to be considered with respect to them in a DSU Article 21.5 proceeding. That is the situation here.

17. Fourth, the analysis would not change even if one were to assume – incorrectly – that export credit *guarantees* are not specific measures and that the original panel's findings applied to the GSM 102 program itself. Even then, to give meaning to the original panel's analysis under Articles 10.1 and 8 of the *Agreement on Agriculture* and the Peace Clause, one must acknowledge that the original findings of WTO-inconsistency did not apply to the *entire* program but rather those aspects of it that related to guarantees "in respect of exports of upland cotton and other unscheduled agricultural products supported under the programmes, and in respect of one scheduled product (rice)." The question in an Article 21.5 proceeding, then, is whether the complaining party has shown that proper implementation measures have been taken with respect to *that aspect of the measure found to be*

[15] *Upland Cotton (Panel)*, para. 8.1(d)(i) (emphasis added).

[16] *Upland Cotton (Panel)*, para. 8.1(d)(i). By contrast, the original panel specifically found "in respect of exports of unscheduled agricultural products not supported under the programmes and other scheduled agricultural products," including pig meat and poultry meat, that "export credit *guarantees* under the GSM 102, GSM 103 and SCGP export credit guarantee programmes have not been applied in manner which either results in, or which threatens to lead to, circumvention of United States export subsidy commitments within the meaning of Article 10.1 and that they therefore are not inconsistent with Article 8 of the Agreement on Agriculture. *Upland Cotton (Panel)*, para. 8.1(d)(ii) (emphasis added). As such, the Peace Clause applied and the panel "treat[ed] them as if they are exempt from actions based on Article XVI of the GATT 1994 and Article 3 of the SCM Agreement in this dispute." *Upland Cotton (Panel)*, para. 8.1(d)(ii)

[17] Brazil Rebuttal Submission, para. 378 (emphasis added).

[18] Brazil Rebuttal Submission, para. 378 (emphasis added).

WTO-inconsistent. As the Appellate Body recognized in *EC – Bed Linen (21.5)*, the mandate of a DSU Article 21.5 panel does not extend to examining even those aspects of a measure that were *not* found to be WTO-inconsistent in the original proceeding.[19] Although the *EC – Bed Linen* dispute involved a situation where – except for a "minor change"[20] – the challenged aspect of the measure had remained more or less unchanged between the original proceeding and the compliance proceeding, the reasoning therein applies with equal force to the GSM 102 export credit guarantees in respect of poultry meat and pig meat. The United States turns to that issue and, more generally, Brazil's (incorrect) assertions that the GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat are measures taken to comply next.

B. ***GSM 102 Guarantees Provided In Support of Exports of Pig Meat, Poultry Meat, And Other Scheduled Products (Other that Rice) Are Not Measures Taken To Comply With Any DSB Recommendations and Rulings***

18. For the reasons above, export credit guarantees in respect of exports of pig meat and poultry meat clearly *are* measures for purposes of WTO dispute settlement. However, they are *not* measures that were ever subject to any DSB recommendations and rulings.

19. Recall that there are two categories of claims that may be made in Article 21.5 proceedings – regarding (a) the existence of measures taken to comply in respect of original measures or (b) the consistency of measures taken to comply with a covered agreement. Because GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat are not original measures that were subject to any DSB recommendations and rulings, Brazil has no basis to make claims in the first category with respect to those guarantees. The United States could not have taken any measures to comply with respect to DSB recommendations and rulings in respect of those guarantees because there are no DSB recommendations and rulings in respect of those guarantees.

20. The question, then, is whether Brazil has any basis to make claims in the second category with respect to those guarantees (*i.e.*, claims that GSM 102 guarantees in respect of exports of pig meat and poultry meat are not consistent with a covered agreement). Under Article 21.5 of the DSU, Brazil could only do so if these guarantees were themselves measures taken to comply with recommendations and rulings of the DSB. Contrary to Brazil's assertions, however, they are not.

21. Brazil argues that GSM 102 guarantees in respect of pig meat and poultry meat became measures taken to comply with the DSB's recommendations and rulings simply because they were affected by some of the changes made by the United States in respect of the measures that *were* subject to the DSB's recommendations and rulings (*i.e.*, GSM 102, GSM 103, and SCGP guarantees "in respect of exports of upland cotton and other unscheduled agricultural products supported under the programmes, and in respect of one scheduled product (rice)").[21]

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[19] *EC – Bed Linen (AB) (21.5 – India)*, para. 86.

[20] According to the Appellate Body, the European Communities did "expand[] its findings in the redetermination with respect to the development of consumption of bed linen in order to take into account slightly different figures on domestic industry sales." *EC – Bed Linen (21.5) (AB)*, para. 72, n. 67. However, India's claim in the Article 21.5 proceedings apparently "did not rely on this minor change." *EC – Bed Linen (21.5) (AB)*, para. 72, n. 67.

[21] For example, the United States did not cease issuing GSM 103 and SCGP guarantees only "in respect of exports of upland cotton and other unscheduled agricultural products supported under the programmes, and in respect of one scheduled product (rice)." The United States did not narrowly limit application of the new risk-based fee schedule to GSM 102 guarantees "in respect of exports of upland cotton and other unscheduled agricultural products supported under the programmes, and in respect of one scheduled product (rice)" the application of the new risk-based fee schedule implemented to address the original panel's findings. Nor did the United States reclassify certain high-risk countries into ineligible categories solely with

22. Brazil makes the remarkable assertion that because the United States went above and beyond its WTO obligations it should be subject to greater exposure to challenge in an Article 21.5 proceeding than if it had narrowly circumscribed its changes so they applied solely to export credit guarantees "in respect of exports of upland cotton and other unscheduled agricultural products supported under the programmes, and in respect of one scheduled product (rice)":

> During implementation, the United States could have taken steps to amend the GSM 102 program exclusively with respect to the terms and conditions applicable to rice and unscheduled products. However, it did not do so. Instead, it revised the general terms and conditions of the program, including the guarantee fee schedule, adopting an amended GSM 102 program that still applies on a non-product-specific basis.[22]

23. In other words, Brazil *admits* that the United States had no WTO obligation to take any action with respect to guarantees under the program in respect of exports of products *other* than "rice and unscheduled products." Brazil also effectively *admits* that, if the terms and conditions applicable in respect of those guarantees had remained precisely the same as before, those guarantees could not be the subject of the present Article 21.5 proceeding regardless of whether those terms and conditions were consistent with any covered agreement. Brazil's contention is, however, that those guarantees come within the scope of this compliance proceeding simply because the United States did not wall them off from changes affecting guarantees in respect of exports of rice and unscheduled products. This argument does not make sense either from a textual or a practical standpoint.

24. The measures taken by the United States to comply with the recommendations and rulings of the DSB are the various changes made by the United States – including the changes to the fee schedule and the conditions for eligibility – *to the measures that were subject to the original export subsidy finding to bring them into compliance*. The question presented to the Panel is whether Brazil has proven that these U.S. changes have failed to bring *those measures* into compliance with the recommendations and rulings (and the other provisions of the covered agreements cited by Brazil). The question is *not* what effect the changes might have had on other measures that were *not* required to be brought into compliance with any DSB recommendations and rulings.

25. The fact that the changes made to transform the original measures into measures taken to comply may affect more than just the original measures does not render all other affected measures themselves measures taken to comply. That would effectively treat *any* changed measure as a "measure taken to comply" regardless of whether it is actually changed to comply with any DSB recommendations or rulings or – as in the present case, where changes were applied on a program-wide basis for ease of administration and to improve the programs generally – for other reasons entirely. This would not only read "taken to comply" out of Article 21.5 of the DSU altogether but would have entirely undesirable implications. A Member would be forced to create a tangle of separate regimes to address the application of a measure in different situations simply to avoid exposure to a dispute settlement challenge under the expedited procedures of an Article 21.5 proceeding with the accompanying disadvantages. Moreover, the incentive would be for Members to make the most limited changes possible and to retain the status quo – even at the cost of general improvements – because any broader approach would simply be rewarded with exposure to challenge in Article 21.5 proceedings.

26. Nothing in the WTO Agreement compels such a result. Moreover, none of the prior Appellate Body reports discussed by Brazil even address this particular situation, let alone suggest that Brazil's approach is appropriate.

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respect to export credit guarantees "in respect of exports of upland cotton and other unscheduled agricultural products supported under the programmes, and in respect of one scheduled product (rice)."

[22] *See* Brazil Rebuttal Submission, para.15.

C. *The Reasoning in Prior Disputes Confirms that Brazil Cannot Impermissibly Extend the Scope of this Proceeding to GSM 102 Guarantees In Respect of Exports of Pig Meat and Poultry Meat*

27. Contrary to Brazil's assertions, the reasoning in prior disputes does not support Brazil's efforts impermissibly to extend the scope of this proceeding to claims against measures that were never subject to any DSB recommendations and rulings and that are not measures taken to comply with any such recommendations and rulings. Nor could it. This limitation is established by Article 21.5 of the DSU itself.

28. To the contrary, the Appellate Body has expressly acknowledged that "[p]roceedings under Article 21.5 do not concern just any measure of a Member of the WTO; rather, Article 21.5 proceedings are limited to those 'measures *taken to comply* with the recommendations and rulings' of the DSB."[23] Moreover, "[i]f a *claim* challenges a *measure* which is not a 'measure taken to comply,' that *claim* cannot properly be raised in Article 21.5 proceedings."[24] This reasoning applies regardless of whether a complaining party attempts to make the "same" claim or a "new" claim in an Article 21.5 proceeding – if the measure subject to the claim is "not a 'measure taken to comply,' that *claim* cannot properly be raised in Article 21.5 proceedings."[25]

29. Nothing in the prior Appellate Body reports discussed by Brazil undermines this reasoning or supports Brazil's attempts to challenge the GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat. Indeed, much of Brazil's analysis continues to rely on the fundamentally flawed assertion that a "final resolution" standard governs the claims that are properly within the scope of an Article 21.5 proceeding.[26] As the United States has explained[27], this is not the proper standard set out in the text of Article 21.5.

30. ***EC – Bed Linen (21.5):*** Brazil argues, for example, that "the circumstances that prevented India from renewing, in Article 21.5 proceedings in *EC – Bed Linen*, the same claim it had pursued in the original proceedings, are *not* present in the current dispute."[28] This is not true. In the *EC – Bed Linen* dispute, the Appellate Body found that India was precluded from raising certain claims in respect of the "other factors" assessment in a dumping redetermination on two different grounds: (a) it was not a part of the "implementation measure" and, thus, was outside the scope of an Article 21.5 proceeding *and* (b) by failing to appeal the original panel's rejection of the same claim against the exact same aspect of the measure taken to comply in the original proceeding, India had accepted the rejection of the claims by the original panel as a "final resolution" of the dispute between the parties and therefore could not raise it again in *any* subsequent proceeding.[29]

31. Brazil correctly observes that the present dispute is *not* identical to *EC – Bed Linen (Article 21.5 – India)* on the question of whether or not the original panel's rejection of Brazil's claims against the pig meat and poultry meat constitutes a "final resolution" of the matter for purposes of WTO dispute settlement; certainly, Brazil is not precluded from challenging those measures in a new dispute. However, on the question of whether the claims are subject to review *in an Article 21.5 proceeding*, the outcome in this dispute is the same as in *EC – Bed Linen (Article 21.5 – India)*. Like the claims made by India in that dispute, Brazil's claims here against the pig meat and poultry meat

[23] *Canada – Aircraft (21.5 Brazil) (AB)*, para. 36 (italics in original; underlining added).
[24] *EC – Bed Linen (21.5 India) (AB)*, para. 78 (emphasis in original).
[25] *EC – Bed Linen (21.5 India) (AB)*, para. 78 (emphasis in original).
[26] *See e.g.*, Brazil's assertions that *EC – Bed Linen*
[27] Including in response to the Panel's Question 10, *see* U.S. Answers to Parts A-C of First Set of Panel Questions, paras. 25-26 (February 27, 2007).
[28] Brazil Responses to Panel Section A-C Questions, para. 47 (February 26, 2007).
[29] *EC – Bed Linen (21.5 – India) (AB)*, paras. 32-35 and 87-95.

GSM 102 guarantees are not claims against a "measure taken to comply" and, as such, are outside the scope of this proceeding by operation of the express limitations in Article 21.5 of the DSU.

32. Brazil also asserts that the Appellate Body reached certain "conclusions" about the situations in which claims could be raised *in Article 21.5 proceedings* where an original proceeding involves an exercise of false judicial economy. According to Brazil, the circumstances in the present dispute are "similar" to the exercise of false judicial economy because the "original panel erroneously excluded [export credit guarantees] for pig meat and poultry meat from its findings regarding Brazil's circumvention claim."[30] Not only does Brazil's argument simply *presume* that the original Panel's findings would have extended to export credit guarantees for pig meat and poultry meat – a finding that the Appellate Body specifically found was *not* supported by sufficient uncontested facts on the record before it – but Brazil attempts to equate two fundamentally different things.

33. The Appellate Body has explained that judicial economy "allows a panel to refrain from making multiple findings that the same measure is inconsistent with various provisions when a single, or a certain number of findings of inconsistency, would suffice to resolve the dispute."[31] Here, by contrast, the Appellate Body did not decline to make findings because other findings existed with respect to GSM 102 export credit guarantees. Rather, it did not find sufficient facts to make *any* finding of WTO-inconsistency with respect to the GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat. This distinction is an important one. This is *not* a situation where the United States had an obligation to implement DSB recommendations and rulings with respect to those guarantees on the basis of certain WTO provisions but not others with respect to which the original panel/Appellate Body had exercised judicial economy. The United States simply had *no implementation obligations whatsoever* in respect of those measures. Moreover, as explained above, the GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat are not measures taken to comply with any recommendations and rulings. In these circumstances, Article 21.5 of the DSU does not permit claims against those measures in a compliance proceeding.

34. In any event, contrary to Brazil's assertions, the Appellate Body did *not* conclude that claims with respect to which an original panel had exercised false judicial economy could automatically be reasserted in an Article 21.5 proceeding. This is evident even from the language cited by Brazil from that dispute: "in a situation where a panel, in declining to rule on a certain claim, has provided only a partial resolution of the matter at issue, a complainant should not be held responsible for the panel's false exercise of judicial economy, such that a complainant would not be prevented from raising the claim *in a subsequent proceeding*."[32] This discussion does not deal with the scope of an Article 21.5 proceeding. Indeed, this language is part of the Appellate Body's separate discussion of what claims can be considered to be "finally resolved" such that they could not be the subject of *any* subsequent WTO dispute settlement proceeding. On the question of the scope of an Article 21.5 proceeding, the Appellate Body was unequivocal: "[i]f a claim challenges a measure which is not a 'measure taken to comply,' that claim cannot properly be raised in Article 21.5 proceedings."[33]

35. ***Canada – Aircraft (21.5):*** Brazil asserts that "[t]he situation in these Article 21.5 proceeding is very similar to the situation that arose in the Article 21.5 proceeding in *Canada – Aircraft*."[34] According to Brazil, Canada "amended the terms and conditions of an export subsidy program" and, thus, the Appellate Body found that the "measure taken to comply" was the revised export subsidy *program*.[35] Brazil argues that the same reasoning applies here and militates in favor of finding the

[30] Brazil Responses to Panel Section A-C Questions, para. 46 (February 26, 2007).
[31] *Canada – Wheat (AB)*, para. 133.
[32] *EC – Bed Linen (AB)*, para. 96, n. 115.
[33] *EC – Bed Linen (21.5 – India) (AB)*, para. 78.
[34] Brazil Responses to Panel Section A-C Questions, para. 36 (February 26, 2007).
[35] Brazil Responses to Panel Section A-C Questions, para. 36 (February 26, 2007).

entire GSM 102 program to be the measure taken to comply in this dispute.[36] What Brazil fails to acknowledge is that the scope of the measure taken to comply with the recommendations and rulings of the DSB is determined by reference – logically – to the recommendations and rulings of the DSB. As the Appellate Body explained:

> A . . . feature of the first sentence of Article 21.5 is the express link between the "measures taken to comply" and the recommendations and rulings of the DSB. Accordingly, determining the scope of "measures taken to comply" in any given case must also involve examination of the recommendations and rulings contained in the original report(s) adopted by the DSB. Because such recommendations and rulings are directed at the measures found to be inconsistent in the original proceedings, such an examination necessarily involves consideration of those original measures.[37]

36. In *Canada – Aircraft (21.5)*, Canada was required to withdraw the subsidy with respect to *all* "[Technology Partnerships Canada or "TPC"] assistance to the Canadian regional aircraft industry" consistent with Article 4.7 of the *SCM Agreement*.[38] Unlike the recommendations and rulings in the present dispute, Canada was not required to withdraw the subsidy only with respect to a subset of the TPC assistance. It is only natural, therefore, that the "measure taken to comply" in that dispute would be the changes made with respect to *all* TPC assistance, rather than some subset thereof. By contrast, here, it is to be expected that the "measure taken to comply" encompasses only the changes made with respect to that subset of measures with respect to which the United States had an implementation obligation. Thus, far from supporting Brazil's argument that the *entire* GSM 102 program is suddenly somehow a "measure taken to comply," the reasoning in *Canada – Aircraft (21.5)* confirms that Brazil's argument is not tenable.

37. ***U.S. – Shrimp (21.5):*** Brazil notes that in *U.S. – Shrimp (21.5)*, the Appellate Body found that claims were not properly part of an Article 21.5 proceeding where they challenged an aspect of a measure that was found to be WTO-consistent in an original proceeding and remained unchanged between the original and compliance proceeding.[39] Brazil correctly observes that those are not the precise circumstances at issue here.[40] However, the outcome in that dispute is consistent with the U.S. position that – where there is no finding of WTO-inconsistency with respect to a measure *and* the measure is not taken to comply with any DSB recommendations and rulings – neither the measure nor any claims with respect to it are properly the subject of a DSU Article 21.5 proceeding.

38. ***Canada – Dairy (21.5 II):*** Brazil asserts that the factual situation in *Canada – Dairy (21.5 II)* is "precisely the situation in which Brazil finds itself."[41] However, even Brazil's explanation of the facts of that dispute confirms that this is not a correct statement. As Brazil acknowledges, *Canada – Dairy (21.5 II)* involved the question of whether a *second* Article 21.5 proceeding could be initiated "where the Appellate Body was unable to reach a decision [in an earlier proceeding] regarding the WTO-consistency of certain Canadian *measures taken to comply* because of a lack of sufficient facts."[42] There is no question before this Panel of whether a second Article 21.5 proceeding is permissible. Nor has the Appellate Body been asked to address, in this dispute, the question of whether any U.S. *measures taken to comply* are WTO-inconsistent. Indeed, it is not clear how the Appellate Body would have reached such an issue without this Panel having even completed a first Article 21.5 proceeding. Rather, the question implicated by Brazil's claims in this proceeding is

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[36] Brazil Responses to Panel Section A-C Questions, para. 36 (February 26, 2007).

[37] *United States – Final Countervailing Duty Determination (21.5 – Canada) (AB)*, para. 68.

[38] *Canada – Aircraft (21.5) (AB)*, para. 2.

[39] Brazil Responses to Panel Section A-C Questions, paras. 48-51 (February 26, 2007).

[40] Brazil Responses to Panel Section A-C Questions, paras. 48-51 (February 26, 2007).

[41] Brazil Responses to Panel Section A-C Questions, para. 52 (February 26, 2007).

[42] Brazil Responses to Panel Section A-C Questions, para. 52 (February 26, 2007) (quoting U.S. Rebuttal Submission, para. 13, n. 19) (emphasis added).

whether those claims "challenge[] a measure which is not a 'measure taken to comply.'"[43] If they do, they are not properly within the scope of this proceeding. Neither that question – nor one similar to it – was at issue in *Canada – Dairy (21.5 II)*. To the contrary, all the parties to that dispute *agreed* that the Canadian measures at issue were "taken to comply" with the DSB recommendations and rulings in that dispute. The only question there was whether the WTO dispute settlement provisions would permit a second Article 21.5 proceeding.

39. ***Conclusion:*** The reasoning in the reports examined by Brazil does not support its efforts to draw into the scope of this proceeding claims with respect to GSM 102 guarantees in respect of exports of pig meat and poultry meat.

<u>Questions to Brazil</u>

7. Is Brazil of the view that it is only in the circumstances identified by the Appellate Body in EC – Bed Linen (Article 21.5 – India) that the scope of Article 21.5 proceedings is limited by the scope of the original proceedings? [Paragraphs 11-15 of Submission of Brazil to the Panel Regarding US Requests for Preliminary Ruling]

8. How does Brazil respond to the arguments of the United States that Brazil "incorrectly assumes that the standard is one of whether there has been a 'final resolution' of the issue in the original proceeding" and that Brazil misreads the Appellate Body report in EC – Bed Linen (Article 21.5 – India) and confuses the issue of "the scope of a compliance proceeding pursuant to Article 21.5 of the DSU" and the distinct issue of "when a claim against a specific measure or aspect of a measure can be considered to be 'finally resolved' for purposes of WTO dispute settlement"? [Paragraphs 8 and 12 of the Rebuttal Submission of the United States]

40. Brazil's response to this question suggests that Brazil misunderstands the U.S. position. Contrary to Brazil's suggestions, the United States does *not* agree that the scope an Article 21.5 proceeding is determined by reference to whether or not claims have been "finally resolved." The United States considers that to be a distinct question regarding the circumstances under which a particular matter can no longer be the subject of *any* subsequent WTO dispute settlement proceeding.

41. By contrast, the scope of a proceeding pursuant to Article 21.5 of the DSU is established by Article 21.5 itself. As is clear from the text, such proceedings are limited in terms of the *claims* that can be made and the *measures* in respect of which the claims can be made. Examining the text, the Appellate Body has explained, "[p]roceedings under Article 21.5 do not concern just any measure of a Member of the WTO; rather, Article 21.5 proceedings are <u>limited</u> to those 'measures *taken to comply* with the recommendations and rulings' of the DSB."[44] Moreover, "[i]f a *claim* challenges a *measure* which is not a 'measure taken to comply,' that *claim* cannot properly be raised in Article 21.5 proceedings."[45]

42. Brazil incorrectly suggests in its response to this question that the U.S. objection is limited to the *measure* that Brazil challenges in this Article 21.5 proceeding but that the United States accepts that Brazil claims can be made in this proceeding. In fact, the U.S. objection is to *both* the measures challenged by Brazil – GSM 102 export credit guarantees in respect of pig meat and poultry meat which were not subject to the DSB's recommendations and rulings and are not measures taken to comply with any such recommendations and rulings – as well as all *claims* in respect of those

[43] *EC – Bed Linen (21.5 – India) (AB)*, para. 78.
[44] *Canada – Aircraft (21.5 Brazil) (AB)*, para. 36 (italics in original; underlining added).
[45] *EC – Bed Linen (21.5 India) (AB)*, para. 78 (emphasis in original).

measures. As the Appellate Body has made clear, "[i]f a *claim* challenges a *measure* which is not a 'measure taken to comply,' that *claim* cannot properly be raised in Article 21.5 proceedings."[46]

9. What are the comments of Brazil on the arguments in footnote 22 of the United States' rebuttal submission?

43. Brazil appears to argue that it is entitled to ignore the Appellate Body's finding that there were insufficient uncontested facts to support any finding of WTO-inconsistency with respect to GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat. According to Brazil, the present situation is "the effective equivalent of the exercise of judicial economy."[47] And, in Brazil's view, the Appellate Body "concluded" in *EC – Bed Linen (21.5)* that "the exercise of judicial economy with respect to a claim raised in the original proceedings does not bar a complaining Member from reasserting that same claim in Article 21.5 proceedings."[48] The United States disagrees with Brazil both as to its assertion that the present circumstance is the "effective equivalent" of the exercise of judicial economy and its argument that the Appellate Body somehow indicated that a complaining party could simply reassert *in an Article 21.5 proceeding* any claims with respect to which an original panel had exercised false judicial economy. Judicial economy occurs when the arbitral body decides it need not reach an issue in order to resolve a dispute, but here the Appellate Body did not decide it need not reach the issue. Rather, the Appellate Body found that it lacked sufficient basis to make a finding on the claim. These two situations are not "effectively equivalent" – they are quite different.

44. As explained above, Brazil persists in ignoring (a) the actual arguments made by the EC in *EC – Bed Linens (21.5)*, (b) the fact that the EC and the Appellate Body distinguished between arguments regarding the scope of a DSU Article 21.5 proceeding and those regarding claims "finally resolved" for purposes of WTO dispute settlement, and (c) the Appellate Body's unequivocal clarification that, in terms of the former, the salient question under Article 21.5 is whether the claims presented relate to the existence or consistency with a covered agreement of *measures taken to comply* with the recommendations and rulings of the DSB. As the Appellate Body explained "[i]f a *claim* challenges a *measure* which is not a 'measure taken to comply,' that *claim* cannot properly be raised in Article 21.5 proceedings."[49] It did not qualify this in any way or suggest that this was subject to a further consideration of whether false judicial economy had been exercised with respect to the claim.

<u>Question to the US</u>

10. Could the United States explain why it considers that what it describes as the "final resolution" standard is not the correct standard to decide whether Brazil's claims regarding export credit guarantees for pig meat and poultry meat are within the scope of this proceeding?

2. Preliminary objections of the United States with respect to claims of Brazil regarding marketing loan and counter-cyclical payment programmes

<u>Questions to Brazil</u>

11. Is Brazil of the view that a finding under Article 6 of the SCM Agreement that a "subsidy" is causing serious prejudice necessarily always applies to both the subsidy "payments" and the subsidy "programme"? [Paragraphs 31-35 of

[46] *EC – Bed Linen (21.5 India) (AB)*, para. 78 (emphasis in original).
[47] Brazil Responses to Panel Section A-C Questions, para. 71 (February 26, 2007).
[48] Brazil Responses to Panel Section A-C Questions, para. 70 (February 26, 2007).
[49] *EC – Bed Linen (21.5 India) (AB)*, para. 78 (emphasis in original).

Submission of Brazil Regarding US Requests for Preliminary Ruling and paragraph 38 of the Rebuttal Submission of Brazil]

45. The Panel's question is specific, asking for Brazil's views as to whether serious prejudice findings are such that they must "necessarily always" apply simultaneously to the legislative/regulatory provisions authorizing payments and payments themselves. Brazil uses the opportunity, however, to attempt to shore up its unfounded arguments that the Panel should disregard the original panel report and find that the findings of "present" serious prejudice therein applied to Step 2, marketing loan, and counter-cyclical payment programs as well as payments thereunder (a "measure" that was never even subject to a *claim* of "present" serious prejudice in the original proceeding).

46. The United States addresses what appears to be Brazil's response to the specific question, first, and then addresses Brazil's *post hoc* attempts to change the findings of the original panel and the recommendations and rulings of the DSB.

A. There Is No Basis For Brazil's New Argument that Any Finding that Particular Payments Are Causing Serious Prejudice Necessarily Means that the Program Providing for the Payment is **Per Se** ***WTO-Inconsistent***

47. Brazil appears to argue that whenever payments are made pursuant to a program, any finding that particular payments are causing serious prejudice necessarily redounds to the program as such, so that the 'legal/regulatory provisions' for the grant or maintenance of the subsidies[50] must be treated as being WTO-inconsistent as such. Brazil identifies no citation, support, or other basis for this argument. Nor can it.

48. The Appellate Body has clarified that:

> "[A]s such" challenges against a Member's measures in WTO dispute settlement proceedings are serious challenges. By definition, an "as such" claim challenges laws, regulations, or other instruments of a Member that have general and prospective application, asserting that a Member's conduct – not only in a particular instance that has occurred, but in future situations as well – will necessarily be inconsistent with that Member's WTO obligations. In essence, complaining parties bringing 'as such' challenges seek to prevent Members *ex ante* from engaging in certain conduct.
>
> The implications of such challenges are obviously more far-reaching than "as applied" claims. We also expect that measures subject to 'as such' challenges would normally have undergone, under municipal law, thorough scrutiny through various deliberative processes to ensure consistency with the Member's international obligations, including those found in the covered agreements, and that the enactment of such a measure would implicitly reflect the conclusion of that Member that the measure is not inconsistent with those obligations. The presumption that WTO Members act in good faith in the implementation of their WTO commitments is particularly apt in the context of measures challenged "as such.[51]

49. Brazil's newly-asserted approach would flout the "serious" nature of challenges to a Members' "laws, regulations, or other instruments of a Member that have general and prospective application" by permitting a finding of WTO-inconsistency against such measures *without* any actual showing that "a Member's conduct – not only in a particular instance that has occurred, but in future situations as

[50] Brazil's Answers to Additional Questions Following Second Panel Meeting, para. 31-32 (20 January 2004).

[51] *U.S. – Argentina OCTG Sunset Reviews (AB)*, paras. 172-173.

well – will necessarily be inconsistent with that Member's WTO obligations."[52] Under Brazil's approach a showing about "a particular instance" would automatically be sufficient for a finding that "a Member's conduct . . . in [all] future situations . . . will necessarily be inconsistent with that Member's WTO obligations." Brazil has identified nothing in Article 6 of the *SCM Agreement* – or any other provision of the WTO agreement – that permits such an approach.

50. The sole justification that Brazil appears to offer is an assertion that because a challenge to particular payments may require an assessment of how the program operates and, conversely, because a challenge to a program requires an assessment of the effects of particular payments, any distinction between the WTO-consistency of programs and payments is "artificial."[53] This argument makes little sense. It is hardly remarkable that it may be necessary to examine the "laws, regulations, or other instruments of a Member" in determining whether their application in a particular instance is WTO-consistent. Nor is it remarkable that an examination of the application of "laws, regulations, or other instruments of a Member" is necessary to determine whether those measures are themselves WTO-consistent. This is true in any circumstance where either the "laws, regulations, or other instruments of a Member" or their application are at issue; it is not unique to claims under Article 6 of the *SCM Agreement*. Brazil fails to explain why this renders any distinction between the WTO-consistency of the "laws, regulations, or other instruments of a Member" themselves and their application in particular circumstances "artificial." Indeed, Brazil's argument would undermine the clear distinction drawn by the Appellate Body in *U.S. – Argentina OCTG Sunset Reviews* and scores of other disputes between claims against these distinct measures.

51. In any event, the United States does not recall that Brazil clarified it was making an "artificial" distinction between programs and payments in the original dispute when it made separate serious prejudice claims relating to payments made in MY 1999-2002, future payments allegedly mandated to be made in MY 2003-2007, and specific provisions of the 2002 FSRI Act and the 2000 Agricultural Risk Protection Act. Nor does the United States recall Brazil arguing that the original panel was making an "artificial" distinction between payments and programs when – tracking the claims presented to it – the original panel set out to separately address the effects of payments made in MY 1999-2002, the effects of payments allegedly mandated to made in future marketing years, and the effect of specific provisions of the 2002 FSRI Act and the 2000 Agricultural Risk Protection Act.

52. To the contrary, Brazil specifically acknowledged that a claim against the specific provisions of the 2002 FSRI Act and the 2000 Agricultural Risk Protection Act would have different implications and requirements than a claim against specific payments thereunder. For example, Brazil made separate claims of *threat* of serious prejudice[54] against payments allegedly "mandated" to be made in MY 2003-2007[55] and the legal regime providing for these payments.[56] In so doing, Brazil expressly acknowledged to the original panel that the claims were comprised of distinct elements because of the different measures at issue.[57] Indeed, in the case of its threat claims against the

[52] *U.S. – Argentina OCTG Sunset Reviews (AB)*, paras. 172-173.

[53] Brazil Responses to Panel Section A-C Questions, para. 84 (February 26, 2007).

[54] The claims were under Articles 5(c) and 6.3(c) of the *SCM Agreement*, Articles 5(c) and 6(d) of the *SCM Agreement*, and Article XVI:1 of the GATT 1994.

[55] *Upland Cotton (Panel)*, para. 3.1(vii).

[56] *Upland Cotton (Panel)*, para. 3.1(viii). These claims too were under Articles 5(c) and 6.3(c) of the *SCM Agreement*, Articles 5(c) and 6(d) of the *SCM Agreement*, and Article XVI:1 of the GATT 1994.

[57] To take just one example, Brazil explained how a showing of the mandatory nature of the statutory/regulatory provisions was a "required element" for its *per se* claims but not for the "threat" of serious prejudice claims "that do not involve claims regarding the 'per se' validity of the statutes":

> The mandatory nature of the U.S. subsidies is relevant to (a) Brazil's "per se" claims as well as (b) Brazil's threat of serious prejudice claims that do not involve claims regarding its "per se" validity of the statutes. The evidence of mandatory (or "normative") measures is a required element for Brazil's "per se" claims. And a threat of serious prejudice under Article 6.3

programs as such, Brazil asked the original panel to find that the "provisions of the 2002 FSRI Act and the 2000 ARP Act together with their implementing regulations, as listed above, *cannot be applied in a WTO consistent manner*."[58] This echoes precisely the Appellate Body's reasoning in *U.S. – Argentina OCTG Sunset Reviews* that "[b]y definition, an "as such" claim challenges laws, regulations, or other instruments of a Member that have general and prospective application, asserting that a Member's conduct – not only in a particular instance that has occurred, but in future situations as well – *will necessarily be inconsistent with that Member's WTO obligations*."[59]

53. Moreover, Brazil argued that payments could have adverse effects even when the programs that authorized them were no longer in existence[60] and that programs could have adverse effects even when no payments were being made under the programs.[61] In other words, Brazil argued that the *effects* of the programs and the payments could well be distinct.

54. Brazil's new argument for purposes of this proceeding that a finding under Articles 5 and 6 of the *SCM Agreement* automatically applies to both programs and the payments made thereunder is inconsistent with all of Brazil's prior arguments noted above and is unsupported by the text of any covered agreement.

B. Brazil's Efforts to Expand the Original Panel's Findings of WTO-Inconsistency and the DSB's Recommendations and Rulings are Unavailing

55. Not only does Brazil fail to show that findings under Articles 5 and 6 necessarily apply to both programs and payments, as a general matter, but it identifies no basis to expand the original panel's findings of "present" serious prejudice to the Step 2, marketing loan, and counter-cyclical payment programs and all payments thereunder.

(1) Brazil continues to ignore the evidence showing that it only challenged – and the original panel only found – "present" serious prejudice with respect to a package of payments made in MY 1999-2002

56. The United States recalls that in the section of the original panel report entitled "Parties' Requests for Findings and Recommendations," the panel set out the claims presented by Brazil as follows:

> and 5(c) will be more likely to exist if the subsidies are mandatory, i.e., that the subsidies must be paid to eligible producers, exporters, and users.

Brazil's Answers to Additional Questions Following Second Panel Meeting, para. 18 (20 January 2004). Brazil's explanation shows not only that Brazil separately challenged the "per se" validity of the statutes and the payments authorized to be made under the statutes – despite its argument now that no distinction can be drawn between them "in the circumstances of this dispute" – but that it considered the claims to entail distinct factual showings.

[58] Brazil's 9 September 2003 Further Submission, para. 435 (emphasis added).

[59] *U.S. – Argentina OCTG Sunset Reviews (AB)*, paras. 172 (emphasis added).

[60] *See Upland Cotton (Panel)*, paras. 7.105, 7.107-7.122. Brazil argued that, even though, the legislation providing for PFC and MLA payments had expired, it "pursues claims . . . in respect of the subsidies and domestic support provided under the expired programmes and authorizing legislation, in other words, *the payments themselves*" because, according to Brazil, these payments continued to cause adverse effects to its interests. *Upland Cotton (Panel)*, para. 7.108 (emphasis added).

[61] For example, Brazil argued that "the very existence of the mandatory marketing loan, Step 2 and counter-cyclical payment program alone impacts farmers' planting decisions" even when no payments were being made under them. Brazil's Answers to Additional Questions Following Second Panel Meeting, para. 20 (20 January 2004)

- claims of "present" serious prejudice with respect to "U.S. subsidies provided during MY 1999-2002"[62];

- claims of threat of serious prejudice with respect to "U.S. subsidies mandated to be provided in MY 2003-2007;"[63] and

- *per se* claims of threat of serious prejudice[64] against "selected provisions of the FSRI Act of 2002 and the ARP Act of 2000" providing for these subsidies, to the extent relevant to upland cotton, and their implementing regulations.[65]

57. The original panel did *not* identify a "present" serious prejudice claim under Article 5(c) and 6.3(c) of the *SCM Agreement* as one of the claims "concerning selected provisions of the FSRI Act of 2002 and the ARP Act of 2000."[66] Nor did the original panel identify "selected provisions of the FSRI Act of 2002 and the ARP Act of 2000" as part of the measures subject to Brazil's claims of "present" serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*.[67]

58. To the contrary, the original panel identified only "the subsidies provided during MY 1999-2002" as the measures subject to Brazil's claim of "present" serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*.[68] The original panel then identified the "challenged measures" that were alleged to be the "subsidies" for purposes of that claim[69]; these were the "user marketing (Step 2) *payments* to domestic users and exporters; marketing loan programme *payments*; PFC *payments*; MLA *payments*; DP *payments*; CCP *payments*; crop insurance *payments*; and cottonseed *payments*."[70] The original panel found that these constituted "subsidies" within the meaning of Article 1 of the *SCM Agreement* because they were "financial contributions" (mostly in the form of "grants") conferring a "benefit."[71] The original panel did not consider whether the statutory/regulatory provisions authorizing these payments were also "subsidies."

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[62] *Upland Cotton (Panel)*, para. 3.1(vi)). In the case of Brazil's "present" serious prejudice claims under Articles 5(c) and 6.3(d) of the *SCM Agreement*, the Panel understood Brazil as alleging that the relevant period was MY 1999 through MY 2001.

[63] *Upland Cotton (Panel)*, para. 3.1(vii)). In the case of Brazil's threat of serious prejudice claims under Articles 5(c) and 6.3(d) of the *SCM Agreement*, the Panel understood Brazil as alleging that the relevant period was MY 2002-2007.

[64] The original panel clarified that Brazil's claims against the programs *per se* were ones of threat of serious prejudice in *Upland Cotton (Panel)*, para. 7.1507. Brazil confirms in its response to the U.S. preliminary ruling requests that its "'per se' claim before the original panel was raised as a claim of 'threat of serious prejudice.'" *See* Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 70, n. 94.

[65] *Upland Cotton (Panel)*, para. 3.1(viii).

[66] *Upland Cotton (Panel)*, para. 3.1(viii)

[67] *Upland Cotton (Panel)*, para. 3.1(vi).

[68] *Upland Cotton (Panel)*, para. 3.1(vi). *See also Upland Cotton (Panel)*, para. 7.1108 ("Brazil claims that United States subsidies provided during MY 1999-2002 have caused, cause and continue to cause "serious prejudice" to Brazil's interests. . . .") and para. 7.1112 ("Brazil alleges that all of the challenged measures constitute "subsidies". According to Brazil, most of them – user marketing (Step 2) payments to domestic users and exporters; marketing loan programme payments; production flexibility contract payments; market loss assistance payments; direct payments; counter-cyclical payments; crop insurance subsidies1248; and cottonseed payments – provide "financial contributions" in the form of "grants" to participating United States producers, processors, users or exporters of upland cotton within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*.")

[69] *Upland Cotton (Panel)*, para. 7.1112-7.1120.

[70] *Upland Cotton (Panel)*, para. 7.1120.

[71] *Upland Cotton (Panel)*, paras. 7.1112-7.1120.

59. The original panel then found that only certain of the identified "subsidies" – namely, Step 2 payments, marketing loan payments, and counter-cyclical/market loss assistance payments provided in MY 1999-2002 – caused serious prejudice to the interests of Brazil under Articles 5(c) and 6.3(c):

> [i]n conclusion, in light of all of these considerations, we find that the effect of the mandatory, price contingent United States subsidies at issue – that is, marketing loan programme *payments*, user marketing (Step 2) *payments* and MLA *payments* and CCP *payments* – is significant price suppression in the same world market for upland cotton in the period MY 1999-2002 within the meaning of Articles 6.3(c) and 5(c) of the SCM Agreement.[72]

60. As shown in the table below, the original panel did not make any further finding of WTO inconsistency with respect to Brazil's claims.

Measure Challenged	**Claim Made**	**Resolution by Original Panel**	**Paragraph in Panel Report**
"U.S. subsidies provided during MY 1999-2002"	"Present" serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*	**Finding** of WTO-inconsistency against Step 2, marketing loan, and counter-cyclical/market loss assistance programs	7.14168.1(g)(i)
"U.S. subsidies provided during MY 1999-2001"	"Present" serious prejudice under Articles 5(c) and 6.3(d) of the *SCM Agreement*	**Rejected** for failure to make *prima facie* case	7.14658.1(g)(ii)
"U.S. subsidies provided during MY 1999-2002"	"Present" serious prejudice under Articles XVI:1 and XVI:3 of the GATT 1994	**Declined** to address, *inter alia*, because of finding of inconsistency with Articles 5(c) and 6.3(c) of the *SCM Agreement*	7.1476
"U.S. subsidies" allegedly "mandated" to be provided during MY 2003-2007	"Threat" of serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*	**Declined** to address in light of finding of inconsistency with Articles 5(c) and 6.3(c) and 3.1(a) and 3.2 of the *SCM Agreement*	7.1503
"U.S. subsidies" allegedly "mandated" to be provided during MY 2002-2007	"Threat" of serious prejudice under Articles 5(c) and 6.3(d) of the *SCM Agreement*	**Rejected** for failure to make *prima facie* case	7.1504
"U.S. subsidies" allegedly "mandated" to be provided during MY 2003-2007	"Threat" of serious prejudice under Articles XVI:1 and XVI:3 of the GATT 1994	**Declined** to address, *inter alia*, because of finding of inconsistency with Articles 5(c) and 6.3(c) of the *SCM Agreement*	7.1505
"selected provisions of the FSRI Act of 2002 and the ARP Act of 2000"	"Threat" of serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*	**Declined** to address in light of findings regarding export subsidies, import subsidies, "present" serious prejudice, and "threat" of serious prejudice	7.1511
"selected provisions of the FSRI Act of 2002 and the ARP Act of 2000"	"Threat" of serious prejudice under Articles 5(c) and 6.3(d) of the *SCM Agreement*	Same as above	7.1511

[72] *Upland Cotton (Panel)*, paras. 7.1416 (emphasis added).

Measure Challenged	Claim Made	Resolution by Original Panel	Paragraph in Panel Report
"selected provisions of the FSRI Act of 2002 and the ARP Act of 2000"	"Threat" of serious prejudice under Articles XVI:1 and XVI:3 of the GATT 1994	Same as above	7.1511

61. Upon appeal, the Appellate Body upheld the original panel's finding "that the effect of marketing loan program payments, Step 2 payments, market loss assistance payments, and counter-cyclical payments is significant price suppression within the meaning of Article 6.3(c) of the SCM Agreement."[73] Brazil did not appeal the panel's decisions to reject or decline to address its claims regarding "U.S. subsidies" allegedly "mandated" to be provided in MY 2003-2007 or the *per se* claims with respect to the programs. Moreover, Brazil's arguments to the Appellate Body reflected the understanding that the original panel's "present" serious prejudice finding applied only with respect to subsidies provided in MY 1999-2002.[74]

62. On 21 March 2005, the DSB adopted the Appellate Body report and the original panel report, as modified by the Appellate Body report.[75] This included adoption of the single actionable-subsidy related finding that "the effect of the mandatory, price contingent United States subsidies at issue – that is, marketing loan programme *payments*, user marketing (Step 2) *payments* and MLA *payments* and CCP *payments* – is significant price suppression in the same world market for upland cotton in the period MY 1999-2002 within the meaning of Articles 6.3(c) and 5(c) of the SCM Agreement."[76]

63. Brazil has not even attempted to reconcile its argument that the original panel's findings of "present" serious prejudice applied to the Step 2, marketing loan, and counter-cyclical payments with all of the facts above. Nor has Brazil addressed the other clear textual signals that – consistent with the claims presented to it – the original panel's findings of "present" serious prejudice were made with respect to payments made in MY 1999-2002. For example:

- The fact that the panel's prohibited subsidy-related conclusions and recommendations regarding the Step 2 program, *as such*, expressly refer to "section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters of upland cotton"[77] and "section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users of upland cotton."[78] If the findings and conclusions in paragraphs 8.3(d) and 8.1(g)(i) of the original panel report also pertained to the Step 2 program, *as such*, together with the marketing loan program and counter-cyclical payment program, the panel would certainly have included the same specific kind of reference, rather than a reference to *payments*.

- The fact that in Section VII:D of the Panel Report, dealing with the evaluation of domestic support measures under Article 13 of the *Agreement on Agriculture*, the original panel expressly stated that, "[i]n this Section of our report, the Panel will consider the current programmes 'as applied' and 'as such' together. Therefore, references to marketing loan programme, user marketing (step 2), direct,

[73] *Upland Cotton (AB)*, para. 496.
[74] *See e.g.*, *Upland Cotton (AB)*, para. 529.
[75] *United States – Subsidies on Upland Cotton*, Action by the Dispute Settlement Body, WT/DS267/20.
[76] *Upland Cotton (Panel)*, para. 7.1416.
[77] *See Upland Cotton (Panel)*, paras. 8.3(b) and 8.1(e).
[78] *See Upland Cotton (Panel)*, paras. 8.3(c) and 8.1(f).

counter-cyclical and crop insurance 'payments' include the legislative and regulatory provisions authorizing those payments unless otherwise indicated."[79] No similar statement can be found in Section VII:G, which is the section including the original panel's analysis of the effects of the subsidies alleged to be causing serious prejudice. In fact, the original panel in Section VII:G clearly distinguishes payments from provisions providing for those payments. Nor is there any similar statement made in connection with the recommendation in paragraph 8.3(d) of the panel report (or paragraph 8.1(g)(i), which contains the conclusion on actionable subsidies to which the recommendation relates).

64. For the reasons above, it is clear that the original panel did *not* make any finding under Article 5(c) and 6.3(c) of the *SCM Agreement* against the marketing loan and counter-cyclical payment programs, as such, whether alone or in addition to payments.

(2) Brazil seeks to read aspects of the original panel report out of context and inconsistently with the clear evidence that the findings of "present" serious prejudice were with respect to a package of payments made in MY 1999-2002

65. Brazil's arguments to the contrary grasp at isolated statements in the original panel report and attempt to attribute to them meaning that is directly undermined by all of the evidence above. First, Brazil argues that the original panel found both payments and programs to be part of its terms of reference and that "[t]he United States did not appeal these findings."[80] This argument is irrelevant. The United States does not dispute that the original panel considered both programs and payments to be within its terms of reference. The question is what measures were subject to the original panel's finding of "present" serious prejudice.

66. Second, Brazil attempts to attach significance to the fact that the listing of the "measures at issue" in paragraph 7.1107 does not include a "temporal limitation." Brazil argues that this means that the original panel was disregarding its own clear acknowledgment:

- in the very next paragraph – under the heading "Overview of Brazil's present serious prejudice claims under the *SCM Agreement* and GATT 1994" – that "Brazil claims that United States *subsidies provided during MY 1999-2002* have caused, cause and continue to cause 'serious prejudice' to Brazil's interests by [*inter alia*] . . . significantly suppressing upland cotton prices in the United States, world and Brazilian markets in violation of Articles 5(c) and 6.3(c) of the SCM Agreement;"[81] and

- in paragraph 3.1(vi) that "Brazil requests that the Panel make the following findings . . . concerning present serious prejudice to the interests of Brazil: the *subsidies provided during MY 1999-2002* caused and continue to cause serious prejudice to the interests of Brazil by suppressing upland cotton prices in the U.S., world, and Brazilian markets for upland cotton in violation of Articles 5(c) and 6.3(c) of the *SCM Agreement*."[82]

67. According to Brazil, by not including a "temporal limitation" in paragraph 7.1107, the original panel was also ignoring Brazil's repeated clarifications in the original proceeding that its claims of "present" serious prejudice applied to subsidies provided in MY 1999-2002:

[79] ***Upland Cotton (Panel)*, para. 7.337(ix), n. 466.**
[80] Brazil Responses to Panel Section A-C Questions, para. 86-87 (February 26, 2007).
[81] *Upland Cotton (Panel)*, para. 7.1108.
[82] *Upland Cotton (Panel)*, para. 3.1(vi) (emphasis added).

- "Brazil's actionable subsidy claims" comprise "first, claims of present serious prejudice resulting from subsidies *provided in MY 1999-2002*;"[83]

- "The U.S. subsidies *provided during MY 1999-2002* cause present significant price suppression in the world and Brazilian market, as well as in markets where Brazilian producers export."[84]

- "Brazil's first serious prejudice claim relates to the significant price suppression caused by U.S. actionable subsidies in violation of Articles 5(c) and 6.3(c) of the SCM Agreement. The measures involved are *subsidies provided in each year between MY 1999-2002, under the 1996 FAIR Act, the 2000 ARP Act and the 2002 FSRI Act*."[85]

- "The first [Brazilian adverse effects claim] is that the effect of the U.S. subsidies *provided during each of the MY 1999-2002* have caused and continue to cause significant price suppression in the U.S., Brazilian, and other world markets for upland cotton."[86]

- "Brazil sets forth evidence below from which the Panel may conclude that the effects of the *U.S. subsidies in MY 1999-2002* is significant price suppression in MY 1999-2002 in the U.S., world and Brazilian market, as well as in third country markets where Brazil exported its upland cotton."[87]

- "Based on the arguments and evidence presented above, Brazil requests that this Panel make the following findings and recommendations . . . The U.S. subsidies *provided during MY 1999-2002* caused and continue to cause serious prejudice to the interest of Brazil by suppressing upland cotton prices in the U.S., world and Brazilian markets for upland cotton in violation of Articles 5(c) and 6.3(c) of the SCM Agreement."[88]

- "First, I will discuss Brazil's present serious prejudice claims that relate to U.S. subsidies provided for the production, export and use of U.S. upland cotton during the period MY 1999-2002. The four-year period in which these subsidies were provided is *both the period of time covering the measures challenged by Brazil as well as the period of investigation to examine present serious prejudice caused by the U.S. subsidies under Articles 5(c) and 6.3 of the SCM Agreement*."[89]

68. Brazil's argument regarding the absence of a "temporal limitation" in paragraph 7.1107 is simply not credible. Rather, the more logical explanation is that the original panel was identifying in paragraph 7.1107 the types of measures at issue in the case of Brazil's "present" serious prejudice claims – specifically, payments and, thus, the application of the "legislative and regulatory provisions" providing for such payments. The original panel then went on to explain and address the *specific* payments (*i.e.*, application of the "legislative and regulatory provisions" in particular years) that were subject to the claims of "present" serious prejudice.

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[83] Brazil's 9 September 2003 Further Submission, para. 9 (emphasis added).
[84] Brazil's 9 September 2003 Further Submission, para. 14 (emphasis added).
[85] Brazil's 9 September 2003 Further Submission, para. 71 (emphasis added).
[86] Brazil's 9 September 2003 Further Submission, para. 100 (emphasis added).
[87] Brazil's 9 September 2003 Further Submission, para. 104 (emphasis added).
[88] Brazil's 9 September 2003 Further Submission, para. 471 (emphasis added).
[89] Brazil's 7 October 2003 Second Statement at First Panel Meeting, para. 3 (emphasis added).

69. Third, Brazil argues that MY 1999-2002 was simply a "reference period" and did not "circumscribe[] the *measures* involved in Brazil's present serious prejudice claims."[90] This is directly contradicted by Brazil's own repeated reference to "subsidies provided in MY 1999-2002" as the measures subject to its "present" serious prejudice claims, as well as its own *express* acknowledgment that:

> Brazil's present serious prejudice claims . . . relate to U.S. subsidies provided for the production, export and use of U.S. upland cotton during the period MY 1999-2002. The four-year period in which these subsidies were provided is *both the period of time covering the measures challenged by Brazil as well as the period of investigation to examine present serious prejudice caused by the U.S. subsidies under Articles 5(c) and 6.3 of the SCM Agreement.*"[91]

70. Fourth, Brazil asserts as "evidence" that the "present" serious prejudice claims applied to programs, not payments, the fact that the original panel decided not to apply the precise quantification rules in Part V of the *SCM Agreement*. According to Brazil, "[i]f the original panel's findings had related to 'payments' alone, and not to the subsidy program, its reasoning would have been very different indeed."[92] Brazil's argument, again, makes little sense. As Brazil well knows, the original panel declined to apply the precise quantification rules in Part V because it found that this was not required in the case of *any* claims under Part III of the *SCM Agreement*, not because it was examining the effects of programs, as Brazil asserts:

> In view of the contrast in the text, context, legal nature and rationale of the provisions in Part III of the SCM Agreement relating to a multilateral assessment as to whether a Member is causing, through the use of any subsidy, "adverse effects" in the form of "serious prejudice to the interests of another Member" and Part V of the Agreement relating to obligations of a Member in conducting a unilateral countervailing duty investigations, we decline to transpose directly the quantitative focus and more detailed methodological obligations of Part V into the provisions of Part III of the SCM Agreement.[93]

71. Nor is it surprising that the original panel would have looked to how the Step 2, marketing loan, and counter-cyclical payment programs operate generally in assessing whether particular payments under those programs were causing adverse effects. Payments are the application of programs in particular circumstances. It is absurd for Brazil to suggest that a finding of "present" serious prejudice could only be understood to have been made with respect to specific payments, if the original panel had put on blinders regarding the structure, nature, and operation of programs pursuant to which the payments were provided.

72. Finally, Brazil again underscores the statement by the original panel that "[b]ecause the Panel's 'present' serious prejudice finding deal with the FSRI Act of 2002 and subsidies granted thereunder in MY 2002, the United States is obliged to take action concerning its present statutory and regulatory framework as a result of our 'present' serious prejudice finding."[94] As the United States has explained, however, Brazil's reliance on this language is misplaced. The panel states that its "present" serious prejudice findings "deal with" the statute; it does not state that it found the statutory provisions to be WTO-inconsistent, as such, as Brazil suggests. Indeed, the panel's statement is properly understood as reflecting the panel's view that payments under a program constitute programs "as applied" and, thus, a finding against payments is a finding against programs "as applied."

[90] Brazil Responses to Panel Section A-C Questions, para. 136 (February 26, 2007).
[91] Brazil's 7 October 2003 Second Statement at First Panel Meeting, para. 3 (emphasis added).
[92] Brazil's 7 October 2003 Second Statement at First Panel Meeting, para. 96 (emphasis added).
[93] *Upland Cotton (Panel)*, para. 7.177.
[94] Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 63.

73. Moreover, regarding the original panel's statement that the United States would be "obliged to take action concerning" the statutory/regulatory provisions as a result of the "present" serious prejudice finding, the United States notes, first, that this is not a recommendation[95] and Brazil has conceded as much.[96] Rather, this appears to be a statement of the original panel's views as to what would be a likely response of the United States to the recommendation that the original panel *did* make to remove the adverse effects of, or withdraw, the "subsidy" that the original panel had identified. And the United States did indeed take action to repeal the Step 2 program. While the original panel may have considered that the adverse effects of the "subsidy" it was examining would be eliminated through "action concerning" the statutory provisions authorizing the payments, this does not change the fact that the "subsidy" it was examining was a package of payments made in MY 1999-2002 under the Step 2, marketing loan, and counter-cyclical payment programs, and not the programs, as such, or the programs in addition to payments thereunder.

(3) Conclusion

74. As shown above and in the U.S. submissions, there is no basis for Brazil's efforts to rewrite the original panel report. Brazil demands that this Panel find that the original panel acted inappropriately; that the original panel disregarded the very matter that it expressly *recognized* Brazil as having presented[97] and made findings on different matters not before it without so much as an explanation or any identification of the legal basis for such action, and in complete disregard of the fact that similar action has been found impermissible in other disputes.[98] Moreover, Brazil asks the Panel to believe that the original panel made findings of WTO-inconsistency against certain programs, as such, and against payments allegedly mandated to be made in certain future years without even addressing the extensive arguments that the parties made in respect of those claims, and without making any of the factual findings that *Brazil* conceded would be necessary to support an affirmative finding of WTO-inconsistency.[99] Nothing in the original panel report compels such a result.

[95] The original panel's recommendations simply provide, in relevant part, that "upon adoption of this report, the United States is under an obligation to 'take appropriate steps to remove the adverse effects or ... withdraw the subsidy'" subject to the conclusion in paragraph 8.1(g)(i). Paragraph 8.1(g)(i) provides that "the effect of the mandatory price-contingent United States subsidy measures – marketing loan programme *payments*, user marketing (Step 2) *payments*, MLA *payments* and CCP *payments* – is significant price suppression in the same world market within the meaning of Article 6.3(c) of the SCM Agreement constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*." *Upland Cotton (Panel)*, para. 8.1(g)(i).

[96] Brazil First Written Submission, para. 32.

[97] *Upland Cotton (Panel)*, para. 3.1(vi).

[98] *See e.g., Chile – Price Bands (AB)*, para. 173 (finding that, by making a finding on a mater that was not before it, the Panel acted *ultra petita* and inconsistently with Article 11 of the DSU.") *Chile – Price Bands (AB)*, para. 173.

[99] For example, in the case of its claims against the challenged programs, *per se*, Brazil asked the Panel "to find that the mandatory provisions of the 2002 FSRI Act and the 2000 ARP Act together with their implementing regulations, as listed above, *cannot be applied in a WTO consistent manner*." Brazil's 9 September 2003 Further Submission, para. 435-436. Explaining what this would mean in the context of this dispute, Brazil argued "[f]irst, the Panel needs to evaluate whether the U.S. subsidies will *necessarily threaten* to cause serious prejudice at price levels below the trigger prices of the U.S. subsidies. Second, the Panel needs to consider whether the U.S. subsidies threaten to cause serious prejudice *even at price levels at which only crop insurance subsidies and direct payments are made*." Brazil's 9 September 2003 Further Submission, para. 426 (emphasis added). The original panel did not conduct the requested evaluation and did not make the requested findings.

12. In paragraph 44 of its Rebuttal Submission, Brazil states:

> ***"Accordingly, there is no need for Brazil to challenge per se the FSRI Act of 2002. Nor does it assert an 'as applied' challenge to the FSRI Act of 2002. Rather, Brazil challenges the counter-cyclical and marketing loan programs in the FSRI Act of 2002 and the payments that such programmes require to U.S. upland cotton farmers, as they cause adverse effects." (emphasis added)***

Could Brazil please explain:

a. How its claims against "programmes and payments... as they cause adverse effects" differ from claims against programmes as such?

b. How these claims differ from claims against programmes as applied?

75. First, Brazil's response to these questions – in particular, its acknowledgment that there is no "practical difference between challenging the programs and payments, and challenging the programs as such" – confirm that Brazil is attempting to make an "as such" challenge without establishing any of the necessary facts. Again, the United States reiterates the Appellate Body's caution that:

> "[A]s such" challenges against a Member's measures in WTO dispute settlement proceedings are serious challenges. By definition, an "as such" claim challenges laws, regulations, or other instruments of a Member that have general and prospective application, asserting that a Member's conduct – not only in a particular instance that has occurred, but in future situations as well – will necessarily be inconsistent with that Member's WTO obligations. In essence, complaining parties bringing 'as such' challenges seek to prevent Members *ex ante* from engaging in certain conduct.
>
> The implications of such challenges are obviously more far-reaching than "as applied" claims. We also expect that measures subject to 'as such' challenges would normally have undergone, under municipal law, thorough scrutiny through various deliberative processes to ensure consistency with the Member's international obligations, including those found in the covered agreements, and that the enactment of such a measure would implicitly reflect the conclusion of that Member that the measure is not inconsistent with those obligations. The presumption that WTO Members act in good faith in the implementation of their WTO commitments is particularly apt in the context of measures challenged "as such.[100]

76. Consistent with the very "definition" of as such challenges, to successfully prosecute this type of challenge, a complaining party must show that "a Member's conduct – not only in a particular instance that has occurred, but in future situations as well – will necessarily be inconsistent with that Member's WTO obligations."[101] Brazil has recognized this both in this dispute[102] and others."[103] Brazil has argued that "[i]t is established under WTO law that a Member can only challenge measures

[100] *U.S. – Argentina OCTG Sunset Reviews (AB)*, paras. 172-173.

[101] *U.S. – Argentina OCTG Sunset Reviews (AB)*, paras. 172.

[102] Brazil First Submission in Original Panel Proceding, para. 244 (citing *US – 1916 Act (AB)*, para. 88).

[103] *See e.g., Canada – Aircraft II (Panel)*, paras. 7.56-7.58 ("Given that Brazil's claims are in respect of the programmes as such, the mandatory/discretionary distinction would traditionally apply. . . .There is . . . no disagreement between the parties regarding the applicability of the mandatory/discretionary distinction.").

of another Member *per se* if such measures mandate a violation of the WTO Agreement."[104] The United States agrees fully.

77. Indeed, in the original proceeding, Brazil had argued that, in order to make an affirmative finding of WTO-inconsistency against the challenged programs, *per se*:

> [T]he Panel needs to evaluate whether the U.S. subsidies will *necessarily threaten to cause serious prejudice* at price levels below the trigger prices of the U.S. subsidies. Second, the Panel needs to consider whether the U.S. subsidies *threaten to cause serious prejudice even at price levels at which only crop insurance subsidies and direct payments are made*."[105]

78. Similarly, Brazil asked the Panel "to find that the mandatory provisions of the 2002 FSRI Act and the 2000 ARP Act together with their implementing regulations, as listed above, *cannot be applied in a WTO consistent manner*."[106]

79. The fact that the original panel neither conducted the requested evaluations, nor made any findings along the lines requested by Brazil confirms – once again – that the panel made no adverse effects finding with respect to the Step 2, marketing loan, and counter-cyclical payment programs as such (either alone or in addition to any payments). Moreover, Brazil's express acknowledgment of its obligations in making an as such claim in the original proceeding underscores the unreasonableness of its efforts to evade those obligations here.

80. Second, it is remarkable that having carefully set out "as applied" and "as such" claims in the original proceeding, Brazil now asserts that "serious prejudice claims are among those that cannot be readily classifiable as 'as such' and 'as applied.'"[107] Brazil asserted no difficulty in "classifying" the claims in the original proceeding. The original panel had no difficulty in resolving Brazil's claims as so "classified." And panels in other disputes have not had such difficulty either.[108] Brazil's assertion of such difficulties for the first time in this proceeding – and with the aim of impermissibly expanding the scope of this proceeding – are not credible.

13. In paragraph 45 of its Rebuttal Submission, Brazil refers to the failure of the United States "to implement the original recommendation of the DSB requiring the United States to take actions concerning its present statutory and regulatory framework providing for marketing loan and counter-cyclical payments".

a. Does Brazil consider that the statement in paragraph 7.1501 of the original panel report that "the United States is obliged to take action concerning its present statutory and regulatory framework..." forms an integral part of the recommendation made by the original panel in paragraph 8.3(d) of its report?

b. Does Brazil consider that the absence of actions by the United States "concerning its present statutory and regulatory framework providing for marketing loan and counter-cyclical payments" is in itself a sufficient basis

[104] Brazil First Submission in Original Panel Proceding, para. 244 (citing *US – 1916 Act (AB)*, para. 88).

[105] Brazil Further Submission, para. 426 (9 September 2003) (emphasis added).

[106] Brazil Further Submission, para. 435-436 (9 September 2003).

[107] Brazil Responses to Panel Section A-C Questions, paras. 114 and 118 (February 26, 2007).

[108] *See e.g., Korea – Ships (Panel)*, para. 7.679 (examining serious prejudice from "a relative handful of individual subsidized transactions" and not the programs providing for the subsidization as such).

for this Panel to find that the United States has not complied with the DSB recommendation under Article 7.8 of the SCM Agreement?

c. Is there any difference, in Brazil's view, between, on the one hand, the nature of the action the United States was obliged to take with respect to its statutory and regulatory framework as a consequence of the recommendation in paragraph 8.3(d) of the original panel report and, on the other, the nature of the action the United States would have been obliged to take if the original panel had found that the relevant provisions of this statutory and regulatory framework were WTO-inconsistent as such?

81. The United States offers two comments in regard to Brazil's responses to these questions.

82. First, the United States notes that having conceded that the language in paragraph 7.1501 was *not* part of any recommendation by the original panel[109], Brazil now changes its position and asserts that "the statement in paragraph 7.1501 of the original panel report forms an integral part of the recommendation made by the original panel in paragraph 8.3(d) of its report."[110] Indeed, Brazil goes even further and argues now that the panel's recommendation required the United States to take "actions . . . 'concerning *its present statutory and regulatory framework providing for marketing loan and counter-cyclical payments*'" even though paragraph 7.1501 states no such thing.[111]

83. These assertions are fundamentally at odds with DSU Article 19.1. Article 19.1 of the DSU controls on the question of the recommendations that a panel can make where it "concludes that a measure is inconsistent with a covered agreement." In those circumstances, the panel "*shall* recommend that the Member concerned bring the measure into conformity with that agreement." The term "shall" confirms that this is the *required* recommendation; a panel is not free to recommend something else. Contrary to Brazil's allegations, the Appellate Body has clarified that panels do not have authority to dictate to Members the specific way to "bring the measure into conformity with that agreement."[112] It is left to the discretion of the Member concerned to determine how best to do so.

84. The same result obtains upon an analysis of Article 7.8 of the *SCM Agreement*, which establishes the obligations of a Member "where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy [of the responding Member] has resulted in adverse effects to the interests of [another] Member within the meaning of Article 5." In those circumstances, the responding Member may either "take appropriate steps to remove the adverse effects" or "withdraw the subsidy." Article 7.8 of *SCM Agreement* does not provide that a panel may dictate precisely how the Member is to meet these obligations. And, indeed, were a panel to do so, it would raise serious concerns under that provision, Article 3.2 of the DSU, which provides that "[r]ecommendations and rulings of the DSB cannot add to or diminish the rights and obligations provided in the covered agreements," and Article 19.2 of the DSU, which provides that "in [its] findings and recommendations, the panel . . . cannot add to or diminish the rights and obligations provided in the covered agreements."

85. Thus, the United States does not consider that it is appropriate to interpret the language in paragraph 7.1501 in the manner asserted by Brazil, which would attribute to the original panel action inconsistent with Article 19.1 of the DSU and Article 7.8 of the *SCM Agreement*. Rather, the

[109] Brazil First Written Submission, para. 32.

[110] Brazil Responses to Panel Section A-C Questions, para. 119 (February 26, 2007).

[111] Brazil Responses to Panel Section A-C Questions, para. 120 (February 26, 2007).

[112] *See e.g., EC – Customs (AB)*, para. 134. Indeed, while Article 19.1 of the DSU permits panels to "suggest ways in which the Member concerned could implement the recommendations," it is clear from the text that such a suggestion is not a recommendation and is not binding.

United States considers that the more logical understanding of the language in paragraph 7.1501 is that it is a statement of the original panel's views as to what would be a likely response of the United States to implement the recommendation to remove the adverse effects of, or withdraw, the "subsidy" that the original panel had identified, particularly in light of the fact that the original panel was at the same time making a finding that the Step 2 program was a prohibited subsidy and so the United States would in fact be obliged to change its statutory and regulatory framework as part of its response to that prohibited subsidy finding.

86. Second, the United States disagrees with Brazil's assertion that "the action required by the United States would have been the same" if the recommendation in paragraph 8.3(d) of the panel report had applied to the Step 2, counter-cyclical payment, and marketing loan programs, as such, rather than against particular payments made under those programs in MY 1999-2002, as was the case. If the recommendation had applied to programs, as such, the "action required by the United States" would have been to either (a) withdraw the programs themselves or (b) remove the adverse effects of the programs. As the recommendation applied to certain payments made in MY 1999-2002, the "action required by the United States" was to either (a) withdraw the particular payments; or (b) remove the adverse effects of the specific payments. While it is conceivable that the United States could *choose* to take the same or similar steps in both cases, this does not mean that the "action required by the United States" would be the same.

14. Could Brazil please explain how this Panel should interpret the relationship between the three categories of measures identified in paragraph 3.1(v),(vii) and (viii) of the original panel report? Is it the view of Brazil that "subsidies provided" or "subsidies mandated to be provided" must be interpreted to encompass both payments of subsidies and the regulatory provisions pursuant to which such payments were "provided" or "mandated to be provided"?

87. Please see the U.S. comments regarding Brazil's response to Question 11 above. The United States notes, in addition, that Brazil provides no citation or other basis for its assertion that "the measures identified in paragraphs 3.1(vi) and 3.1(vii)" – *i.e.,* "U.S. subsidies provided during MY 1999-2002" and "U.S. subsidies mandated to be provided in MY 2003-2007" – "must be interpreted to encompass the statutory and legislative framework establishing the contested subsidy programs, as well as payments mandated by those programs."[113]

88. Brazil's argument is also inconsistent with its own clarification in the original proceeding that:

> Brazil's . . . Panel Request . . . challenges two types of domestic support 'measures' provided to upland cotton and various different types of export subsidy measures. The first type of domestic support "measure" is the *payment* of subsidies for the production and use of upland cotton. These *payments* were and continue to be made between MY 1999 to the present (and will be made through MY 2007) through the various statutory and regulatory instruments listed on pages 2-3 of Brazil's Panel Request. Brazil referred to these payments at pages 2-3 of the Panel Request as *'subsidies and domestic support provided under' or 'mandated to be provided' under the various listed statutory and regulatory instruments*. . . .Brazil's "Further Submission" on 9 September 2003 will provide considerable detail concerning the effects of the subsidies provided and mandated to be provided by the United States. *It is these effects in respect of which Brazil seeks relief with respect to the first type of domestic support measures*.
>
> A second type of domestic support "measure" challenged by Brazil are *legal instruments as such*. The "legislative and regulatory provisions, by number and

[113] Brazil Responses to Panel Section A-C Questions, para. 119 (February 26, 2007).

> letter, in respect of which Brazil seeks relief" are those involving the 2002 FSRI Act and the 2000 Agricultural Risk Protection Act . . . .[114]

89. Brazil's new argument is also inconsistent with the original panel's analysis of the subsidies subject to Brazil's "present" serious prejudice claims. As noted above, the original panel identified as the "challenged measures" that were alleged to be the "subsidies" for purposes of Brazil's "present" serious prejudice claims the following – "user marketing (Step 2) *payments* to domestic users and exporters; marketing loan programme *payments*; PFC *payments*; MLA *payments*; DP *payments*; CCP *payments*; crop insurance *payments*; and cottonseed *payments*."[115] The original panel found that these constituted "subsidies" within the meaning of Article 1 of the *SCM Agreement* because they were "financial contributions" (mostly in the form of "grants") conferring a "benefit."[116] The original panel did not consider whether the statutory/regulatory provisions authorizing these payments were also "subsidies."

90. Finally, Brazil's argument makes little sense in light of the fact that Brazil made separate claims of *threat* of serious prejudice "concerning selected provisions of the FSRI Act of 2002 and the ARP Act of 2000."[117] Brazil tries to explain this away by arguing that it was simply being "over-inclusive."[118] Brazil provides no explanation of why it would be "over-inclusive" in the case of its threat claims but not when it came to the "present" serious prejudice claims. These arguments are nothing more than *post hoc* attempts to change the claims Brazil presented in the original proceeding and the resolution thereof.

15. Does Brazil agree or disagree with the United States that the listing of certain legislative and regulatory provisions in paragraph 7.1107 of the original panel report reflects the original panel's view that "payments under a programme constitute programmes 'as applied'"? [Paragraphs 46-47 of the Rebuttal Submission of the United States]

91. For the reasons set out in prior U.S. submissions and the U.S. comments regarding Brazil's response to Question 11 above, there is no merit to Brazil's assertion that the original panel's finding of "present" serious prejudice applied to the Step 2, marketing loan, and counter-cyclical payment programs and all payments thereunder. The further bases asserted by Brazil in response to this question also fail to withstand scrutiny.

92. First, Brazil argues that "[t]he United States' 'as applied' argument incorrectly transforms the original panel's decision to use MY 2002, and the longer period of MY 1999 – MY 2002, as 'reference periods,' into a period that circumscribes the *measures* involved in Brazil's present serious prejudice claims."[119] Yet this is precisely what Brazil clarified in the resumed session of the first meeting with the panel in the original proceeding:

> First, I will discuss Brazil's present serious prejudice claims that relate to U.S. subsidies provided for the production, export and use of U.S. upland cotton during the period MY 1999-2002. *The four-year period in which these subsidies were provided is both the period of time covering the measures challenged by Brazil as well as the*

[114] Answers of Brazil to Questions from the Panel, para. 15-16 (11 August 2003).
[115] *Upland Cotton (Panel)*, para. 7.1120.
[116] *Upland Cotton (Panel)*, paras. 7.1112-7.1120.
[117] *Upland Cotton (Panel)*, para. 3.1(viii).
[118] Brazil Responses to Panel Section A-C Questions, para. 132 (February 26, 2007).
[119] Brazil Responses to Panel Section A-C Questions, para. 135(February 26, 2007).

period of investigation to examine present serious prejudice caused by the U.S. subsidies under Articles 5(c) and 6.3 of the SCM Agreement.[120]

93. Brazil cannot explain this away by asserting that this was a unique statement by Brazil and not representative of Brazil's actual position (as it attempted to do in the meeting with the Panel). It is difficult to credit that in the presentation of it case to the original panel, Brazil would provide an incorrect statement on an issue as fundamental as the measures subject to its claims of "present" serious prejudice. In any event, other assertions by Brazil in the original proceeding fully confirm that the measures subject to Brazil's "present" serious prejudice claim – and, hence, the original panel's finding of "present" serious prejudice – were subsidies provided in MY 1999-2002, not subsidies allegedly "mandated" to be provided in later years and not the statutory/regulatory provisions authorizing the payments:

- "Brazil's actionable subsidy claims" comprise "first, claims of present serious prejudice resulting from subsidies *provided in MY 1999-2002*;"[121]

- "The U.S. subsidies *provided during MY 1999-2002* cause present significant price suppression in the world and Brazilian market, as well as in markets where Brazilian producers export."[122]

- "Brazil's first serious prejudice claim relates to the significant price suppression caused by U.S. actionable subsidies in violation of Articles 5(c) and 6.3(c) of the SCM Agreement. The measures involved are *subsidies provided in each year between MY 1999-2002, under the 1996 FAIR Act, the 2000 ARP Act and the 2002 FSRI Act*."[123]

- "The first [Brazilian adverse effects claim] is that the effect of the U.S. subsidies *provided during each of the MY 1999-2002* have caused and continue to cause significant price suppression in the U.S., Brazilian, and other world markets for upland cotton."[124]

- "Brazil sets forth evidence below from which the Panel may conclude that the effects of the *U.S. subsidies in MY 1999-2002* is significant price suppression in MY 1999-2002 in the U.S., world and Brazilian market, as well as in third country markets where Brazil exported its upland cotton."[125]

- "Based on the arguments and evidence presented above, Brazil requests that this Panel make the following findings and recommendations . . . The U.S. subsidies *provided during MY 1999-2002* caused and continue to cause serious prejudice to the interest of Brazil by suppressing upland cotton prices in the U.S., world and Brazilian markets for upland cotton in violation of Articles 5(c) and 6.3(c) of the SCM Agreement."[126]

94. Second, as discussed above, the fact that there is no "temporal limitation" in paragraph 7.1107 is not remarkable. That paragraph simply describes the types of measures at issue. In the very next

[120] Brazil's 7 October 2003 Second Statement at First Panel Meeting, para. 3 (emphasis added).
[121] Brazil's 9 September 2003 Further Submission, para. 9 (emphasis added).
[122] Brazil's 9 September 2003 Further Submission, para. 14 (emphasis added).
[123] Brazil's 9 September 2003 Further Submission, para. 71 (emphasis added).
[124] Brazil's 9 September 2003 Further Submission, para. 100 (emphasis added).
[125] Brazil's 9 September 2003 Further Submission, para. 104 (emphasis added).
[126] Brazil's 9 September 2003 Further Submission, para. 471 (emphasis added).

paragraph – under the heading "Overview of Brazil's present serious prejudice claims under the *SCM Agreement* and GATT 1994" – the panel expressly clarified that "Brazil claims that United States *subsidies provided during MY 1999-2002* have caused, cause and continue to cause 'serious prejudice' to Brazil's interests by [*inter alia*] . . . significantly suppressing upland cotton prices in the United States, world and Brazilian markets in violation of Articles 5(c) and 6.3(c) of the SCM Agreement;"[127] This is consistent with paragraph 3.1(vi), in which the original panel set out the claim presented as follows:

> Brazil requests that the Panel make the following findings . . . concerning present serious prejudice to the interests of Brazil: the *subsidies provided during MY 1999-2002* caused and continue to cause serious prejudice to the interests of Brazil by suppressing upland cotton prices in the U.S., world, and Brazilian markets for upland cotton in violation of Articles 5(c) and 6.3(c) of the *SCM Agreement*.[128]

95. Similarly, there is no merit to Brazil's efforts to claim the absence of a temporal limitation in paragraph 8.1(g) as evidence that the finding of "present" serious prejudice applies to Step 2, marketing loan, and counter-cyclical programs and all payments thereunder. There was no reason for the panel to have included such a limitation in that paragraph given that:

- the panel had already explained earlier in its report what the "subsidies" were (certain payments)[129] and that Brazil's claims of serious prejudice only applied to "subsidies provided during MY 1999-2002;"[130] and

- the only "subsidies" that were even capable of causing "present" serious prejudice were the ones provided in MY 1999-2002 and not the ones allegedly "mandated" to be provided in MY 2003-2007.

The latter not only were *not* the subject of Brazil's present serious prejudice claims but also were not yet even in existence at that time. Thus, the original panel may reasonably have considered it unnecessary to specify that the particular payments to which the finding of "present" serious prejudice applied were the payments that had actually been made in MY 1999-2002.[131]

96. Third, Brazil argues that the use of the present tense in Article 8.1(g) – "the effect of mandatory price-contingent United States subsidy measures . . . *is* significant price suppression" – signals that the "subsidy measures" could not have been payments made in the past. This argument is flawed for a number of reasons. First, the original panel's conclusion in paragraph 7.1416, on which the finding in paragraph 8.1(g) is based, expressly states that "the effect ... is significant price suppression ... *in the period MY 1999-2002*." Thus, Brazil's argument does not even comport with the panel's own express conclusions.

97. Second, Brazil's argument assumes that payments made in the past could not be causing *present* significant price suppression. This is undermined by the Appellate Body finding precisely to the contrary – "the effects of a 'recurring' subsidy may continue after the year in which it is paid."[132]

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[127] *Upland Cotton (Panel)*, para. 7.1108.

[128] *Upland Cotton (Panel)*, para. 3.1(vi) (emphasis added).

[129] *Upland Cotton (Panel)*, para. 7.1120.

[130] *Upland Cotton (Panel)*, para. 7.1108.

[131] Indeed, the conclusion of the panel's report necessarily is based on and reiterates the panel's findings as set out previously in the report. *See Upland Cotton (Panel)*, para. 7.1416. The conclusion could not alter that previous finding since the panel then would not have set out the basic rationale behind its findings as required DSU Article 12.7.

[132] *Upland Cotton (AB)*, para. 484, although the Appellate Body did not explain that in fact in this instance the effects did indeed persist nor what these effects were nor how they persisted.

Indeed, it is surprising that Brazil would assert otherwise given that it forcefully argued before the Appellate Body that subsidies provided in MY1999-2002 must be found to be capable of having "present" effects at the time of the appeal (*i.e.*, in late 2004 to 2005) in order for it to have any remedy in the dispute. Brazil argued, specifically, that if the U.S. arguments to the contrary were credited "Brazil will have no remedy under Article 7.8 of the SCM Agreement for its serious prejudice, since it is allegedly legally impossible for the MY 2002 price-contingent recurring subsidies to have any adverse effects after 31 August 2003 (the close of MY 2002)."[133] It is difficult to see how Brazil could claim to have "no remedy" if, as Brazil attempts to argue now, the original panel had actually made a "serious prejudice" finding not only against the Step 2, marketing loan, and counter-cyclical payments made in MY 1999-2002 but also the programs themselves and all payments (including future payments) allegedly "mandated" to be made under the programs. Indeed, Brazil's argument only makes sense if – as is actually the case – the original panel's serious prejudice finding applied in respect of payments made in MY 1999-2002.

98. Fourth, Brazil argues again that the original panel would not have stated that the United States was obligated to take action concerning its "present statutory and regulatory framework" unless the statutory and regulatory framework was, as such, the measure subject to the original panel's finding of "present" serious prejudice. This is simply incorrect. Brazil attempts to conflate two distinct issues: (a) what measures were subject to findings/DSB recommendations and rulings and (b) what the United States could to do to implement the findings. The original panel may reasonably have considered that, because of both the export subsidy findings against the Step 2 program as such and the adverse effects findings against the Step 2, marketing loan, and counter-cyclical payment programs as applied in particular years, the United States would take action with respect to the statutory/regulatory framework. But this does not change the fact that the adverse effects findings were made with respect to the application of the Step 2, marketing loan, and counter-cyclical payment programs in MY 1999-2002, not the programs as such.

99. In conclusion, there is no basis for Brazil's reading of the original panel's report that would, rather, re-write what is found there. To the contrary, the evidence – including, *inter alia*, Brazil's own explanation of its claims in the original proceeding, the original panel's explanation of the claims presented to it, the original panel's resolution of those claims (and, in particular, its rejection or refusal to address all but the single "present" serious prejudice claim in respect of payments made in MY 1999-2002), the absence of factual findings that Brazil expressly stated would be *necessary* for an "as such" adverse effects finding against the Step 2, marketing loan, and counter-cyclical payment programs, and Brazil's own explanation to the Appellate Body that it would have a "remedy" only to the extent that payments made in MY 1999-2002 were considered to have continuing effects past the year in which they were made – confirm that the original panel made a finding of "present" serious prejudice with respect to payments made under the Step 2, marketing loan, and counter-cyclical payment programs in MY 1999-2002, not with respect to any future payments and not with respect to the programs *per se*.

100. Finally, there is no merit to Brazil's argument that "even assuming that the original panel's findings of present serious prejudice were 'as applied' findings limited to marketing loan and counter-cyclical payments made during a particular historical period (***quod non***), subsequent payments made under the same program are also subject to the United States' implementation obligations."[134] Brazil cites to *U.S. – Softwood Lumber IV (21.5)* to support this argument. However, that dispute said nothing about whether a complaining party could, in *post hoc* fashion, attempt to add to the measures found to be WTO-inconsistent by asserting that other measures not found to be WTO-inconsistent are similar. Rather, that dispute addressed the distinct issue of what measures could be considered to be part of the *measure taken to comply*. Future payments in MY 2003-2007 are not measures taken to comply with any recommendations and rulings. To the contrary, they were original measures that

[133] *Upland Cotton (AB)*, para. 529.
[134] Brazil Responses to Panel Section A-C Questions, para. 145 (February 26, 2007).

were challenged by Brazil but against which the original panel made no finding of WTO-inconsistency. The reasoning in *U.S. – Softwood Lumber IV (21.5)* does not allow Brazil to escape that fact.

101. There is similarly no merit to Brazil's assertion that, if its arguments were not credited, "WTO dispute would dissolve into a 'Groundhog Day' situation, with no remedy available to Members suffering adverse effects."[135] That is, in fact, an absurd assertion. Under the reasoning of the original panel, nothing prevents Members from challenging present adverse effects of past or current payments, threat of serious prejudice of past, current, or future payments, or present adverse effects or threat of serious prejudice from payment programs as such. Indeed, Brazil availed itself of many of those opportunities in the present dispute. The obligations of a responding Member depend on what the outcome is of those challenges. Where, as here, a complaining Member only *prevails* on one claim – that of "present" serious prejudice with respect to particular payments made in particular years – the Member is bound by that outcome. It cannot seek to avoid that outcome either through *post hoc* attempts to rewrite the original panel report, or by asserting in a compliance proceeding that other measures are like the ones subject to the original panel's findings.

> ***16. Could Brazil clarify whether or not its claim in this Article 21.5 proceeding regarding a threat of serious prejudice caused by marketing loan and counter-cyclical payments is a claim with respect to the marketing loan and counter-cyclical payment programmes as such? [Paragraphs 237-314 of the First Written Submission of Brazil]***

102. The United States offers two comments in respect of Brazil's response to this question. First, Brazil suggests that the Panel "follow[] the approach of the original panel, as upheld by the Appellate Body" in assessing Brazil contingent claim of threat of serious prejudice.[136] This suggestion is baseless, of course, because the original panel *declined* to address Brazil's claims of threat of serious prejudice both with respect to payments allegedly mandated to be provided in future marketing years under the Step 2, marketing loan, and counter-cyclical payment programs[137] as well as the "selected provisions of the FSRI Act of 2002 and the ARP Act of 2000" allegedly mandating those payments.[138] There was, thus, no "approach" taken by the original panel with respect to any threat claims and no such "approach" was upheld by the Appellate Body. The question of how to assess those claims is, thus, a question of first impression before this Panel.

103. Second, Brazil asserts that it "considers that serious prejudice claims are among those that cannot be readily classifiable as 'as such' and 'as applied.'"[139] The United States notes, again, that Brazil asserted no difficulty in "classifying" the claims in the original proceeding. The original panel had no difficulty in resolving Brazil's claims as so "classified." And panels in other disputes have not had such difficulty either.[140] Brazil's assertion of such difficulties for the first time in this proceeding are simply not credible.

<u>Questions to the United States</u>

> ***17. The United States argues in paragraph 16 of its Rebuttal Submission that "[a]ccording to Brazil, its claims apply not only to the marketing loan and counter-cyclical payment programs, as such, but to the programs in addition to all payments***

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[135] Brazil Responses to Panel Section A-C Questions, para. 149 (February 26, 2007).
[136] Brazil Responses to Panel Section A-C Questions, para. 152 (February 26, 2007).
[137] *Upland Cotton (Panel)*, para. 7.1503-7.1505.
[138] *Upland Cotton (Panel)*, para. 7.1511.
[139] Brazil Responses to Panel Section A-C Questions, para. 153 (February 26, 2007).
[140] *See e.g., Korea – Ships (Panel)*, para. 7.679 (examining serious prejudice from "a relative handful of individual subsidized transactions" and not the programs providing for the subsidization as such).

authorized under the programs" (original emphasis). The United States also argues in this respect that "it is abundantly clear that the original panel did not make any finding under Article 5(c) and 6.3(c) of the SCM Agreement against the marketing loan and counter-cyclical payment programs, as such, whether alone or in addition to payments". [Paragraph 43 of Rebuttal Submission of the United States]

a. *How does the United States respond to the argument of Brazil that the United States mischaracterizes Brazil's claims in these proceedings in that Brazil is not challenging the subsidy programmes at issue as such? [Paragraph 31 of Submission of Brazil to the Panel Regarding US Requests for Preliminary Ruling; paragraph 33 of Rebuttal Submission of Brazil]*

b. *Could the United States also comment in this regard on the arguments in paragraph 31 of the Third Party Submission of Chad? Does the United States agree or disagree with the proposition that statutory or regulatory provisions can be challenged on an as applied basis and that Brazil's claims in the original proceeding "were as applied claims regarding measures that included legislative and regulatory provisions"?*

18. *The United States submits that the only measures subject to the DSB's recommendation under Article 7.8 of the SCM Agreement are payments made under the Step 2, marketing loan, and counter-cyclical payment programmes in 1999-2002. The United States also asserts, in this regard, that Brazil fails to submit evidence "as to the present effects, if any, of the measures that were subject to the original panel's actionable subsidy finding".*

a. *Do these statements mean that the United States considers that the DSB recommendation under Article 7.8 of the SCM Agreement only obliged the United States to ensure that payments made in 1999-2002 would no longer have any adverse effects?*

b. *Could the United States comment on the argument of New Zealand in paragraph 4.08 of the Third Party Submission of New Zealand?*

19. *Regarding the argument of the United States that the marketing loan and counter-cyclical payments programmes are not measures "taken to comply", is it the view of the United States that Article 21.5 of the DSU only applies to measures actually taken by a party to comply and does not apply to measures that a Member should have taken to comply?*

20. *How does the United States respond to the argument in the Third Party Submission of Japan that the Appellate Body report in EC – Bed Linen (Article 21.5 – India) does not support the argument of the United States that the marketing loan and counter-cyclical payments programmes are not within the scope of this Article 21.5 proceeding?*

3. Claim of Brazil regarding the failure of the United States to comply with the DSB recommendations between 21 September 2005 and 1 August 2006

<u>Questions to Brazil</u>

21. *Could Brazil please explain whether its request for a finding that the United States failed to comply with the DSB recommendations between 21 September 2005 and*

1 August 2006 is supported by prior panel practice in Article 21.5 proceedings? [Paragraph 68 of the Rebuttal Submission of the United States]

104. Brazil argues that the Panel should attach significance to the fact that *Australia – Salmon (21.5)* involved a suspended arbitration and that the two disputes discussed by the United States – *EC – Bed Linen (21.5)* and *U.S. – Shrimp (21.5)* – did not. The United States recalls that in the more recent disputes discussed by the United States, the panels properly determined that it was appropriate to review the "existence" or "consistency with a covered agreement of measures taken to comply as of the date that the matter was referred to it, not as of the date of the end of any implementation period:

- In *United States – Shrimp (21.5)* the panel considered "that it should take into account all the relevant facts occurring until the date the matter was referred to it. By applying this approach, an Article 21.5 panel can reach a decision that favours a prompt settlement of the dispute. Indeed, it avoids situations where implementing measures allowing for compliance with the DSB recommendations and rulings would be disregarded simply because they occur after the end of the reasonable period of time.[141]

- In *EC – Bed Linen (21.5)*, the panel noted that "[i]t appears India considers that we must make two decisions on the existence or consistency of measures taken to comply – one as of the end of the reasonable period of time, and one as of the date of establishment of the Panel. We do not consider that it would be either necessary or appropriate, as a matter of judicial economy, to first examine whether compliance had occurred as of the end of the reasonable period of time, and second consider compliance as of the later date.[142]

105. The distinction that Brazil attempts to draw between the present dispute and *EC – Bed Linen (21.5)* and *U.S. – Shrimp (21.5)* is meaningless. In the *United States – Shrimp* dispute, the United States and Malaysia entered into a "sequencing agreement" very similar to the one that exists in this proceeding between Brazil and the United States which would permit Malaysia to request DSB authorization to suspend concessions pursuant to Article 22.6 of the DSU – and would permit the United States to refer the matter to arbitration pursuant to Article 22.6 – at any time following the completion of the Article 21.5 proceeding.[143] In *EC – Bed Linen (21.5)*, the EC and India entered into a similar sequencing agreement with virtually identical language.[144] Hence, the outcome of the *EC – Bed Linen* and *U.S. – Shrimp* Article 21.5 proceedings could have had *exactly* the same implication for an Article 22.6 arbitration as in this dispute or in *Australia – Salmon (21.5)*.

[141] *United States – Shrimp (Panel) (21.5 – Malaysia)*, para. 5.12.

[142] *EC – Bed Linen (Panel) (21.5 – India)*, para. 6.28.

[143] *See* Understanding between Malaysia and the United States Regarding Possible Proceedings under Articles 21 and 22 of the DSU, WT/DS58/16 (circulated January 12, 2000) ("If on the basis of the proceedings under Article 21.5 Malaysia decides to initiate proceedings under Article 22, the United States will not assert that Malaysia is precluded from obtaining DSB authorization because Malaysia's request was made outside the 30-day time period specified in the first sentence of Article 22.6. This is without prejudice to the rights of the United States to have the matter referred to arbitration in accordance with Article 22.6.")

[144] *See* Understanding between India and the European Communities Regarding Procedures under Articles 21 and 22 of the DSU, WT/DS141/11 (circulated September 21 2001) ("If on the basis of the results of proceedings under Article 21.5 of the DSU that might be initiated by India no later than 31 March 2002, India decides to initiate proceedings under Article 22 of the DSU, the EC will not assert that India is precluded from obtaining DSB authorization because India's request was made outside the 30 day time-period specified in the first sentence of Article 22.6 of the DSU.")

106. This fact did not compel the *EC – Bed Linen (21.5)* and *U.S. – Shrimp (21.5)* panels to assess compliance at of the moment of the termination of the reasonable period of time for implementation. And there is even less basis for such an assessment here given that this would require an assessment of a factual scenario that the parties agree no longer exists.

107. Considerations of suspension of concessions/countermeasures are not only inappropriate guides for a *compliance* panel's assessment of the matters referred to it but such considerations do not support Brazil's position regarding findings of compliance in past periods. Suspension of concessions/countermeasures are not available retroactively; they may only be invoked so long as a breach exists under the *present* factual circumstances.[145] The approach taken by the panels in *EC – Bed Linen (21.5)* and *U.S. – Shrimp (21.5)* respect and are fully consistent with this fact. The same approach is appropriate in this dispute.

22. How does Brazil respond to the argument of the European Communities that "the lack of positive action taken by the United States to comply with the panel and Appellate Body's findings and recommendations between the implementation date of 21 September 2005 and 31 July 2006 is not necessarily fatal to its defence"? [Paragraph 48 of the Third Party Submission of the European Communities]

108. The United States disagrees with Brazil's argument that – in all cases – some positive action by a responding Member is required in order to satisfy an obligation under Article 7.8 of the *SCM Agreement* to "take appropriate steps to remove the adverse effects" or "withdraw the subsidy."

109. Contrary to Brazil's arguments, the ordinary meaning of the phrase "take appropriate steps" is sufficiently broad to encompass situations where changes are brought about not by particular actions by the responding Member itself but by other factors (for example, changes in market conditions, the passage of time, or some other extraneous change). As the United States explained in its response to Question 24 from the Panel, "take" means both "undertake and perform" – as Brazil asserts – but also "receive or obtain (something given, bestowed, or administered).[146] This term is, thus, entirely capable of encompassing both an active or a passive role on the part of a responding Member. "Steps" – especially in the sense of "taking steps" – refers to "an action, measure, or proceeding, esp. one of a series, which leads towards a result."[147] Together these terms recognize that some positive change must come about. But, they do not *require* that the change be solely attributable to actions by the responding Member.

110. Brazil not only reads "take" "steps" too narrowly but it reads out of Article 7.8 of the *SCM Agreement* the term "appropriate," which is the specific guidance provided in that provision as to the nature of the steps to be taken. "Appropriate" means, *inter alia*, be "specially suitable (*for, to*)" the removal of the adverse effects found to exist in the panel and Appellate Body reports.[148] There is no basis to exclude the possibility *a priori* that – given the particular adverse effects found to exist in the panel and Appellate Body reports – a responding Member may not need to take positive steps in order to "remove the adverse effects." Indeed, the original panel specifically allowed for such a possibility in recognizing that the effects of subsidies dissipate over time.[149] Under the particular facts

[145] Thus, for example, Article 22.8 of the DSU clarifies that "[t]he suspension of concessions or other obligations shall be temporary and shall only be applied until such time as the measure found to be inconsistent with a covered agreement has been removed, or the Member that must implement recommend or rulings proves a solution to the nullification or impairment of benefits, or a mutually satisfactory solution is reached."

[146] *The New Shorter Oxford English Dictionary* at 3206, Volume 2, (1993 Edition) (Exhibit US-125).

[147] *The New Shorter Oxford English Dictionary* at 3050, Volume 2, (1993 Edition) (Exhibit US-126).

[148] *The New Shorter Oxford English Dictionary* at 103, Volume 1, (1993 Edition) (Exhibit US-128).

[149] *Upland Cotton (Panel)*, para. 7.1179, n. 1298 ("We do not disagree with the general proposition underlying . . . [the] "expensing" rules [in Part V of the *SCM Agreement*], which we understand to be that, with

of a dispute – for example, the present dispute in which the subsidies challenged and found to be WTO-inconsistent were payments made under the Step 2, marketing loan, and counter-cyclical payment programs in MY 1999-2002 – it may well be that any adverse effects have dissipated and no further steps need to be taken to remove them. In those circumstances, it could be "appropriate" for a Member not to take any further steps to remove the adverse effects. Certainly, Brazil has not shown that any adverse effects of the package of payments made in MY 1999-2002 remain today that the United States has an outstanding obligation to remove.

111. A similar analysis could apply with respect to the obligation to "withdraw the subsidy." As explained in the U.S. response to Question 24, "withdraw" means, among other things, "cause to decrease or disappear" and "take back or away (something bestowed or enjoyed)."[150] According to Article 7.8 of the *SCM Agreement*, the thing to be "caused to decrease or disappear" or "taken back or away" is the "subsidy." Depending on the circumstances, extraneous factors may have caused the subsidy to "decrease or disappear" or be "taken away" without specific action by the responding Member itself. There is no reason to assert that the Member could not, in such a circumstance, be found to have fulfilled its obligations under Article 7.8 of the *SCM Agreement*.

Question to the United States

> ***23. Does the United States consider that the text of Article 21.5 of the DSU should be interpreted to mean that a compliance panel may only review the "existence" or "consistency" with a covered agreement of measures taken to comply as of the date that the matter was referred to the panel and not as of the date of the end of the implementation period? [Paragraph 68 of the Rebuttal Submission of the United States]***

D. CLAIMS OF BRAZIL REGARDING PRESENT SERIOUS PREJUDICE

1. General

Questions to both parties

> ***24. Could the parties explain how they interpret the phrases "take appropriate steps to remove the adverse effects" and" withdraw the subsidy" in Article 7.8 of the SCM Agreement?***

112. The United States has addressed a number of the interpretive flaws in Brazil's analysis above in response to Question 22 and refers the Panel to the discussion there.

113. The United States notes, in addition, that Brazil is wrong to assert that the original findings of WTO-inconsistency apply with respect to the Step 2, marketing loan, and counter-cyclical payment programs and all payments thereunder. As such, Brazil's arguments about what "appropriate steps" were available to the United States within the meaning of Article 7.8 of the *SCM Agreement* are also off the mark.

114. The United States also disagrees with Brazil's assertion that the original panel *dictated* what the particular "appropriate steps" must be pursuant to Article 7.8 of the *SCM Agreement*.[151] Contrary

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the passage of time, a subsidy's effects may diminish. For example, a subsidy granted 9 or 10 years ago would indubitably be less likely to affect producers decisions now than it did 8 years ago.")

[150] *The New Shorter Oxford English Dictionary* at 3704, Volume 2, (1993 Edition) (Exhibit US-118).

[151] Brazil Responses to Panel Section D-E Questions, para. 7 (March 6, 2007) ("the original panel identified the particular *appropriate step* under Article 7.8 that the United States must take regarding the 'basket' of price-contingent and mandatory subsidies found to cause present significant price suppression. . . .").

to Brazil's assertion, nothing in Article 7.8 of the *SCM Agreement* – or any other provision of the WTO agreement – provides a reviewing panel with such authority. Indeed, unlike Article 4.7 of the *SCM Agreement* or Article 19.1 of the DSU, Article 7.8 does not even *discuss* the *recommendation* that a panel must make where it determines that a subsidy is causing adverse effects within the meaning of Article 5 of the *SCM Agreement*. It simply sets out the general obligation on a Member that find itself in the situation "where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy [of the Member] has resulted in adverse effects to the interests of [another] Member within the meaning of Article 5." This obligation is either to "take appropriate steps to remove the adverse effects" of the subsidy or "withdraw the subsidy." Nothing in Article 7.8 of the *SCM Agreement* binds the Members' discretion in this regard.

115. Moreover, the United States does not consider that the panel intended to dictate "appropriate steps" in noting that the United States would be "obliged to take action concerning" the statutory/regulatory provisions as a result of the "present" serious prejudice finding.[152] Indeed, Brazil has acknowledged before that this does not constitute a recommendation.[153] Rather, this appears to be a statement of the original panel's views as to what would be a likely response of the United States to the recommendation that the original panel *did* make (*i.e.,* to remove the adverse effects of, or withdraw, the "subsidy" that the original panel had identified). And, indeed, the United States did "take action concerning" the statutory/regulatory provisions when it terminated the Step 2 program.

116. While the original panel may have considered that the adverse effects of the "subsidy" it was examining would be eliminated through "action concerning" the statutory provisions authorizing the payments, this does not change the fact that the "subsidy" it was examining was a package of payments made in MY 1999-2002 under the Step 2, marketing loan, and counter-cyclical payment programs, and not the programs, as such, or the programs in addition to payments thereunder. Nor does it change the fact that – under Article 7.8 of the *SCM Agreement* – other actions or changes might also have been appropriate to "remove the adverse effects or . . . withdraw the subsidy'" subject to the conclusion in paragraph 8.1(g)(i) of the original panel report.

25. How do the parties interpret the relationship between Article 7.8 of the SCM Agreement and Article 21.5 of the DSU?

117. The United States agrees that Article 21.5 of the DSU permits review of a disagreement as to whether a Member has implemented the obligations set out in Article 7.8 of the *SCM Agreement*. However, the United States disagrees with Brazil's outline of the steps this Panel allegedly "must" take under these provisions. In particular, there is no basis for Brazil's assertion that "the compliance Panel, under Article 7.8 of the *SCM Agreement* and Article 21.5 of the DSU, *must first assess Brazil's claims that no measures taken to comply exist with respect to the period 21 September 2005 and 1 August 2006*"[154] As the United States has explained, neither Article 7.8 of the *SCM Agreement* nor Article 21.5 of the DSU – nor any other provision of the WTO agreement – requires making findings of compliance as of the end of the six-month period set out in Article 7.9 of the *SCM Agreement*. Moreover, prior panels in *EC – Bed Linen* and *U.S. – Shrimp* have properly determined that it was appropriate to review the "existence" or "consistency with a covered agreement" of measures taken to

[152] The original panel's recommendations simply provide, in relevant part, that "upon adoption of this report, the United States is under an obligation to 'take appropriate steps to remove the adverse effects or ... withdraw the subsidy'" subject to the conclusion in paragraph 8.1(g)(i). Paragraph 8.1(g)(i) provides that "the effect of the mandatory price-contingent United States subsidy measures – marketing loan programme *payments*, user marketing (Step 2) *payments*, MLA *payments* and CCP *payments* – is significant price suppression in the same world market within the meaning of Article 6.3(c) of the SCM Agreement constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*." *Upland Cotton (Panel)*, para. 8.1(g)(i).

[153] Brazil First Written Submission, para. 32.

[154] Brazil Responses to Panel Section D-E Questions, para. 19 (March 6, 2007) (emphasis added).

comply as of the date that the matter was referred to it, not as of the date of the end of any implementation period.[155] As discussed above, this approach is equally appropriate here (if not more so given that the parties agree that the facts and circumstances have changed since the end of the six-month period set out in Article 7.9 of the *SCM Agreement*).

26. Could the parties explain whether they agree or disagree with the arguments of New Zealand in its Third Party Submission that Article 7.8 of the SCM Agreement has certain consequences for the burden of proof in an Article 21.5 proceeding? [Paragraphs 5.04-5.06 of the Third party Submission of New Zealand]

27. Could the parties comment on the following statement of the European Communities:

> ***"The text of Article 7.8 of the SCM Agreement does not state expressly that a Member that has been requested by the DSB to implement its recommendations and rulings under Article 7.8 of the SCM Agreement has to do anything" (original emphasis)***

118. Please see the U.S. comments regarding Brazil's response to Questions 22 and 24 above.

28. The parties present divergent views with respect to the relevant marketing year to be considered by the panel in its analysis of Brazil's serious prejudice claims.

a. Could the parties explain what they consider to be the relevant legal considerations by which the Panel should be guided in determining whether MY 2005 or MY 2006 is the appropriate marketing year?

119. Brazil devotes its entire response to arguing that the proper "reference period" for the Panel's analysis is MY 2005. However, the Panel's question does not ask for an identification of a "reference period;" it asks what "the relevant marketing year" is for purposes of Brazil's serious prejudice claims. The United States maintains that the two are distinct questions.

120. On the question of the relevant marketing year for purposes of Brazil's serious prejudice claims, the United States maintains that, under the text of Articles 6.3(c) and 6.3(d), the proper inquiry is as to the *present* effect of any challenged measures. Accordingly, the present period (or marketing year) – in this case MY 2006 – is the relevant one. While the United States does not disagree that data from earlier marketing years may be considered where reliable data regarding MY 2006 is not available (as a *proxy)*, this cannot obscure the fact that the relevant query is as to effects given *present* facts and circumstances.

121. This is especially true given that – as Brazil finally acknowledges – a comparison to "historical data shows that there have been fairly significant shifts of prices, demand, [and] supply based on a number of different factors."[156] The United States appreciates this acknowledgment that, in fact, market and production conditions *have* changed substantially, especially since the termination of the Step 2 program. As the United States has explained, since the termination of the Step 2 program:

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[155] *United States – Shrimp (Panel) (21.5 – Malaysia),* para. 5.12; *EC – Bed Linen (Panel) (21.5 – India)*, para. 6.28.

[156] Brazil Responses to Panel Section D-E Questions, para. 24 (March 6, 2007) (emphasis added).

- U.S. exports for MY 2006 are *down 30 percent* from the levels observed at the same time last year.[157]

- Weekly cotton sales are *31 percent below* the 5-year average.[158]

- And total U.S. export commitments are currently approximately *40 percent below* last year's level and *27 percent* below the 5-year average.[159]

- Forecasts for the future are similarly gloomy. As the United States explained in the meeting with the Panel, in February of this year, USDA lowered the U.S. cotton export forecast for MY 2006 by nearly 8 percent, following a 2 percent downward revision in January.[160]

- These downward revisions are taking place at the same time that USDA estimates record *high* foreign cotton mill use, which means that U.S. share of foreign consumption is expected to drop from 16 percent in MY 2005 to 12 percent in MY 2006.

- Moreover, U.S. share of world exports is expected to drop from 40 percent in MY 2005 to 36 percent in MY 2006.

- U.S. domestic mill use for MY 2006 is projected at just 5 million bales, the lowest since MY 1931.

- And the declining demand for U.S. upland cotton is also being reflected in planting and production decisions. The annual survey of planting intentions conducted by the National Cotton Council indicates that U.S. upland cotton plantings are likely to be down an average of 14 percent in MY 2007 from 2006 levels.[161]

122. Under these conditions, it is the historical data that Brazil presses that should be viewed with caution. Whatever the data say about any effects that existed in the historical period is unlikely to be true under the very different conditions that exist at present. While the Panel may – in some cases – have to rely on that data because reliable or complete data does not exist for the present marketing year, it is appropriate to keep in mind the different conditions that exist at present in assessing Brazil's claims.

b. Do the parties agree or disagree with the argument of the European Communities that in a dispute involving a claim of present serious prejudice the parties must provide the "most recent reasonably available" data? [Paragraphs 43 and 54-55 of the Third Party Submission of the European Communities]

123. Please see the U.S. response to Question 28 and comments above regarding Brazil's response to Question 28(a).

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[157] Weekly Export Performance Report for week ending February 15, 2007 (Exhibit US-113).
[158] Weekly Export Performance Report for week ending February 15, 2007 (Exhibit US-113).
[159] Weekly Export Performance Report for week ending February 15, 2007 (Exhibit US-113).
[160] February 2007 World Agricultural Supply and Demand Estimates (WASDE) Report (Exhibit US-114).
[161] National Cotton Council Planting Intentions Survey MY 2007 (Exhibit US-115).

Questions to the United States

29. Does the United States contest the fact that a "strong positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production" exists?*[162] *In particular, does the US disagree with the following statements*[163]*:

- ***a very large proportion of farms with upland cotton base acres continue to plant upland cotton in the year of payment;***
- ***the overwhelming majority of farms enrolled in the programs which plant upland cotton also hold upland cotton base;***

Question to Brazil

30. How does Brazil respond to the argument of the United States that "whether or not the marketing loan and counter-cyclical payment programs or payments under the programs cause significant price suppression is a question of first impression"? [Rebuttal Submission of the United States, paragraph 219]

124. The United States welcomes Brazil's acknowledgment that whether or not the marketing loan and counter-cyclical payment programs or payments under the programs cause significant price suppression is a question of first impression. The United States respectfully requests that the Panel bear this in mind as it addresses Brazil's repeated assertions that the U.S. arguments have all been rejected – and the issues before this Panel have all been decided – by the original panel.

125. The United States does offer two brief clarifications, however, in this regard. First, contrary to Brazil's assertions, the United States does not take the position that all of the findings of the original panel are "irrelevant." Indeed, Brazil's failure to provide even a single citation to a U.S. submission in support of this assertion confirms that it is unfounded.

126. Second, Brazil assumes that the sole reason that the question above is one of first impression is because the original panel did not consider whether *these particular measures* caused significant price suppression. This is not the only basis. The original panel also did not consider what the effects of any measures would be *in the present period and under the kind of market conditions that exist at present*. To the contrary, as discussed above, the measures subject to the original panel's analysis were certain payments made in MY 1999-2002 and the question examined by the panel was as to the effects that those payments had in MY 1999-2002. These limitations cannot be ignored in assessing the relevance of findings made by the original panel.

2. The structure, design and operation of the countercyclical and marketing loan payment programs

Question to the United States

31. Brazil claims that the structure, design and operation of US counter-cyclical payments stimulate US upland cotton production. Both Brazil and the United

[162] ***[ORIGINAL FOOTNOTE: See para. 131 of Brazil's first submission. The Panel clarifies that this phrase refers to the fact that "the recipients who hold upland cotton base acres" and "those who continue to plant upland cotton" overlap with each other to a great extent. (See para. 7.637 of the report of the original panel.) The Panel understands that Brazil uses this phrase in the same sense.]***

[163] ***[ORIGINAL FOOTNOTE: These passages are reproduced from para. 7.636 of the report of the original panel.]***

States have referred to the Westcott (2005)[164] study to provide support for their opposing analysis of the possible production impact of counter-cyclical payments. In its rebuttal, Brazil quotes the following passage from Westcott:

> *So where do CCPs fit compared with other farm commodity programs in the 2002 Farm Act? Marketing loans are fully coupled since they are available on all production and their link to market prices means they affect production decisions of farmers. Direct payments are mostly decoupled, since they are paid on a fixed, historically-based quantity rather than on current production and are not dependent on market prices or other factors that would affect production. …*
>
> *CCPs fall in between these two programs, having some properties similar to mostly decoupled direct payments and other properties similar to fully coupled marketing loans. Like direct payments, CCPs do not depend on current production since they are paid on a fixed, historically-based quantity. However, similar to marketing loans, CCPs are linked to market prices so there may be some influence on current production decisions of farmers, which would potentially make CCPs at least partially or somewhat coupled.*

a. *Does the United States agree with this characterization of the CCP?*

b. *How would the United States respond to the argument that, by design, counter-cyclical payments are in some measure coupled to production decisions because part of the payments is contingent on the actual realization of market prices?*

3. Economic simulation model

<u>Question to the United States</u>

32. *Brazil has presented a partial equilibrium model to simulate the effects of eliminating US upland cotton payments, particularly the marketing loan and counter-cyclical payments. In both its submission and rebuttal, the United States has provided reactions to the simulation model.*

a. *Would it be accurate to describe the United States' response as constituting a general acceptance of the framework of analysis adopted by Brazil but contesting the assumptions made regarding the values of the parameters, the supply and demand elasticities and the "coupling factor", used in the model? (The coupling factor is the amount by which the expected price is increased by each dollar per unit of subsidy payments.)*

b. *In its First Written Submission and Rebuttal Submission, the United States uses the same value of 1 that Brazil adopts for the coupling factor assigned to marketing loan payments. Does this imply an acceptance by the United States that, by design, marketing loan payments provide a one-for-one incentive to upland cotton production?*

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[164] *[ORIGINAL FOOTNOTE: Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" (Exhibit US-35).]*

c. ***In its First Written Submission and Rebuttal Submission, the United States used a non-zero value of 0.25 (not much lower from the 0.4 that Brazil adopts) for the coupling factor assigned to counter-cyclical payments. Does this imply an acceptance by the United States that, by design, counter-cyclical payments are partially tied to upland cotton production, and of a magnitude (25 cents to a dollar of counter-cyclical payments) not very far from Brazil's own estimate (of 40 cents to a dollar of counter-cyclical payments)?***

E. EXPORT CREDIT GUARANTEES

1. Permissibility of an *a contrario* interpretation of item (j) of the Illustrative List

Questions to the United States

33. Please discuss whether (and if so, how) the panel rulings in Korea – Vessels and Brazil – Aircraft (21.5) (I and II) affect the United States' approach to the interpretation of the relationship between item (j) of the Illustrative List and Article 3.1(a) of the SCM Agreement.

34. Does the United States considers that item (j) of the Illustrative List is one of the provisions to which footnote 5 of the SCM Agreement applies? What impact does this have for the United States' interpretation of the interaction between item (j) of the Illustrative List and Article 3.1(a) of the SCM Agreement?

35. How does the United States address Brazil's argument that permitting an a contrario reading of item (j) would prevent a Member from challenging specific export credit guarantees or cohorts of such guarantees granted by a Member, as opposed to export credit guarantee programs [see paragraphs 472 ff. of Brazil's Rebuttal].

Questions to Brazil

36. What is Brazil's reading of the Appellate Body's statement in paragraph 80 of its Report in Brazil – Aircraft (21.5) that it "... would have been prepared to find that the payments made under the revised PROEX are justified under item (k) of the Illustrative List"? Should the Panel take this statement into account in deciding whether item (j) can be interpreted* a contrario*?

127. Brazil's response to this question does not withstand scrutiny. Nor is Brazil's response credible in light of the directly contradictory positions taken by Brazil where its measures were at issue and an *a contrario* interpretation of item (k) would have accrued to its benefit.

128. The United States recalls that in *Brazil – Aircraft (21.5)*, Brazil expressly argued that an *a contrario* interpretation of items in the Illustrative List was possible entirely separate from any application of footnote 5 of the *SCM Agreement*.[165] Following from this, the Appellate Body noted that it was not interpreting footnote 5 but that it, nonetheless, was prepared to accept Brazil's argument that the first paragraph of item (k) could be read *a contrario* to determine when measures

[165] *Brazil – Aircraft (21.5) (AB)*, para. 57 ("Brazil emphasizes, first of all, that its argument that subsidies under the revised PROEX are 'permitted' was not based on footnote 5 but rather on an 'a contrario' interpretation of the text of the first paragraph of item (k).")

are "justified."[166] The Appellate Body's silence as to footnote 5 simply derived from Brazil's own arguments in that dispute, it was not a signal that footnote 5 of the *SCM Agreement* does not apply to item (j) or item (k).

129. Moreover, the United States recalls, again, Brazil's argument in that dispute that footnote 5 *did* in fact apply to items (j) and (k) and that both contained the kind of limitation encompassed by footnote 5:

> Footnote 5 of the SCM Agreement specifies that Annex I contains not only a list of prohibited export subsidies, but also measures that do not constitute export subsidies, such as in items (b), (h), (i) and (k). Comparing the structure of item (j) and item (k), the two provisions share a similar structure in that they define practices that constitute prohibited export subsidies with *language that limits the scope of the definition. In the case of item (j) regarding export credit guarantee or insurance programs, the limiting language is "premium rates which are inadequate to cover the long-term operating costs and losses of the programs."*[167]

130. In light of those arguments, it is curious that Brazil now suggests that "item (k) is substantively distinct from other Illustrative List items" such that the Appellate Body's acceptance of an *a contrario* reading "would not extend beyond item (k)."[168] Brazil asserts that this is because the "material advantage" clause in the first paragraph of item (k) is allegedly "closely related" to the 'benefit' standard under Article 1.1. Brazil asserts that, by contrast, item (j) "tells one nothing about whether [export credit guarantees] confer benefits on recipients relative to market benchmarks" and would allegedly "eliminate any consideration of that 'benefit'." Importantly, none of this was set out *by the Appellate Body* to explain its decision to accept an *a contrario* interpretation of item (k). Instead, it is simply *post hoc* reasoning by Brazil to avoid application of the same interpretive considerations to the U.S. measures that Brazil would have benefitted from in *Brazil – Aircraft (21.5)* had it made the proper factual showing.

131. The Appellate Body did not indicate that the permissibility of an *a contrario* interpretation depended on the proximity of the standard set out in the Illustrative List to the one asserted by Brazil as being the *sole* standard of "benefit" under Article 1.1(a) of the *SCM Agreement*. Nor has the Appellate Body stated that "benefit" under Article 1.1(a) of the *SCM Agreement* must be understood to require an assessment of "benefit to the recipient" even where the drafters specifically *agreed* in the Illustrative List that a different approach is appropriate in assessing whether particular measures are prohibited export subsidies. Indeed, if it had done so, the Appellate Body would effectively have rendered inutile footnote 5 of the *SCM Agreement*. That footnote recognizes that – for provisions of the Illustrative List, which either explicitly or implicitly limit the measures that may be deemed export subsidies – it is the Illustrative List itself that definitely clarifies the conditions under which the listed measures will be considered "subsidies" within the meaning of Article 1.1 that are "export contingent" within the meaning of Article 3.1(a).

2. Outstanding export credit guarantees / measures taken to comply

<u>Questions to Brazil</u>

37. Brazil relies on the panel and Appellate Body Reports in Brazil – Aircraft (21.5) in support of its arguments that the United States has not "withdrawn" the subsidy

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[166] *Brazil – Aircraft (21.5) (AB)*, para. 80 (arguing that, if Brazil had made the correct factual showing under paragraph 1, "we would have been prepared to find that the payments made under the revised PROEX are justified under item (k) of the Illustrative List.")

[167] *Brazil – Aircraft (AB)*, para. 19 (emphasis added).

[168] Brazil Responses to Panel Section D-E Questions, para. 40 (March 6, 2007) (emphasis added).

and is, "[a]t a minimum... prohibited from making 'payments' on claims against" any outstanding export credit guarantees [Paragraph 397 of Brazil's Rebuttal Submission]. Please discuss how the findings of the panel and Appellate Body in that case apply to the provision of the US export credit guarantees at issue.

132. As the United States explained in its oral statement before the Panel, the reasoning in the *Brazil – Aircraft (21.5)* dispute does *not* support Brazil's arguments that the United States has not "withdrawn" the subsidy with respect to the challenged export credit guarantees or Brazil's assertions about "performing on" export credit guarantees.

133. *Brazil – Aircraft (21.5)* involved the issuance by Brazil of WTO-inconsistent bonds. Brazil asserted the right, in that dispute, to continue to issue these WTO-inconsistent bonds even after the end of the reasonable period of time to "withdraw" them simply because it had entered into letters of commitment to provide them prior to the end of the reasonable period of time. The Appellate Body disagreed with Brazil. The Appellate Body noted that:

> The existence of a "subsidy" was not contested by Brazil in the proceedings before the original panel; and Brazil also conceded before the original panel that subsidies under PROEX were export contingent. The only issue before us now is whether the continued issuance of NTN-I bonds by Brazil after 18 November 1999, pursuant to letters of commitment issued before 18 November 1999, is consistent with the recommendation of the DSB to "withdraw" the prohibited export subsidies within 90 days.[169]

134. In the Appellate Body's view, continuing to provide WTO-inconsistent bonds on precisely the same terms and conditions as before was not consistent with Brazil's obligation to withdraw the export subsidy.

135. The U.S. export credit guarantees are not like Brazil's WTO-inconsistent bonds. Brazil's bonds continued to be prohibited export subsidies both before and after the date of implementation. By contrast, since July 1, 2005 (and, indeed, even before that time), U.S. export credit guarantees ceased being part of any program that is being operated at a "net cost to the government."[170] Thus, unlike Brazil, the United States has not attempted to continue providing prohibited export subsidies past the date of implementation. Unlike Brazil, the United States has withdrawn the subsidy that was found to exist with respect to any export credit guarantees outstanding at the end of the implementation period and all export credit guarantees issued thereafter.

3. "Benefit" under Articles 1 and 3.1(a) of the SCM Agreement

Question to the United States

38. Please discuss the relevance of the original panel's characterization, in paragraph 6.31 of its report, of Brazil's reliance on Articles 1 and 3.1(a) of the SCM Agreement as "not a separate claim, but merely another argument" on the United States' view in this respect (and notably the United States statement, in paragraph 67 of its First Written Submission, that "... the panel in the original proceeding specifically declined to address Brazil's alleged 'claim' under Articles 1 and 3.1(a) of the SCM Agreement")?

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[169] *Brazil – Aircraft (21.5) (AB)*, para. 44.
[170] *Upland Cotton (Panel)*, para. 7.804.

Questions to Brazil

39. The Panel understands the United States to argue that it has relied on the Panel's findings under item (j) to implement the DSB recommendations with respect to export credit guarantees. How would this, in Brazil's view, affect the compliance panel's role in this proceeding? Was the United States also expected to implement changes in order to make its export credit guarantee programmes consistent with article 1.1 and 3.1(a) of the SCM Agreement, even though there were no findings of the original panel in this respect?

136. Brazil's assertion that the U.S. reliance on the original Panel's findings under item (j) "should not affect the compliance Panel's role in these Article 21.5 proceedings" is regrettable and incorrect. As the United States explained in response to Question 2, it is important to examine the DSB's recommendations and rulings – and the factual findings underpinning them – in order to determine whether the responding Member was, in fact, required to take measures to come into compliance and, if so, the scope of the obligation to do so.[171] Contrary to Brazil's assertion, this Panel's role specifically *includes* looking to the DSB's recommendations and rulings and the findings in the original dispute and determining whether the United States has heeded them. It clearly has done so here.

137. Brazil's asserts that, to the extent the United States "somehow relied" on the findings of the panel and Appellate Body in the original dispute, the United States is seeking to "escape the export subsidy disciplines of the *Agreement on Agriculture* and the *SCM Agreement*."[172] This accusation is baseless. Moreover, it assumes Brazil's own arguments that there is a separate standard for what is a prohibited export subsidy exists under Article 1.1 and 3.1(a) of the *SCM Agreement* and that different standard involves different implementation obligations from which the United States is seeking to "escape." That Brazil specifically made the same arguments to the panel and Appellate Body and that they nevertheless *declined* to address any separate "claims" or "arguments" under the allegedly different standard in Article 1.1 and 3.1(a) of the *SCM Agreement* is consistent with the fact that no such different standard exists.

40. In paragraph 410 of its Rebuttal, Brazil refers to paragraph. 7.398 of the Panel Report in Canada – Aircraft II. The Panel notes, however, that in the same paragraph, the Canada -- Aircraft II panel also indicated that there would be a "'benefit' when the cost-saving for a Bombardier customer for securing a loan with an IQ loan guarantee is not offset by IQ's fees". Please discuss, in light of this sentence, whether the Panel should read the Canada – Aircraft II panel as having rejected the "total cost of funds" as the proper benchmark under Article 14(c) of the SCM Agreement.

138. Brazil concedes in response to this question that the panel in *Canada – Aircraft II* did *not* reject the standard in Article 14(c) of the *SCM Agreement*, but that it simply found that – in the particular circumstances of that dispute – it was "safe to assume" that the test in Article 14(c) would be satisfied if the fees charged for the IQ loan guarantees were not "market based."[173] In fact, even while the panel asserted that it was "safe" to make such an assumption, the panel actually *required* Brazil to provide "arguments or information regarding what the [airline] might have had to pay on a *comparable commercial loan* absent the *IQ* loan guarantee."[174] The panel noted that:

[171] *See e.g., United States – Final Countervailing Duty Determination (21.5 – Canada) (AB),* para. 68.
[172] Brazil Responses to Panel Section D-E Questions, para. 48 (March 6, 2007) (emphasis added).
[173] *Canada-Aircraft II,* para. 7.399 (emphasis added).
[174] *Canada-Aircraft II,* para. 7.399 (emphasis added).

> Brazil has made no arguments to the effect that 'there is a difference between the amount that the [Mesa Air Group] pays on a loan guaranteed by [IQ] and the amount that the [Mesa Air Group] would pay on a comparable commercial loan absent the [IQ] guarantee', adjusted for any difference in fees. In particular, although Brazil does not deny that loan guarantees are available on a commercial basis, Brazil has failed to adduce any arguments or information regarding what Mesa Air Group might have had to pay on a comparable commercial loan absent the IQ loan guarantee.[175]

139. On the basis of *that* failure on the part of Brazil – as well as Brazil's failure to "make any other argument to the effect that IQ's fee for its loan guarantee to Mesa Air Group is not market based" – the panel "reject[ed] Brazil's claim that the IQ loan guarantee to Mesa Air Group confers a 'benefit.'"[176]

140. In this dispute, Brazil has again failed to make the kind of particularized showing contemplated under Article 14(c) of the *SCM Agreement*; it has not shown that the overall cost, including fees, of each of the loans guaranteed by the government is less than overall cost of a comparable commercial loan that could be obtained without a government guarantee. Nor has Brazil provided any basis why it would be "safe to assume" that the test in Article 14(c) would be satisfied in the present dispute simply by showing a difference in fees between GSM 102 guarantees and other commercially-available guarantees. Indeed, given the evidence submitted by the United States showing that – contrary to Brazil's assertions – foreign obligors are in fact able to obtain financing even without GSM 102 guarantees and on terms better than those available *with* GSM 102 guarantees, it is clear that it is *not* safe to make such an assumption here.

Questions to both parties

41. What are the relevant considerations to guide the Panel in the selection of a market benchmark in this case?:

> ***a. That the institution that provides the product is, on the whole, or on a program or product-specific basis, profitable? If so, is "any" profit sufficient to qualify an institution/ product/program as a relevant "market benchmark" or must the institution/product/program achieve a certain level of profit? Must the Panel conduct an examination of the level of profit achieved by commercial or private actors operating in the field?***
>
> ***b. Are the institution/program/products' stated goals relevant in assessing whether they can be used as a "market benchmark"?***
>
> ***c. Is the "governance" of the institution relevant?***
>
> ***d. What other factors are relevant?***

141. The United States disagrees with Brazil's arguments in response to this question on the threshold matter of *what benchmark* is needed for purposes of this case. Contrary to Brazil's assertions, the proper "benchmark" is not a commercially-available *guarantee* similar to GSM 102. This is not the relevant consideration under *either* item (j) of the Illustrative List or Article 14(c) of the *SCM Agreement*. Under item (j), to determine whether an export subsidy exists in the case of export credit guarantees, the proper consideration is whether premiums charged are inadequate to cover the long-term operating costs and losses of a program. That is the standard for assessing whether export credit guarantees are export subsidies for purposes of the *SCM Agreement*. Moreover,

[175] *Canada-Aircraft II*, para. 7.399.
[176] *Canada-Aircraft II*, para. 7.399.

under Article 14(c), the proper consideration of "benefit" is whether and how much the guarantees affect the terms of the *underlying* loans. Brazil has no basis to ask this Panel to ignore all of the textual provisions dealing with export credit and loan guarantees and to adopt out of whole cloth a standard that looks simply to *fees* for different guarantees.

142. Indeed, as the United States has explained, Brazil's asserted approach would undermine the express recognition of Members in Article 14(c) of the *SCM Agreement* that provision of loan guarantees are fundamentally different from the provision of other government services.[177] In the case of government services, Article 14(d) applies and provides that a "benefit" may be calculated only where "the provision [of the service] is made for less than adequate remuneration" which "shall be determined in relation to prevailing market conditions for the . . . service in question in the country of provision (including price, quality, availability, marketability, transportation and other conditions of purchase. . .)." In that context, a comparison of fees for a government service against the fees charged in the market for a comparable service is the proper approach. However, Article 14(c) specifically *precludes* such an approach for loan guarantees. Recognizing that a loan guarantee is made for the sole purpose of *supporting a loan transaction* and becomes an integral part of that transaction, Article 14(c) requires an assessment of the total costs of the transaction to assess whether a "benefit" is actually conferred by the guarantee.

143. For these reasons, the United States considers that Brazil's arguments regarding the appropriate benchmark in this case are flawed at the outset. Nonetheless, Brazil's clarifications in response to this question are useful insomuch as they confirm the unreasonable – not to mention unsupported – approach advanced by Brazil.

144. Specifically, Brazil clarifies that it is advancing a one-way theory under which it may use government-provided guarantees as a benchmark to show that GSM 102 guarantees are *WTO-inconsistent* but the United States may never use guarantees provided by a government or so-called "public" entity to show that the GSM 102 guarantees are *WTO-consistent*. Brazil argues that no government/public entity could ever supply a market benchmark – regardless of its profitability, stated goals, or any other factor, and regardless of whether the particular product that provides the benchmark is offered on market terms. In Brazil's view, this is necessary "to avoid circumvention of the disciplines in the *SCM Agreement*."[178]

145. At the same time, however, Brazil states that it is "willing to accept" government-provided guarantees as a benchmark "[i]n the circumstances of these particular proceedings" to demonstrate WTO-inconsistency. Brazil then proceeds to ask the Panel to assume that Ex-Im Bank guarantees are provided at below-market rates and to find that any guarantees under the GSM 102 program confer a benefit simply if the fees for the particular guarantees are lower to any extent that the allegedly "comparable" Ex-Im Bank guarantees. This is nothing more than an exercise in circular logic. Brazil has not shown that (a) a consideration of fees alone is appropriate in determining whether export credit guarantees or loan guarantees confer a benefit; (b) Ex-Im Bank guarantees are provided at below-market rates; or (c) fees for GSM 102 guarantees would be provided at below-market rates simply if they were below the fees charged by another government agency.

146. Indeed, Brazil's approach would lead to absurd results. For example, unless *all government-provided guarantees* are provided at precisely the same level of fees, a complaining Member like Brazil could simply point to the guarantees with the highest fees, assert that these guarantees are themselves provided at below-market rates because they are government-provided, and then seek export subsidy findings with respect to all the rest simply on their relative position vis-a-vis the

[177] The "*financial contribution*" by the government is itself different in the two contexts. The "financial contribution," in the case of a loan guarantee is "the potential direct transfer[] of funds or liabilities." In the case of other kinds of services, the provision of the service itself is the "financial contribution."

[178] Brazil Responses to Panel Section D-E Questions, para. 62 (March 6, 2007)

guarantees with the highest fees. In fact, that is effectively what Brazil is seeking to do here. There is no basis in the text for Brazil's approach.

147. The unreasonableness of Brazil's approach confirms once again that Brazil is attempting to unilaterally reclassify export credit guarantees as *per se* prohibited export subsidies, in disregard of the specific provisions agreed to by the Members Articles 1.1, 3.1(a), and 3.2 of the *SCM Agreement* and item (j) of the Illustrative List, as well as Articles 10.1, 10.2 and 8 of the *Agreement on Agriculture*.

4. Claims under item (j) of the Illustrative List

Question to the United States

> ***42. How does the United States address Brazil's arguments with respect to the MPRs under the OECD Arrangement?***

Question to Brazil

> ***43. What is Brazil's reaction to paragraph 25 of Japan's Third Party Submission?***

148. Although the United States does not agree fully with Japan's analysis, it concurs that MPRs under the OECD Arrangement are not an appropriate consideration in assessing whether guarantees under the U.S. export credit guarantee programs have been provided consistently with item (j) of the Illustrative List. The United States does not consider that this turns on any factual distinctions between MPRs and fees charged under the fees charged under the GSM 102 program (though the United States agrees that there are many such distinctions that would render them not comparable, in any event). Rather, as the United States explained in its response to Question 42, item (j) of the *SCM Agreement* clearly provides that the proper comparison is between the "premium rates" charged under the particular programs and "the long-term operating costs and losses" of the programs themselves. The text of the *SCM Agreement* does *not* provide that the Arrangement on Officially Supported Export Credits sets the standard by which to assess whether export credit guarantees constitute export subsidies under item (j) of the *SCM Agreement*.

149. Thus, Brazil's assertion that its discussion of MPRs "offers the compliance Panel a *qualitative* reference point for appreciating the degree to which GSM 102 fees fall below internationally-accepted standards for [export credit guarantee] programs that are, according to the OECD, structured and designed to break even" – even if true (and given the factual distinctions between the two contexts, it is not) – is irrelevant. Item (j) looks to the programs themselves, not any alleged "internationally-accepted standards." This is in contrast to the very next item in the Illustrative List – item (k), dealing with export credits – which *does* contemplate consideration of "internationally-accepted standards." The absence of such a reference in item (j) confirms what the text already states – the appropriate comparison is between the premiums and long-term operating costs and losses of the actual programs themselves.

150. As discussed in the U.S. submissions, the current United States budget data now reflects that the U.S. export credit guarantees have been provided at premiums well in excess of the long-term operating costs of the programs. For cohorts 1992-2002, subsidy estimates and re-estimates by cohort, show a negative subsidy net of all re-estimates, of US$762,676,594. For cohorts 1992-2005, the figure is also a negative subsidy: US$166,549,780. These numbers indicate that the United States has earned a *profit* on its programs in these amounts. In addition, with respect to the only extant

export credit guarantee program (GSM-102), the budget data also reflects that for every fiscal year cohort since 1992 the net lifetime re-estimates have been negative.[179]

151. The current aggregate U.S. budget accounting data for all programs shows that, for the fourteen-year period commencing with fiscal year 1992, the export credit guarantee programs, under the fee structure *preceding* the changes implemented on July 1, 2005, received hundreds of millions of dollars more in premia and interest than required to pay out in operating costs and losses, including interest. The financial strength of the GSM 102 program has only been further *enhanced* by the changes made by the United States to implement the DSB's recommendations and rulings.

[179] 2007 U.S. Government Budget Credit Supplement: Table 8 – Loan Guarantees: Subsidy Reestimates, p. 43 http://www.whitehouse.gov/omb/budget/fy2007/pdf/cr_supp.pdf (Exhibit US-5).

ANNEX D-12

RESPONSES OF BRAZIL TO THE PANEL'S SECOND SET OF QUESTIONS

(2 April 2007)

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LIST OF ABBREVIATIONS

AMS	Aggregate Measurement of Support
Arrangement	OECD Arrangement on Officially Supported Export Credits
AWP	Adjusted World Price
CCC	U.S. Commodity Credit Corporation
CCPs	Counter-Cyclical Payments
CVD	Countervailing Duty
DSB	Dispute Settlement Body
DSU	Understanding on Rules and Procedures Governing the Settlement of Disputes
ECG	Export Credit Guarantee
FAIR Act	Federal Agricultural Improvement and Reform Act of 1996
FAPRI	Food and Agricultural Policy Research Institute
FAS	USDA's Foreign Agriculture Service
FCRA	Federal Credit Reform Act
FSRI Act	Farm Security and Rural Investment Act of 2002
FY	Fiscal Year
GATT	General Agreement on Tariffs and Trade
GAO	Government Accountability Office
GSM 102	General Sales Manager 102
GSM 103	General Sales Manager 103
MPRs	Minimum Premium Rates
MY	Marketing Year
NCC	National Cotton Council of America
NPV	Net Present Value
OECD	Organization for Economic Co-operation and Development
SCGP	Supplier Credit Guarantee Program
SCM Agreement	*Agreement on Subsidies and Countervailing Measures*
SPS Agreement	*Agreement on Sanitary and Phytosanitary Measures*
TBT Agreement	*Agreement on Technical Barriers to Trade*
U.S.	United States
USDA	U.S. Department of Agriculture
WTO	World Trade Organization

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Short Title	Full Case Title and Citation
Argentina – Footwear	Appellate Body Report, *Argentina – Safeguard Measures on Imports of Footwear*, WT/DS121/AB/R, adopted 12 January 2000, DSR 2000:I, 515
Brazil – Aircraft (21.5 II)	Panel Report, *Brazil – Export Financing Programme for Aircraft – Second Recourse by Canada to Article 21.5 of the DSU*, WT/DS46/RW/2, adopted 23 August 2001, DSR 2001:X, 5481
Canada – Aircraft	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377
Canada – Aircraft (21.5)	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/AB/RW, adopted 4 August 2000, DSR 2000:IX, 4299
Canada – Aircraft Credits and Guarantees	Panel Report, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R and Corr.1, adopted 19 February 2002, DSR 2002:III, 849
Canada – Dairy (21.5 I)	Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Recourse to Article 21.5 of the DSU by New Zealand and the United States*, WT/DS103/AB/RW, WT/DS113/AB/RW, adopted 18 December 2001, DSR 2001:XIII, 6829
Dominican Republic – Import and Sale of Cigarettes	Appellate Body Report, *Dominican Republic – Measures Affecting the Importation and Internal Sale of Cigarettes*, WT/DS302/AB/R, adopted 19 May 2005
EC – Asbestos	Appellate Body Report, *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, WT/DS135/AB/R, adopted 5 April 2001, DSR 2001:VII, 3243
EC – Bed Linen (21.5)	Appellate Body Report, *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by India*, WT/DS141/AB/RW, adopted 24 April 2003, DSR 2003:III, 965
EC – Chicken Cuts	Appellate Body Report, *European Communities – Customs Classification of Frozen Boneless Chicken Cuts*, WT/DS269/AB/R, WT/DS286/AB/R, and Corr.1, adopted 27 September 2005
EC – CVDs on DRAMs	Panel Report, *European Communities – Countervailing Measures on Dynamic Random Access Memory Chips from Korea*, WT/DS299/R, adopted 3 August 2005
EC – Hormones	Appellate Body Report, *EC Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998, DSR 1998:I, 135
EC – Sardines	Appellate Body Report, *European Communities – Trade Description of Sardines*, WT/DS231/AB/R, adopted 23 October 2002, DSR 2002:VIII, 3359
EC – Selected Customs Matters	Appellate Body Report, *European Communities – Selected Customs Matters*, WT/DS315/AB/R, adopted 11 December 2006
Japan – Alcohol II	Appellate Body Report, *Japan – Taxes on Alcoholic Beverages*, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS11/AB/R, adopted 1 November 1996, DSR 1996:I, 97
Korea – Commercial Vessels	Panel Report, *Korea – Measures Affecting Trade in Commercial Vessels*, WT/DS273/R, adopted 11 April 2005

Short Title	Full Case Title and Citation
Korea – Various Measures on Beef	Appellate Body Report, *Korea – Measures Affecting Imports of Fresh, Chilled and Frozen Beef*, WT/DS161/AB/R, WT/DS169/AB/R, adopted 10 January 2001, DSR 2001:I, 5
Mexico – Corn Syrup (21.5)	Appellate Body Report, *Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States – Recourse to Article 21.5 of the DSU by the United States*, WT/DS132/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6675
U.S. – CVDs on Certain EC Products	Appellate Body Report, *United States – Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/AB/R, adopted 8 January 2003, DSR 2003:I, 5
U.S. – CVDs on Certain EC Products	Panel Report, *United States – Countervailing Measures Concerning Certain Products from the European Communities*, WT/DS212/R, adopted 8 January 2003, modified by Appellate Body Report, WT/DS212/AB/R, DSR 2003:I, 73
US – FSC	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations"*, WT/DS108/AB/R, adopted 20 March 2000, DSR 2000:III, 1619
U.S. – FSC (21.5 II)	Panel Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Second Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/RW2, adopted 14 March 2006, upheld by Appellate Body Report, WT/DS108/AB/RW2
U.S. – OCTG Sunset Reviews	Appellate Body Report, *United States – Sunset Reviews of Anti-Dumping Measures on Oil Country Tubular Goods from Argentina*, WT/DS268/AB/R, adopted 17 December 2004, DSR 2004:VII, 3257
U.S. – Softwood Lumber IV	Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, adopted 17 February 2004, DSR 2004:II, 571
U.S. – Softwood Lumber IV	Panel Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/R and Corr.1, adopted 17 February 2004, modified by Appellate Body Report, WT/DS257/AB/R, DSR 2004:II, 641
U.S. – Softwood Lumber IV (21.5)	Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada – Recourse by Canada to Article 21.5 of the DSU*, WT/DS257/AB/RW, adopted 20 December 2005
U.S. – Softwood Lumber V	Appellate Body Report, *United States – Final Dumping Determination on Softwood Lumber from Canada*, WT/DS264/AB/R, adopted 31 August 2004, DSR 2004:V, 1875
U.S. – Softwood Lumber VI (21.5)	Appellate Body Report, *United States – Investigation of the International Trade Commission in Softwood Lumber from Canada – Recourse to Article 21.5 of the DSU by Canada*, WT/DS277/AB/RW, adopted 9 May 2006
U.S. – Upland Cotton	Appellate Body Report, *United States – Subsidies on Upland Cotton*, WT/DS267/AB/R, adopted 21 March 2005
U.S. – Upland Cotton	Panel Report, *United States – Subsidies on Upland Cotton*, WT/DS267/R, and Corr.1, adopted 21 March 2005, modified by Appellate Body Report, WT/DS/267/AB/R

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Upland Cotton Prices, March 2007.	Exhibit Bra-673
Cotton Marketing Weekly, 23 March 2007, accessed March 2007 at http://www.cottonexperts.com/solutions/cottonmktweekly.html.	Exhibit Bra-674
Updated Program Crop Comparison, March 2007.	Exhibit Bra-675
USDA Cotton and Wool Outlook, 12 March 2007, accessed March 2007 at http://usda.mannlib.cornell.edu/usda/current/CWS/CWS-03-12-2007.pdf.	Exhibit Bra-676
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Statement of Professor Sundaram.	Exhibit Bra-686
Cash Basis Accounting Worksheet.	Exhibit Bra-687

A. SCOPE OF THIS PROCEEDING

Questions to both parties

44. The European Communities argues in respect of the preliminary objection raised by the United States regarding the claims of Brazil relating to export credit guarantees for pig meat and poultry meat under the GSM 102 programme that "the important issue is the nexus or the degree of interrelatedness or interdependence between different elements of the measure". (Oral Statement of the European Communities, para. 6) The European Communities submits in this regard that:

> "the Panel should examine the original measure at issue and the 'measures taken to comply', and, with particular reference to the 'elements of the measure' that the United States argues are outside the Panel's terms of reference, enquire into the extent to which these are inter*related* or inter*dependent* with measures or 'elements of measures' that the United States accepts are within the Panel's terms of reference". (Oral Statement of the European Communities, para. 11)

Do the parties agree with the approach suggested by the European Communities and with the considerations in paragraph 13 of the Oral Statement of the European Communities?

1. The compliance Panel asks Brazil to comment on the "EC's suggested approach for addressing the United States' objection regarding Brazil's claims concerning the use of GSM 102 export credit guarantees ("ECGs") to circumvent U.S. export subsidy commitments for pig meat and poultry meat. The EC's approach for addressing the U.S. objection is based on an assessment of the "nexus" between the original measure and the measure taken to comply, with particular reference to the "elements" of the measure that the United States argues are not within the Panel's terms of reference.[1]

2. Brazil agrees that the nexus between a measure allegedly taken to comply and the original measure may, in certain circumstances, be relevant is assessing the scope of Article 21.5 proceedings. This approach was adopted by the Appellate Body in *U.S. – Softwood Lumber IV (21.5)* in assessing whether a periodic review was a measure taken to comply with DSB recommendations to an original determination.[2] The Appellate Body relied on the panels' findings in *Australia – Salmon (21.5)* and *Australia – Leather (21.5)* in support of this approach.

3. Brazil does not believe that it is necessary to employ this approach to resolve the U.S. objection, however. As far as Brazil understands, the United States' objection is premised on the view that there are *separate ECG measures* that apply on a product-specific basis, *e.g.*, to pig meat, and to poultry meat. The United States contends that the separate ECG measures for these two products are not "*measures* taken to comply".

4. The United States is incorrect in assuming that different ECG measures apply to different products. The ECG measure taken to comply is the amended GSM 102 program, which applies in precisely the same way to a range of products, including pig meat and poultry meat. Thus, a single amended subsidy program applies generally to numerous products. (In paragraph 13 of its Opening Statement, the EC itself notes that there is a single subsidy program, with a single revised guarantee fee schedule.)

5. Contrary to the United States' arguments in its 16 March comments, the measures taken to comply are not the individual ECGs granted to pig meat and poultry meat pursuant to the amended

[1] EC's Oral Statement, para. 11.
[2] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, paras. 79, 80-93.

GSM 102 program.[3] Unlike the revised GSM 102 fee schedule, the guarantees issued under the amended program were not adopted to implement the Dispute Settlement Body's ("DSB") recommendations. Rather, guarantees issued by the Commodity Credit Corporation ("CCC") represent simply the routine, day-to-day operation, of the amended program in response to applications from U.S. exporters. The fact that the measure taken to comply is the amended GSM 102 program does not mean that the measure is challenged "as such" because, under Article 10 of the *Agreement on Agriculture*, the issue is the application of the amended program.

6. Moreover, although the United States admits that it chose to change the guarantee fee schedule for all eligible products, it seeks to evade the consequences of that choice.[4] An implementing Member must ensure that the changes it makes to WTO-inconsistent measures comply fully with *all* of the Member's WTO obligations.[5] Article 21.5 proceedings are the appropriate forum for examining whether a Member has done so.

7. Under Article 10 of the *Agreement on Agriculture*, Brazil's claim is that this measure is applied in a manner that circumvents the United States' export subsidy commitments regarding certain agricultural products, including pig meat and poultry meat. Although Brazil made claims regarding these products in the original proceedings, these claims were not definitively resolved, and are not therefore excluded in these proceedings. In sum, therefore, Brazil makes product-specific claims regarding the application of a general subsidy measure – the amended GSM 102 program.

8. The United States appears to acknowledge that the amended GSM 102 program constitutes a "measure taken to comply". In these circumstances, it does not appear to be necessary for the Panel to rely on a nexus-based approach to establish that the amended GSM 102 program is covered by these compliance proceedings. Instead, the Panel must decide whether the amended GSM 102 program applies in the same way to all eligible products, including pig meat and poultry meat. If so, the Panel must decide whether there is any limit on the claims that Brazil can make regarding these products.

9. Despite asserting that there are separate ECG measures for pig meat and poultry meat, the United States has not contradicted Brazil's arguments that the amended GSM 102 *program* applies in the same way to all eligible products. The United States has, therefore, failed to establish a fundamental element of its objection; namely, that there are separate ECG measures applicable to pig meat and poultry meat. For this reason alone, the compliance Panel must reject the United States' objection.

45. Could the parties comment on the observations made by the European Communities in paras. 15-24 of its Oral Statement on the issue of whether the marketing loan and counter-cyclical payment programmes are within the scope of the Panel's proceeding?

10. Brazil agrees, generally, with the EC's comments in paragraphs 15-24 of its Oral Statement. However, as stated in its answer to question 78 below (as well as in paragraph 114 of its 26 February answers to questions), Brazil also agrees with the United States' observation in *EC – Selected Customs Matters* that certain claims under the covered agreements are "not readily classifiable in the categories of 'as such' and 'as applied.'"[6] An "as such" claim is typically understood to involve an examination of a general rule or norm in the abstract. However, as the original panel found, an examination of the "*effects*" of the general statutory and regulatory provisions establishing a subsidy program "*cannot be conducted in the abstract*" because they must be considered in light of the market-based effects of the

[3] U.S. 16 March Comments on Brazil's Response to Question 6, paras. 10-17.
[4] U.S. 16 March Comments on Brazil's Response to Question 6, paras. 22-26.
[5] Appellate Body Report, *Canada – Aircraft (21.5)*, paras. 41 and 42.
[6] Appellate Body Report, *EC – Selected Customs Matters*, para. 165.

measures.[7] Thus, Brazil considers that serious prejudice claims are among those that cannot be readily classifiable as "as such" and "as applied."

11. Brazil also agrees, generally, with the EC's comments in paragraphs 16-18 of its Oral Statement. As explained in other submissions, Brazil's present serious prejudice claims, and the original panel's rulings, covered both the Step 2, marketing loan and counter cyclical subsidy *programs* and subsidy *payments* mandated by those programs.[8] The original panel's approach was, therefore, appropriately based on the design, structure and operation of the programs, as well as the general magnitude of the payments made under the programs during a reference period adopted by the panel as a tool to examine the evidence.

12. In its 16 March comments, the United States suggests that the original panel's findings of present serious prejudice pertained solely to subsidy payments made in MY 1999-2002 – although the United States' table in paragraph 60 of its 16 March comments actually states that the findings related to "*programs*". The United States' arguments mischaracterize the original panel's findings from beginning to end.

13. *First*, in describing the measures at issue in paragraph 8.1 of the original panel report, the United States, in the table at paragraph 60 of its 16 March comments, wrongly assumes that "U.S. subsidies" does not include the legislative and regulatory provisions – the subsidy programs – mandating the subsidy payments. In fact, the original panel said expressly that the measures at issue included the "*legislative and regulatory provisions currently providing*" for the subsidy payments.[9] The United States suggestion that this reference merely included the "*application*" of these provisions makes no sense.[10] The "application" of these "provisions" is the payments, which were already separately listed as measures. Thus, there was no need to refer again to the "application" of the "provisions". Moreover, the "legislative and regulatory provisions" were separately identified without any limiting reference to their "application".

14. *Second*, the United States' arguments also mischaracterize the original panel's examination of the measures at issue. According to the United States, the "subsidies" are the payments, not the programs. Moreover, it contends that the operation of the programs was examined merely to assess the effects of the payments. However, the original panel stated that it would "undertake an analysis of the existence and nature of the *subsidies in question* by examining *their structure, design and operation* with a view to discerning their effects."[11] However, it is programs, not individual payments, that have "design, structure and operation". Thus, the original panel's use of the word "their" indicates that the "subsidies in question" included the programs. Consistent with this view, the original panel found that "the structure, design and operation of the marketing loan *programme* has enhanced production and trade-distorting effects".[12]

15. With respect to both the marketing loan and Step 2 programs, the original panel found that "the *structure of the measure*, directly linked to A-index, affects the world market generally."[13] The only "*measure*" that includes a direct link to the A-Index is the Farm Security and Rural Investment Act ("FSRI Act") of 2002. Individual payments themselves do not have "structure", and do not include references to the A-Index. Thus, the original panel again refers to the subsidy *programs* as among the "measures" at issue.

[7] Panel Report, *U.S. – Upland Cotton*, para. 7.1198.
[8] *See, in particular*, Brazil's 26 February response to question 11.
[9] Panel Report, *U.S. – Upland Cotton*, para. 7.1107.
[10] U.S. 16 March comments on Brazil's response to question 11, para. 68.
[11] Panel Report, *U.S. – Upland Cotton*, para. 7.1194.
[12] Panel Report, *U.S. – Upland Cotton*, para. 7.1295.
[13] Panel Report, *U.S. – Upland Cotton*, paras. 7.1296 and 7.1300.

16. In examining causation, the original panel also refers to the "design, structure and operation of *these three measures*".[14] The "three measures" must be the three (marketing loan, Step 2 and counter-cyclical) subsidy *programs* because there are precisely three of these. In contrast, if the individual payments alone were the measures, there would obviously be many more than "three measures".

17. *Third*, if there were any doubt that the subsidy measures includes the three programs, these are removed by the original panel's statements in declining to examine a threat of serious prejudice. The original panel found that Brazil's claims of present serious prejudice findings "pertain to *measures in force* <u>*and*</u> subsidies granted from MY1999 – MY 2002"; it added, "our finding of 'present' serious prejudice thus pertain[s] also to *measures in force* <u>*and*</u> subsidies paid in MY 2002". Individual instances of payment are not "measures *in force*"; only statutory and regulatory provisions have the normative qualities of "measures *in force*". This statement, therefore, distinguishes between: (1) the subsidy programs ("measures in force") "<u>*and*</u>" (2) the subsidy payments ("subsidies granted" and "subsidies paid"). Significantly, the original panel stated unambiguously that Brazil's claims, and its findings, "pertain[ed] to" *both categories of measures*.

18. Almost immediately afterwards, the original panel declared that its present serious prejudice findings "*include findings of inconsistency that deal with the FSRI Act of 2002* <u>*and*</u> subsidies granted thereunder in MY 2002". Again, therefore, the panel stated that its findings pertained to two categories of measures: (1) the FSRI Act (*i.e.* the "measures in force") "<u>*and*</u>" (2) payments.

19. Because the original panel's findings "pertained to", and "deal with", the three programs set forth in the FSRI Act of 2002, it found that the United States "was *obliged* to take action concerning its *present statutory and regulatory framework* as a result of our 'present' serious prejudice finding."[15] This is not idle speculation as to how the United States could implement, as the United States might wish.[16] It is a statement of the United States "*oblig[ations]*" flowing from the panel's present serious prejudice findings that "pertain[ed] to the measures in force" – that is, the "statutory and regulatory framework" – as well as to payments in MY 1999-2002.

20. Also, the original panel's decision not to examine the "as such" claims, which pertained to the "measures in force" alone, can only be explained on the ground that the present serious prejudice findings already dealt with those measures. If the present serious prejudice findings had dealt with payments alone, the dispute concerning the measures in force would not have been resolved. In those circumstances, it would have been necessary for the panel to address the "as such" claims. Yet, because of the present serious prejudice findings – which pertained also to the measures in force – the panel found that it was not necessary to examine the "as such" claims.[17]

21. The United States is, therefore, attempting to rewrite the panel's findings to eliminate the obligation to reform the "statutory and regulatory framework".

22. With respect to the EC's comments in paragraph 19, Brazil agrees that, where a program mandates that payments be made when the recipient fulfils certain conditions which are within the control of the recipient, there is a stronger nexus between the program and the payments than where a program authorizes payments to be made at the discretion of the granting authority. In the former case, Brazil also agrees that panels may treat the program and payments as, essentially, indivisible in examining the effects of the subsidies. In this dispute, the marketing loan and the counter cyclical programs mandate payments when the recipient fulfills certain factual conditions. In this situation,

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[14] Panel Report, *U.S. – Upland Cotton*, para. 7.1349.
[15] Panel Report, *U.S. – Upland Cotton*, para. 7.1501.
[16] U.S. 16 March Comments on Brazil's Answer to question 11, para. 73.
[17] Panel Report, *U.S. – Upland Cotton*, para. 7.1511.

the original panel's reasoning and findings correctly analyzed the programs and mandatory payments together.

23. As regards the EC's comments in paragraphs 20 and 21, Brazil agrees that the original panel found that a *bundle* of subsidies cause adverse effects. As the EC observes, the United States' action in withdrawing the Step 2 program confirms that the bundle of subsidies found to be WTO-inconsistent included the contested subsidy programs. That bundle also included the marketing loan and the counter-cyclical subsidy programs. Because the United States was obliged to take action to withdraw the subsidy programs or remove their adverse effects, those two programs are properly within the compliance Panel's terms of reference.

24. In the alternative, Brazil has argued that, if the compliance Panel rules that the programs are not within its terms of reference, there is a sufficient nexus between the payments found to be causing adverse effects in the original proceedings, and the payments subject to Brazil's adverse effects claims in these proceedings, for the new payments to be subject to these proceedings.[18] In that regard, Brazil also agrees with the EC that, where payments are mandated by a program, there is a sufficient nexus between the payments and the programs for both to be part of compliance proceedings.

25. Generally, Brazil agrees with the EC's comments in paragraphs 22 and 23. However, in Brazil's view, the scope of compliance proceedings is decided by the compliance Panel and is not, as the EC may be suggesting, determined by "what the Parties agree is within the scope of the compliance panel".[19]

46. In its Oral Statement, the European Communities characterizes Brazil's and the United States' respective approaches as the "measure model" and the "element of the measure model" (Oral Statement of the European Communities, para. 7). Please discuss whether you agree with this characterization and whether, in your view, the application of a measure alleged to be a subsidy to different agricultural products relates to a "measure" (or elements thereof) or if, rather it relates to a "claim". Would it be permissible for a compliance panel to examine a "claim" that relates to subsidies (granted as part of measures taken to comply) provided to agricultural products to which the "initial measure" did not apply?

26. In its 26 February reply to question 6, Brazil set forth its understanding on the scope of Article 21.5 proceedings. In Brazil's view, the compliance Panel must determine, *first*, whether the *measures* challenged by Brazil fall within the scope of these proceedings. In Brazil's view, the marketing loan and the counter cyclical programs, and payments made under them, are part of these proceedings because they are subject to the DSB's recommendations in the original proceedings and are identified in Brazil's panel request in these proceedings. This compliance Panel may, therefore, examine whether these unchanged programs, and the mandatory payments made under them, continue to cause adverse effects. Brazil does not consider that it would be appropriate to parse the programs into different "elements", because Brazil's claim relates to the effects of these programs in their totality.

27. Brazil also considers that the amended GSM 102 program, as a whole, is within the scope of these proceedings. The United States has revised the original program, and maintains a new GSM 102 program. Brazil sees no need for the compliance Panel to parse the amended program into sub-elements, and to rule that the measure at issue consists solely of certain elements of the program. Brazil's approach is consistent with the Appellate Body's finding in *Canada – Aircraft (21.5)* that the

[18] *See* Brazil's 26 February answers, paras. 145-150.
[19] EC's Opening Statement, para. 22.

measure at issue was the revised TPC program, even though not all elements of the program had been changed.[20]

28. *Second*, having identified the compliance measures at issue, a panel must consider the claims made with respect to these measures. Brazil recognized in its 26 February reply to question 6 that certain panels have ruled that *no new claims* can be made with respect to *unchanged elements* of the original measure; equally, the *same claim* cannot be made with respect to *unchanged elements* of the measure *if that claim was rejected* in the original proceedings.

29. These limitations do not apply in these proceedings. With respect to the marketing loan and the counter cyclical programs, which are unchanged, Brazil makes the same claim of adverse effects that was upheld in the original proceedings precisely because the WTO-inconsistent programs have not been "withdrawn". As regards ECGs, Brazil claims that the revised guarantee fee schedule of the amended GSM 102 program involves prohibited export subsidies. This claim can be made because it relates to a new element of the amended measure.

30. The compliance Panel asks whether the application of a subsidy program to "different agricultural products" relates to the measure or the claims at issue. The question of the application of a subsidy program to specific products relates to the scope of the measure at issue: does the measure apply to a given product as a matter of municipal law? As the Appellate Body noted in *EC – Chicken Cuts*, "it is the measure at issue that generally will define the product at issue".[21] In this dispute, the amended GSM 102 program applies to a wide range of products, including pig meat and poultry meat.

31. Although a measure may apply to a wide range of products, a complainant may limit the claims made regarding that measure to specified products. For example, in this dispute, Brazil's panel request limits the claims made regarding the amended GSM 102 program relate to specified scheduled agricultural products – pig meat, poultry meat and rice – and to all unscheduled agricultural products.[22]

32. The compliance Panel also asks whether it would be "permissible for a compliance panel to examine a 'claim' that relates to subsidies (granted as part of a measure taken to comply) provided to agricultural products to which the 'initial measure' did not apply". Brazil is not certain which products the compliance Panel has in mind that were not eligible to receive ECGs under the original GSM 102 program, but that are now eligible under the amended program.

33. Brazil has made claims regarding three specified scheduled agricultural products, pig meat, poultry meat and rice.[23] These three products were all eligible to receive ECGs under the original GSM 102 program, and all remain eligible under the new program.

34. Assuming that a subsidy "measure taken to comply" applies to products that were *not* eligible to receive subsidies under the original measure, a compliance panel is permitted to examine a claim relating to the newly eligible products. In that event, the new product scope of the "measure taken to comply" is a *changed element* of the original measure. In Article 21.5 proceedings, there are no limits on the claims that a Member can bring regarding changed elements of the compliance measure. In *EC – Bed Linen (21.5)*, the Appellate Body recognized that "a 'measure taken to comply' may be *inconsistent* with WTO obligations in ways different from the original measure."[24] Accordingly, the claims and arguments made in the original proceedings do not limits the claims and arguments that

[20] Appellate Body Report, *Canada – Aircraft (21.5)*, paras. 41-42.
[21] Appellate Body Report, *EC – Chicken Cuts*, para. 165.
[22] *See* also Brazil's response to question 50, below.
[23] Brazil's claims also concern GSM 102 ECGs for unscheduled products.
[24] Appellate Body Report, *EC – Bed Linen (21.5)*, para. 79 (original emphasis).

can be made regarding the revised measure.[25] This ensures that the compliance measure complies with all of a Member's WTO obligations.

Questions to the United States

47. The United States has raised a preliminary objection regarding Brazil's claims of (threat of) serious prejudice in respect of the marketing loan and counter-cyclical payment programmes. Is the Panel's understanding correct that, apart from this preliminary objection regarding programmes, the United States also considers that the issue of whether payments made under the marketing loan and counter-cyclical payment programme after 21 September 2005 cause serious prejudice to the interests of Brazil is not properly within the scope of this proceeding?

48. How does the United States address the argument of Brazil that "[i]f the United States were to prevail on its view that subsequent mandatory and price-contingent marketing loan and CCP payments are not properly before this Panel, the grant of annual recurring subsidies becomes 'a moving target that escape from [the WTO subsidy] disciplines'"? (Closing Statement of Brazil, para. 4)

49. Could the United States comment on the argument of the European Communities that the text of Article 21.5 of the DSU does not limit the temporal scope of that provision in the manner suggested by the United States? (para. 29 of the Oral Statement of the European Communities)

Question to Brazil

50. Does Brazil maintain its claims with respect to the three unscheduled products (lyocell, lysine, wood products) identified by the United States as falling outside the scope of the Agreement on Agriculture? (see paragraph 83 of the United States' Rebuttal)

35. Brazil maintains its claims under Articles 3.1(a) and 3.2 of the *SCM Agreement* with respect to GSM 102 ECGs for lyocell, lysine and wood products. To the extent that these products fall outside the scope of the *Agreement on Agriculture*, the compliance Panel need not, before addressing Brazil's prohibited subsidy claims under the *SCM Agreement*, address whether the provision of GSM 102 ECGs for these products circumvents U.S. agricultural export subsidy commitments.

B. CLAIMS OF BRAZIL REGARDING PRESENT SERIOUS PREJUDICE

1. Significant price suppression - Article 6.3(c) of the *SCM Agreement*

Questions to both parties

51. The parties disagree on whether or not the marketing loan and counter-cyclical payments have more than minimal effects on production of upland cotton. Could each party explain how its approach to the analysis of the impact of these payments on production of upland cotton is supported by the provisions of Articles 5 and 6 of the SCM Agreement and by any other relevant WTO provisions?

36. Articles 5-7 of the *SCM Agreement*, and Article XVI of GATT 1994 are the only legal bases governing *actionable* subsidy claims. Article 5 of the *SCM Agreement* states that the focus of the analysis is on "any subsidy referred to in paragraphs 1 and 2 of Article 1." Articles 6.3(a)-(d) speak to the "effect of the subsidy." Similarly, Article 7.1 provides that consultations with a subsidizing

[25] Appellate Body Report, *EC – Bed Linen (21.5)*, para. 79; Appellate Body Report, *Canada – Aircraft (21.5)*, paras. 40–42.

Member can be requested regarding "any subsidy referred to in Article 1, granted or maintained by another Member." Finally, Article XVI:1 also refers to "any subsidy."

37. The only exception to bringing any actionable subsidy challenges under Part III of the *SCM Agreement* was Article 13 of the *Agreement on Agriculture*. Yet, the exceptions in Part III of the *SCM Agreement* referring to Article 13 of the *Agreement on Agriculture* (*i.e.*, Article 5, Article 6.9, and Article 7.1 of the *SCM Agreement*) lapsed following the expiration of that provision in 2003. Consequently, *any* domestic support or export subsidy supporting or benefiting the production of an agricultural good covered by Annex 1 of the *Agreement on Agriculture* is properly the subject of a claim under Articles 5 and 6 of the *SCM Agreement*. In sum, the right to challenge the effects of any subsidy, no matter how great or small its effect on production, is now unlimited.

38. The marketing loan and counter-cyclical subsidies fall within the category of "any subsidies," within the meaning of Articles 5 and 7 of the *SCM Agreement*. They are also both "the subsidy" referred to in Articles 6.3(c) and (d) and Articles 7.8 and 7.9 of the *SCM Agreement*. As such, each of these subsidies are properly measures which Brazil claims collectively cause significant price suppression and an increase in the U.S. world market share of upland cotton.

39. There is no provision in the *SCM Agreement* or any other WTO Agreement that precludes WTO panels from examining the effects of subsidies with no more than minimal effects on production. The United States has referred in various of its arguments to Annex 2 of the *Agreement on Agriculture*. The *chapeau* of that Annex states that "[d]omestic support measures for which the exemption from reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade distorting effects, or effects on production." The text of the *chapeau* to Annex 2 sets out a "fundamental requirement" to determine whether particular types of domestic support should – or should not – be tabulated as part of measures exempted from domestic support reduction commitments set out in Articles 6 and 7 of the *Agreement on Agriculture*. This is an entirely separate question of whether actionable subsidy claims can be asserted against such subsidies. Indeed, the drafters contemplated that actionable subsidy claims could be asserted against subsidies properly covered by Annex 2 since they found themselves compelled to include a specific provision into the "due restraint" peace clause – Article 13(a) of the *Agreement on Agriculture*.

40. Whether "domestic support" subsidies are – or are not – exempt from the separate reduction commitments relating to the Aggregate Measurement of Support ("AMS") for domestic support under the *Agreement on Agriculture* has no bearing on either (i) the type of measure that can be challenged or (ii) the claims that can be brought against such measures under the *SCM Agreement*. The text of Articles 5 and 6 of the *SCM Agreement* is unrestricted – all measures meeting the definition of a subsidy are subject to challenge. Thus, there is no basis to for a subsidizing Member to claim that a subsidy is exempt from an actionable subsidy challenge because the challenged subsidies are exempt from reduction commitments under the *Agreement on Agriculture*.

41. From an evidentiary point of view, it is also irrelevant that domestic support subsidies might be exempt from total AMS reduction commitments under Annex 2 of the *Agreement on Agriculture*. Articles 5 and 6 of the *SCM Agreement* require a panel examining the effects of different forms of domestic support subsidies to be color-blind. It is irrelevant whether the subsidies examined are amber, blue, or green. *All* subsidies are actionable. *All* subsidies have at least the *potential* to cause adverse effects. Whether any subsidy causes adverse effects or not involves a detailed factual examination of its nature, magnitude and prevailing conditions of competition – not whether it is the type of subsidy that is or is not exempt from total AMS reduction commitments.

42. To the extent that the compliance Panel's question also addresses Brazil's approach of establishing that the effect of the challenged U.S. subsidies is "significant price suppression," Brazil refers the Compliance Panel to its responses to questions 62-74, below. In response to these questions, Brazil explains its counterfactual approach and the evidence supporting the existence of a

"genuine and substantial relationship of cause and effect" between the subsidies and significant price suppression. Brazil establishes that but for these subsidies, U.S. acreage would be lower. Lower acreage results in lower U.S. production and supply into the world market – either in the form of exports or in the form of increased temporary stocks of upland cotton building up before they will eventually exported. Basic rules of supply and demand indicate that supply that is higher than it would be but for the subsidies results in lower prices. The assessment of the "effect of the subsidy" that is required by Article 6.3 is necessarily a fact-specific, effects-based assessment that must be tailored to the product and markets at issue and that involves assessing the economic impact of these subsidies.

52. In its Third Party Submission New Zealand observes:

> "Marketing loan payments are amber box measures, the category in which are included the non-prohibited measures with the most trade distorting effect on production and trade." (para. 5.19)

Do the parties consider that the fact that under the Agreement on Agriculture a subsidy is included in the "amber box" is relevant to the analysis of the subsidy's consistency with Articles 5 and 6 of the SCM Agreement?

43. For the reasons set forth in Brazil's response to question 51, Brazil considers that the "amber box" nature of a subsidy has no significant relevance to the analysis of its consistency with Articles 5 and 6 of the *SCM Agreement*. Brazil, therefore, agrees with the original panel's assessment that "the fact that the United States notifies the marketing loan programme as 'amber box' support under the *Agreement on Agriculture* may not necessarily be determinative for the purpose of our 'adverse effects' analysis under Part III of the *SCM Agreement.*"[26] Finally, Brazil notes that counter-cyclical subsidies, like marketing loan subsidies, are "amber box."

Questions to the United States

53. The United States argues that Brazil has not provided evidence of "actual production inducing" effects of marketing loan and counter-cyclical payments and that Brazil "purports to demonstrate indirect production effects through its claim that the US planting, production, and exports are not responsive to prices". (Opening Statement of the United States at the meeting of the Panel with the parties, paras. 62 and 69, emphasis in original)

a) Could the United States explain further the distinction between what it terms "actual production inducing effects "and "indirect production effects"? Could the United States also elaborate on how this distinction is legally relevant in the context of Articles 5 and 6 of the SCM Agreement?

b) What is the response of the United States to the argument that the fact that "U.S. upland cotton producers know that their overall revenue will always be protected by marketing loans and counter-cyclical payments ... plays a major role in their planting decisions"? (Rebuttal of Brazil, para. 185; see also Third Party Submission of New Zealand, paras 5.20-5.21)

c) In its Opening Statement at the meeting of the Panel with the Parties, Brazil observed:

> "...we have demonstrated that these subsidies stabilized cotton producers' revenue despite wildly fluctuating market prices, thereby

[26] Panel Report, *U.S. – Upland Cotton*, footnote 1401.

> insulating and numbing acreage response to market price signals. These subsidies also cover the huge long-term gaps between market returns and total costs of production. Both effects are closely interrelated." (para.55)

Is the United States only arguing that Brazil has not empirically substantiated that these two "effects" have actually occurred or is it also the position of the United States that these effects are in any event legally irrelevant to an analysis of whether a subsidy causes significant price suppression within the meaning of Article 6.3 (c) of the SCM Agreement?

54. Could the United States explain whether, and, if so, why, it is of the view that this Panel should not rely on the findings and analysis by the original Panel regarding the effects of marketing loan and counter-cyclical payments on production and exports? Please comment in particular on paras. 7.1291, 7.1295, 7.1302, 7.1349, 7.1353 of the Panel Report.

55. Can the United States confirm that the figures "$868 million" and "$838 million" Brazil cited in para. 40 of its Opening Statement are correct figures if one uses the "Brazil's methodology" and the "Cotton-to-Cotton methodology"? (Please note that the Panel is not asking whether the US agrees with these methodologies.)

56. The United States has cited new empirical research on the production effects of counter-cyclical payments. How does the United States address Brazil's criticism that none of this research has dealt specifically with the effects of countercyclical payments under the FSRI Act of 2002 on upland cotton? (Rebuttal Submission of Brazil, para. 120)

57. The United States has offered the Lin and Dismukes (Exhibit US-34) and Westcott (US-35) studies as examples of new empirical research on the production effects of countercyclical payments.

a) Is it not more accurate to characterize the Lin and Dismukes study as a simulation of the possible effect of countercyclical payments on production rather than a study on the actual impact of the payments since it does not statistically estimate the effect of the actual payments (which began only in 2002) on crop production? (Please refer to pages 9-12 of the paper which describe the data, covering the period 1991-2001, used for the study).

b) How does the United States deal with Brazil's characterization of the Westcott study as offering no new empirical evidence, and instead, being a qualitative discussion, much like that presented to the original panel (see para 128 of Brazil's rebuttal)?

58. The Unites States stated that the key consideration in assessing a farmer's decision to grow upland cotton is whether the farmer has been covering his variable costs of production. In this connection, it presented upland cotton costs and returns estimates for marketing years 1999-2005 (Exhibit US-47). Brazil has disputed the absence of certain items – land, labour and capital recovery costs - in the US calculations of variable costs. In response, the United States has referred to the Commodity Costs and Returns Estimation Handbook (Exhibit US-88) prepared by a Task Force of the American Agricultural Economics Association as the basis for leaving out these items in its calculations. However, the Task Force which authored the Handbook does not use the categories "fixed" or "variable" costs and in fact recommends that the microeconomic concepts of fixed and variable costs not be used in preparing and reporting cost and return estimates. Page 2-67 of the Handbook states:

> The Task Force therefore recommends that costs should be categorized only as to whether they are associated with expendable factors or the services of capital assets.

> The division of costs into categories such as fixed and variable should generally be avoided in preparing CAR estimates. For the purpose of preparing CAR estimates for specific enterprises, the Task Force recommends that all the costs of all expendables be allocated to the generic group OPERATING COSTS and that all other costs be allocated to the group ALLOCATED OVERHEAD.

Would the United States clarify whether the categories "operating costs" and "allocated overhead" correspond to the economic concepts of fixed and variable costs? In particular, are "operating costs" variable costs or not? Would the United States please indicate whether, and if so, where, the Handbook makes these clarifications or distinctions.

59. In discussing the impact of long-term costs of production (and hence long-term profitability) of upland cotton production on farmers' decisions to exit cotton farming, the United States argues that income from other crops and off-farm income must be into account. Why does the United States consider these issues relevant given the original Panel's decision that "off farm income" is not a legally relevant consideration. (Panel Report, para. 7.1354, footnote 1470) Please respond to Brazil's arguments on this matter in paragraphs 249-253 of its Rebuttal Submission.

60. In its Rebuttal Submission, the United States argues that Prof. Sumner's description of the model that appeared in a recent CATO publication is not "appropriate" for use in a WTO dispute involving claims of serious prejudice. Professor Sumner has since introduced "more empirical and institutional detail" to the model used in this dispute. These changes are described in paragraphs 111-117 of Brazil's Opening Statement. Does the United States view these changes as being sufficient to make the model appropriate for use in a WTO dispute involving claims of serious prejudice? If not, what modifications does the United States think should have been made to the model?

61. With respect to marketing year 2006, the United States has provided some data on upland cotton exports (Exhibit US-113), planted and harvested area and cotton production (Exhibit US-114), as well as a copy of the National Cotton Council's survey of planting intensions (Exhibit US-115). The data, all of which have been collected through the first half of marketing year 2006, are variously qualified as "estimates" or "projections" or projected".

a) Please clarify, as completely as possible, what these various terms mean as they apply to US upland cotton exports, acreage and production.

b) Would the United States be able to provide the Panel with some information, based on the average of the past six marketing years or so, of how final marketing year data on these variables, would differ from preliminary estimates, projections and the like, taken at the end of February of the relevant marketing year?

c) Finally, would the United States be able to update that part of Exhibit US-83 dealing with futures prices so as to provide the panel with as complete as possible average January to March 2007 New York futures prices for upland cotton?

Questions to Brazil

62. How does Brazil rebut the argument of the United States that the fact that marketing loan and counter-cyclical payment programmes provide income support when prices are low is not the key question before this Panel and that while, like any other payments to producers, marketing loan and counter-cyclical payments could affect production, Brazil has not provided any evidence of actual production-inducing effects? (Rebuttal Submission of the United States, paras. 222, 287-291; Opening Statement of the United States at the meeting of the Panel with the parties, paras. 62-75;

Comments of the United States on Brazil's 'Oral' Presentation in the meeting with the Panel, paras. 42-57).

44. The price-contingent nature of marketing loan and counter-cyclical subsidies, *i.e.*, the fact that payments are made when prices fall below set trigger prices, is one of the key aspects of the structure, design and operation of these subsidies. It also is one of the fundamental facts supporting Brazil's adverse effects claims. Contrary to the U.S. arguments, whether the price-contingent marketing loan and counter-cyclical subsidies are labelled as "price support" or "income support"[27] is irrelevant for purposes of a panel's fact-specific assessment of the effects of these subsidies under Articles 5 and 6 of the *SCM Agreement*.[28]

45. The strong link between these price-contingent subsidies and upland cotton acreage, production and exports as well as suppressed prices has been recognized by the original panel[29], the Appellate Body[30], U.S. Department of Agriculture ("USDA")[31], and all independent economists.[32] In a review of studies on the world cotton market, the UN Food and Agricultural Organization observed that "all of the recent studies unambiguously demonstrate that the removal of domestic subsidies in industrialized countries reduces cotton production in and exports from these countries."[33] Even the National Cotton Council ("NCC") acknowledged that many of its members would go bankrupt without these subsidies.[34] Bankrupt farmers do not produce upland cotton.

46. As *price-contingent* subsidies, marketing loan and counter-cyclical subsidies are mandated to be made to U.S. upland cotton farmers when prices fall below levels designed with U.S. producers' costs of production in mind. Every U.S. upland cotton farmer knows that marketing loan subsidies will be paid if the adjusted world price ("AWP") falls below 52 cents per pound and that U.S. counter-cyclical payments will be paid if the average farm price falls below 65.73 cents per pound. And every U.S. upland cotton farmer knows that the AWP remained consistently below 52 cents per pound over the past 10 years (with only limited exceptions) and is expected to remain below 52 cents.[35] This is shown in Figure 1, below, which updates Figure 7 in Brazil's First Written Submission:

[27] *See*, *e.g.*, Article 1.1(a)(2) of the *SCM Agreement*, Article XVI of GATT 1994, Articles 6 and 7 as well as Annex 2 of the *Agreement on Agriculture*.

[28] *See* Brazil's response to question 51, above.

[29] Panel Report, *U.S. – Upland Cotton*, paras. 7.1291, 7.1294, 7.1295 and 7.1349.

[30] Appellate Body Report, *U.S. – Upland Cotton*, paras. 445 and 450.

[31] *See* Brazil's Rebuttal Submission, Annex I, para. 10 citing Lin, W., P.C. Westcott, R. Skinner, S. Sanford and D.G. de la Torre Ugarte, "Supply Response Under the 1996 Farm Act and Implications for the U.S. Field Crops Sector,." Technical Bulletin No. 1888, Sep 2000, United States Department of Agriculture, Economic Research Service, available at http://www.ers.usda.gov/publications/tb1888/ and Adams, Gary. "Acreage Response Under the 1996 FAIR Act?" Speech presented at Economic Research Service, U.S. Department of Agriculture seminar series on Supply Response Under the 1996 Farm Act. June 24, 1996.

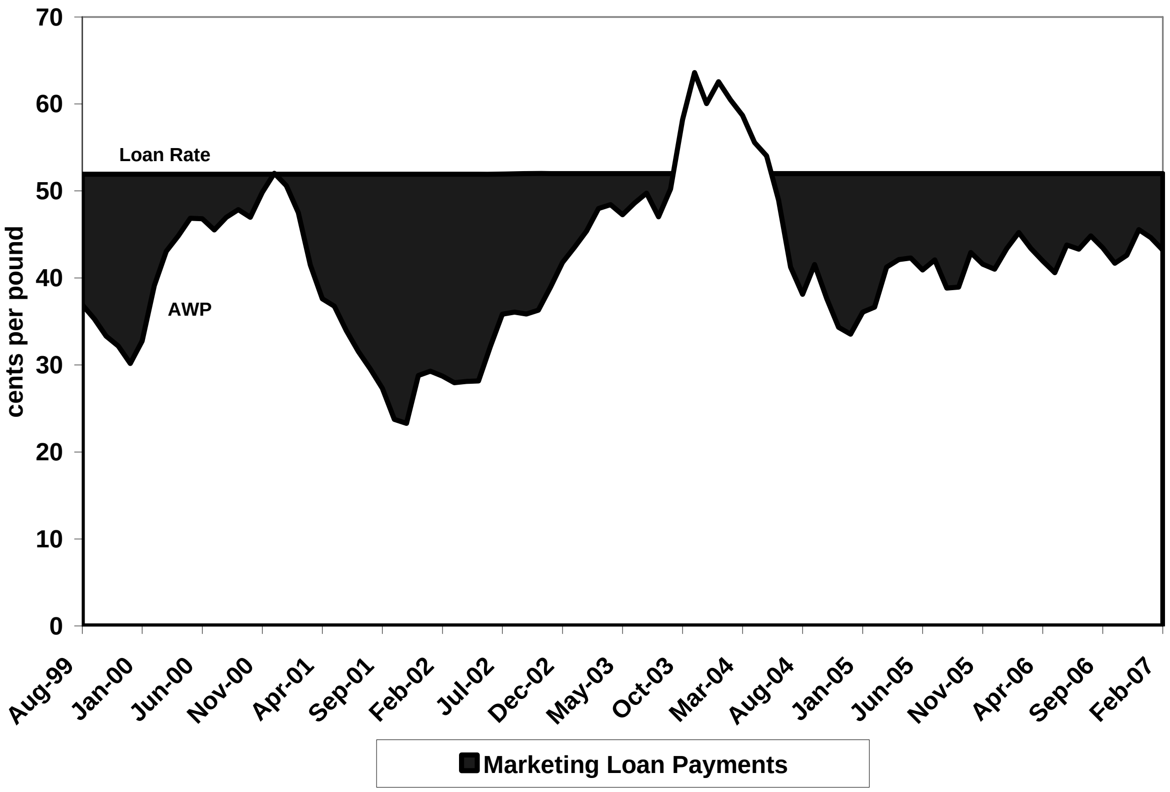
[32] *See*, *e.g*., Exhibit Bra-579 ("Cotton: Impact of Support Policies on Developing Countries – Why Do the Numbers Vary?" FAO Trade Policy Brief, p. 1, accessed December 2006 at ftp://ftp.fao.org/docrep/fao/007/y5533e/y5533e00.pdf); Brazil's Rebuttal Submission, Annex I, para. 10 citing Adams, Gary "Acreage Response Under the 1996 FAIR Act?" Speech presented at Economic Research Service, U.S. Department of Agriculture seminar series on Supply Response Under the 1996 Farm Act. June 24, 1996, and Exhibit US-56 ("Documentation of the FAPRI Modelling System," FAPRI-UMC Report No. 12-04, December 2004).

[33] Exhibit Bra-579 ("Cotton: Impact of Support Policies on Developing Countries – Why Do the Numbers Vary?" FAO Trade Policy Brief, p. 1, accessed December 2006 at ftp://ftp.fao.org/docrep/fao/007/y5533e/y5533e00.pdf).

[34] Exhibit Bra-109 (Testimony (Full) of Robert McLendon, Chairman, NCC Executive Committee, Before the House Agricultural Committee. National Cotton Council (NCC)).

[35] *See* Brazil's response to question 89, below.

Figure 1 – Marketing Loan Subsidy[36]



47. Whether futures market prices are high or low at the time of planting is relevant for U.S. upland cotton producers' planting intentions. However, U.S. upland cotton producers know that expected prices based off the futures market price will not necessarily constitute real prices during the following marketing year and they plant upland cotton in the knowledge that the support provided by marketing loan and counter-cyclical subsidies will guarantee profitable levels of revenue – regardless of the actual farm price. The Appellate Body fully recognized this in finding that "U.S. farmers were aware that if actual prices were ultimately lower, they would be 'insulated' by government support, including not only marketing loan program payments but also counter-cyclical payments, which were based on a target upland cotton price of 72.4 cents per pound."[37] Thus, the revenue- and income-stabilizing role played by marketing loan and counter-cyclical payments insulates producers from low prices. This is key evidence for the compliance Panel to find acreage, production, exports and world market price-suppressing effects from the U.S. marketing loan and counter-cyclical subsidies.

48. A fundamental question in this dispute, as before the original panel, is what would U.S. planted acreage, production, and exports be if there were *no* marketing loan subsidies and *no* counter-cyclical subsidies? (Brazil notes that in response to question 63, below, it explains that it is irrelevant to this counterfactual assessment whether these subsidies "*induce*" *additional* production.) In assessing the significant level of the effects of the subsidies, the views of their recipients constitute particularly relevant evidence. In fact, the NCC representing U.S. upland cotton producers repeatedly stated that these subsidies are crucial to avoid the financial failure of many upland cotton farmers.[38] Bankrupt farmers could not produce upland cotton.

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[36] Exhibit Bra-673 (Upland Cotton Prices, March 2007).

[37] Appellate Body Report, *U.S. – Upland Cotton*, para. 445.

[38] Panel Report, *U.S. – Upland Cotton*, footnote 1471 referring to Exhibit Bra-109 (Testimony (Full) of Robert McLendon, Chairman, NCC Executive Committee, Before the House Agricultural Committee. National Cotton Council (NCC)). *See also* Exhibit Bra-324 (NCC Chairman's Report by Kenneth Hood, 24 July 2002, p. 2).

49. These admissions by the recipients of upland cotton marketing loan and counter-cyclical subsidies are supported by Figure 8 of Brazil's First Written Submission (reproduced also as Figure 6 in Brazil's Rebuttal Submission). Based exclusively on USDA data, this figure show that marketing loan and counter-cyclical subsidies protect upland cotton producers from low market prices, ensuring them a high level of revenue per pound of upland cotton produced. Whether this is termed "income support,"[39] "price support," or "insulation from low prices," the effects are the same.

50. Figures 1-6 in Brazil's Opening Statement and Figures 7 to 12 in Brazil's Comments on the U.S. Oral Statements, based largely on USDA and Food and Agricultural Policy Research Institute ("FAPRI") data, also constitute proof of the crucial role played by these two subsidies in allowing farmers to continue to plant upland cotton. These figures show the role played by the subsidies in covering huge and sustained losses based solely on market revenue. They also show how upland cotton marketing loan and counter-cyclical subsidies keep farmers in the production of upland cotton when, absent the subsidies, it would be much more profitable to grow soybeans or corn.

51. In assessing the supply effects of U.S. subsidies on world market prices, the compliance Panel, like the original panel, must take account of basic principles of supply and demand. The impact of subsidy-fuelled U.S. upland cotton supply in suppressing U.S. and world market prices of upland cotton is reflected day-in and day-out in upland cotton markets. Consider the following statement from market expert A.O. Cleveland, dated 23 March 2007:

> *For now, the sheer volume of U. S. cotton stocks held in the CCC loan program, and the 600,000 plus bales of certificated stocks will keep a heavy lid on the market.* … USDA will release it March planting intentions report on Friday of next week. U.S. upland acreage could have an 11 in front of it, but will likely be a very low 12 something. Look for about 12.2 million acres of upland cotton to be planted. Certainly any total acreage number below 12.5 million acres will be bullish. *The lower the intended plantings the higher the price rally*.[40]

52. Thus, marketing loan and counter-cyclical subsidies "insulate" U.S. upland cotton producers from market price signals, thereby "numbing" their reaction to market prices signals. They results in higher U.S. acreage, production, exports or stocks, and lower world market prices than would exist otherwise. As O.A. Cleveland states in the most basic supply and demand terms, "the lower the intended [U.S.] plantings, the higher the price rally." Brazil refers the compliance Panel to its response to question 69, below, where Brazil outlines the extensive evidence it has submitted to demonstrate this point in its written submissions and its oral statements.

53. In addition, the original panel made numerous findings with respect to the production-enhancing effects of unchanged marketing loan and counter-cyclical subsidies. The original panel found that

> [S]everal of the United States subsidies – marketing loan programme payments, the user marketing (Step 2) payments … [and] CCP payments – are directly linked to world prices for upland cotton, thereby insulating United States producers from low prices. We believe the structure, design and operation of these three measures constitutes evidence supporting a causal link with the significant price suppression we have found to exist.[41]

[39] Brazil notes that Article 1.1(a)(2) of the *SCM Agreement* specifically identifies "any form of income or price support" as a form of financial contribution.
[40] Exhibit Bra-674 (Cotton Marketing Weekly, A.O. Cleveland, 23 March 2007) (emphasis added).
[41] Panel Report, *U.S. – Upland Cotton*, para. 7.1349.

> The further the adjusted world price drops, the greater the extent to which United States upland cotton producers' revenue is insulated from the decline, numbing United States production decisions from world market signals.[42]
>
> We have no doubt that [marketing loan] payments stimulate production and exports and result in lower world market prices.[43]
>
> [T]he structure, design and operation of the marketing loan programme has enhanced production and trade-distorting effects.[44]
>
> [Marketing Loan payments] accounted for more than half of the difference between the adjusted world price and the marketing loan rate (and thus of United States upland cotton producer revenue).[45]

54. On appeal, the United States challenged all of these findings. The Appellate Body rejected all the U.S. appeals in making the following findings:

> We note, based on the evidence provided by the United States, that for four of the five upland cotton crops between 1999 and 2003, the expected harvest price at the time of making planting decisions was always substantially higher than the actual price realized at the time of harvest of the crop. This suggests that although farmers had expected higher prices in making their planting decisions, they were also aware that if actual prices were ultimately lower, they would be "insulated" by government support, not only marketing loan program payments, but also counter-cyclical payments, which were based on a target upland cotton price of 72.4 cents per pound.[46]
>
> With respect to the marketing loan program payments, the Panel found that "[t]he further the adjusted world price drops, the greater the extent to which United States upland cotton producers' revenue is insulated from the decline." As a result, during the 1999-2002 marketing years, United States production and exports remained stable or increased, even though prices of United States upland cotton decreased. … The United States contends that the Panel's analysis of the price-contingent subsidies was "deficient." However, the Panel found that the price-contingent subsidies stimulated United States production and exports of upland cotton and thereby lowered United States upland cotton prices. This seems to us to support the Panel's conclusion that the effect of the price-contingent subsidies is significant price suppression.[47]

55. As the Appellate Body found, U.S. upland cotton producers know that their overall revenue will always be protected by marketing loans and counter-cyclical subsidies. This plays a major role in their planting decisions, which result in continued and sustained higher levels of production and exports than would exist but for these two subsidies. Indeed, these two subsidies were found to be an important factor in "insulating" and "numbing" U.S. cotton producers from low prices.

56. Finally, the U.S. argument that direct payments under the FSRI Act of 2002 also provide support to upland cotton producers[48] does not support a conclusion that marketing loans and

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[42] Panel Report, *U.S. – Upland Cotton*, para. 7.1294.
[43] Panel Report, *U.S. – Upland Cotton*, para. 7.1291.
[44] Panel Report, *U.S. – Upland Cotton*, para. 7.1295.
[45] Panel Report, *U.S. – Upland Cotton*, para. 7.1294.
[46] Appellate Body Report, *U.S. – Upland Cotton*, para. 445 (footnote omitted).
[47] Appellate Body Report, *U.S. – Upland Cotton*, para. 450 (footnote omitted).
[48] U.S. Comments on Brazil's Oral Statement, paras. 42 and 49.

counter-cyclical payments are not production distorting. Under Article 21.5 of the DSU, Brazil is precluded from challenging, in these proceedings, the production effects of direct payments. However, this does not mean that direct payments do not have any production – or price-suppressing – effects. The Appellate Body recognized that non-price contingent subsidies, such as direct payments, can have production effects and contribute to significant price suppression.[49] Indeed, Figures 1-6 in Brazil's Opening Statement show the key role played by, in particular, direct payments in allowing many upland cotton farmers to achieve a healthy "profit" from growing upland cotton. Such profits play an important role in maintaining upland cotton production over the longer term by increasing the "wealth" of the producers.[50]

57. Indeed, USDA recently proposed to increase direct payments to beginning farmers "to better prepare beginning farmers to face the initial financial burdens associated with entering production agriculture."[51] Further, a survey of U.S. farmers by Goodwin and Mishra revealed that 68 percent of farmers would use direct payments on the farm, 34 percent would use direct payments for farm operating costs, 16 percent for farm capital expenditures, 9 percent to pay down farm debt and 9 percent to buy farmland.[52] This evidence confirms that direct payments play an important role in agricultural production.

63. Could Brazil explain whether or not it considers that whether marketing loan and counter-cyclical payments increase acreage is not relevant to the inquiry of whether these payments cause significant price suppression within the meaning of Article 6.3 (c) of the SCM Agreement? (para. 56 of the Opening Statement of Brazil) Could Brazil comment on the points made by the United States in footnote 72 of the Comments of the United States on Brazil's 'Oral' Presentation in the meeting with the Panel?

58. Brazil considers that the question whether marketing loan or counter-cyclical payments *increase* acreage is *not* the relevant inquiry that the compliance Panel is tasked to undertake.

59. Article 6.3 of the *SCM Agreement* does not compel a complaining Member to produce evidence that the challenged subsidies result in a steady *increase* in production or acreage. This is particularly true where a subsidizing Member has supported such production or acreage with massive subsidies for many decades. Where acreage, production and conditions of competition within a subsidizing Member are distorted – but have achieved a relatively stable subsidized *status quo* – a complaining Member does *not* have the burden to establish yet *additional* distortions in order to succeed in demonstrating that the subsidies cause adverse effects to the interests of the complaining Member.

60. The nature of the enquiry in an Article 6.3(c) claim is necessarily counterfactual, as more fully explained in response to question 74, below. This requires an assessment of the extent to which U.S. upland cotton acreage – and the resulting U.S. upland cotton supply in terms of production, exports and stocks – would be lower *but for* the U.S. marketing loan and counter-cyclical subsidies, and whether world market prices for upland cotton would be significantly higher.

61. The counterfactual proposed by Brazil involves examining the acreage and resulting production that would have occurred if the United States had eliminated marketing loan and counter-cyclical subsidies for MY 2005. In such a counterfactual, the typical U.S. upland cotton farmer would

[49] Appellate Body Report, *U.S. – Upland Cotton*, footnote 589.

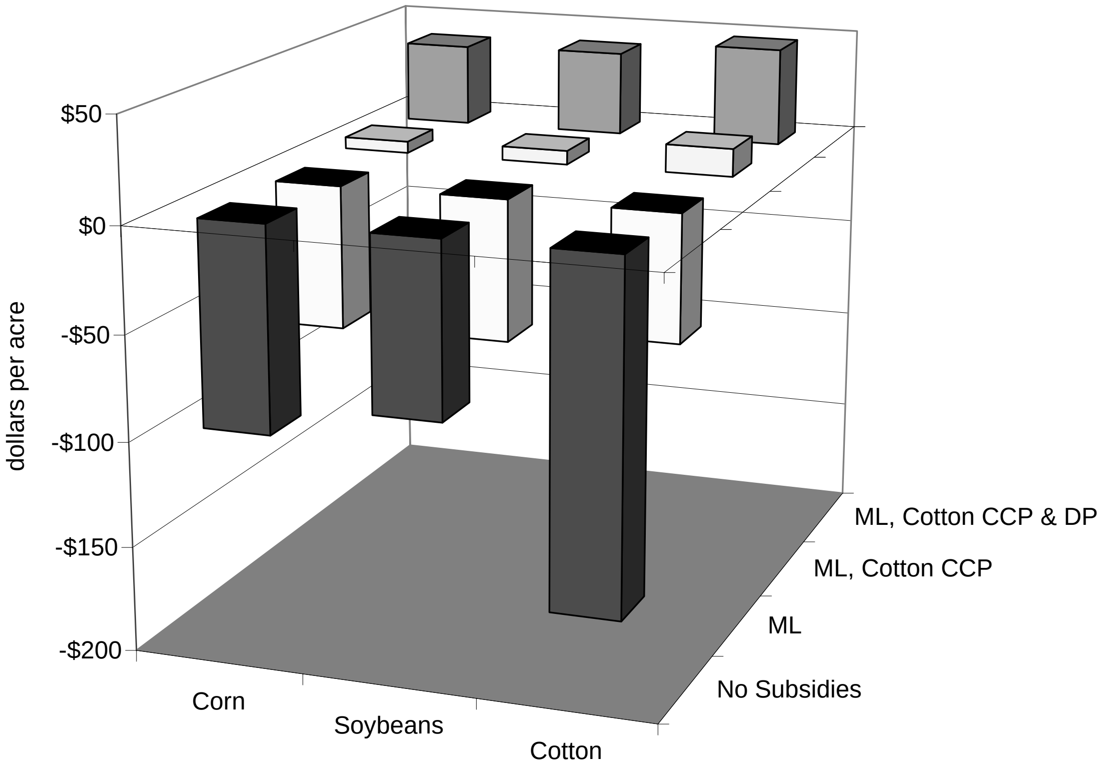
[50] *See* Brazil's 16 March Comments on the U.S. Answers to question 32, paras. 64-67.

[51] Exhibit Bra-671 (U.S. Department of Agriculture's 2007 Farm Bill Proposal, p. 16, accessed March 2007 at http://www.usda.gov/documents/07finalfbp.pdf).

[52] Exhibit US-41 (Goodwin B.K. and Mishra A. "Another Look at Decoupling: Additional Evidence on the Production Effects of Direct Payments." *American Journal of Agricultural Economics* 87(5):1200-1210 (2005), Table 3 at p. 1206).

have suffered significant losses based on low expected upland cotton revenue, as indicated by futures prices in early 2005.[53] This is illustrated by Figure 1 to Brazil's Opening Statement set out below:

Figure 2 – Expected Returns and Total Costs of Growing Cotton, Corn or Soybeans on a Base Acre of Cotton in MY 2005[54]



62. The "no subsidies" counterfactual shows the economic irrationality of planting upland cotton in the spring of 2005 without marketing loan and counter-cyclical subsidies. With many U.S. upland cotton farmers not even expecting to cover their variable costs[55], there is no basis for the U.S. assumption that planted acreage would remain stable. Rather, the only reasonable conclusion given these facts is that acreage would decline significantly. Yet, because the United States finds no production effects from either marketing loan or counter-cyclical subsidies, it assumes that a non-subsidized world would look like the *status quo* and show the same levels of acreage. Under this flawed logic, the United States also asserts that only increases in acreage would represent the effects of subsidies, with the implication that a finding under Article 6.3(c) would necessarily have to include a finding of increasing market share, possibly within the meaning of Article 6.3(d).

63. Brazil has explained how the introduction of market loss assistance payments in 1998, the entry into force of the FSRI Act of 2002 (and its basket of subsidies) and the market condition in MY 1998-2002 resulted in a significant increase in subsidies in the period MY 1998-2002 compared to the relatively low levels of subsidies in the MY 1996-1997 period.[56] While the original panel's causation finding was based, in part, on various temporal correlations, the original panel did not

[53] *See* Brazil's Oral Statement, paras. 63-65 and Brazil's Comments on the U.S. Oral Statement, paras. 18-19. *See also* Exhibits Bra-634 (Analysis of Planting Decisions Based on Expected Returns) and Exhibit Bra-665 (Analysis of Planting Decisions Based on Expected Returns and Cash Costs).
[54] Exhibit Bra-634 (Analysis of Planting Decisions Based on Expected Returns).
[55] *See* Brazil's Comments on the U.S. Oral Statement, para. 19, Figure 7.
[56] Brazil's Rebuttal Submission, paras. 235-236 and 351-352.

believe, however, that the 12 percent drop in planted acreage between MY 2001 and 2002 was relevant.[57] In spite of the U.S. argument that such a drop in acreage would suggest a "negative" correlation between subsidies and acreage effects, this drop in acreage in MY 2002 did not prevent the original panel from finding a strong causal link between MY 2002 price-contingent subsidies and significant price suppression in MY 2002.[58]

64. As discussed more fully in response to questions 69 and 70, the factual situation before the compliance Panel in MY 2002 reflects the *status quo* of market conditions distorted by very high mandated and price-contingent subsidies under the FSRI Act of 2002. The average level of U.S. support between MY 2003-2006 has not changed significantly from the very high levels of support existing in MY 2002, the first year of the FSRI Act of 2002.[59] The very *stability* of the acreage despite large price fluctuations throughout the application of the FSRI Act of 2002 is a key correlation factor that highlights the effects of price-contingent marketing loan and counter-cyclical subsidies. In other words, there is a broad temporal coincidence or correlation between the receipt of these subsidies, continued low market prices, the high costs of production, and the continued high levels of planted acreage.[60]

65. With respect to footnote 72 of the U.S. Comments on Brazil's Oral Statement referenced in the question, Brazil refers the compliance Panel to its response to questions 51, 52 and 62. In response to these questions, Brazil explains that, *inter alia*, the notion of "coupled" and "decoupled" support in the *Agreement on Agriculture*, relied on by the United States, is not relevant for the assessment of the effects of subsidies under Articles 5 and 6 of the *SCM Agreement*. Brazil further refers the compliance Panel to its responses to questions 64 and 65 addressing the literature on the effect of counter-cyclical subsidies. This literature is consistent with Brazil's arguments that upland cotton counter-cyclical payments have significant effects on U.S. acreage and contribute to significant price suppression. Brazil also recalls that counter-cyclical subsidies for different crops can have different effects on planting decisions, depending on whether they are consistently paid and their necessity to cover production costs, among others.

66. To the extent that footnote 72 of the U.S. Opening Statement addresses the inquiry relevant for assessing whether the challenged subsidies cause significant price suppression, Brazil agrees with the U.S. characterization of its claim that these subsidies "affect the planting decision, causing U.S. producers to plant more than they otherwise would and that this ultimately leads to oversupply and suppressed world market prices."[61]

64. Given that Brazil has criticized the new empirical research cited by the United States because it does not deal specifically with the effects of countercyclical payments on upland cotton production, why does Brazil consider that the McIntosh, Shogren & Dohlam study (Rebuttal Submission of Brazil, para. 140) is particularly relevant to this case? Could Brazil comment on the arguments of the United States in paragraphs 248-249 of the Rebuttal Submission of the United States?

67. At the outset, Brazil notes that there are no peer-reviewed empirical studies that have examined the specific effect of counter-cyclical subsidies (or market loss assistance) on upland cotton production. Thus, like the study cited by the United States on counter-cyclical payments (Lin and

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[57] Exhibit Bra-447 (Upland Cotton Supply and Use, October 2006).

[58] Panel Report, *U.S. – Upland Cotton*, paras. 7.596 and 7.1351. *See also* the original panel's description of the reasons for the introduction of market loss assistance payments in MY 1998-2001 and their institutionalization for MY 2002-2007 as counter-cyclical payments in the FSRI Act of 2002. *Id*., paras. 7.216-7.217, 7.223-7.226 and 7.1301.

[59] *See* Brazil's First Written Submission, Figure 8.

[60] Brazil's Rebuttal Submission, paras. 180-194, 226-231; *see also* Brazil's response to question 69, below.

[61] U.S. Comments on Brazil's Oral Statement, footnote 72.

Dismukes), the study by McIntosh, Shogren and Dohlman does not specifically address the effects of upland cotton counter-cyclical payments. However, there are certain features of this study, which make its analytical results more applicable to the assessment that the compliance Panel is tasked with than the study by Lin and Dismukes, or other studies that examine direct payments (Goodwin and Mishra 2005) or market loss assistance (Goodwin and Mishra 2006).

68. *First*, the study by McIntosh, Shogren and Dohlman focuses on key mechanisms through which counter-cyclical payments affect production decisions[62] and excludes extraneous factors that can distort results.[63] The authors explain the advantages of their approach by noting that "experimental methods can provide rapid feedback to policy makers about issues that are not easily teased out with observed data."[64] Indeed, work by Lin and Dismukes and Goodwin and Mishra (2005 and 2006) confirm that it is difficult to empirically "tease out" the effect of specific subsidy programs from survey data.[65] The use of a laboratory experiment mitigates many of these problems.

69. *Second*, the study by McIntosh, Shogren and Dohlman is not confined to examining the acreage response to counter-cyclical payments in *non*-upland cotton producing regions of the United States – as is the case with the empirical studies cited by the United States. Rather, it assesses supply responses based on a laboratory experiment that reflects the economic conditions faced by U.S. upland cotton producers. Studies by Lin and Dismukes and Goodwin and Mishra examine the supply response of corn, wheat and soybean acreage in the mid-West of the United States to direct and counter-cyclical payments. These areas are known for exhibiting small supply responses that are certainly smaller than the supply response of upland cotton.[66] This greatly exaggerates the problem of applying the results of those studies to upland cotton.

70. In sum, while the study by McIntosh, Shogren and Dohlman may not be tailored to the exact circumstances of this proceeding, it is far more relevant than the empirical literature cited by the United States.

71. The United States criticizes the study by McIntosh, Shogren and Dohlman because it is based on a laboratory experiment.[67] As explained by Professor Sumner[68], this criticism is without merit.

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[62] These mechanisms include reducing price variability and the perceived possibility of a base acre update.

[63] McIntosh, Shogren and Dohlman note that "farmers have other risk management tools at their disposal; large and less risk-averse farms tend to dominate production of program crops; and other programs such as marketing loan provisions already offer price protection. These factors underscore the difficulty of separating the effects of CCPs from other influences in observed annual production data, a difficulty reduced when using experimental methods." *See* Exhibit Bra-565 (McIntosh, Christopher R., Jason F. Shogren and Erik Dohlman, "Supply Response to Counter-Cyclical Payments and Base Acre Updating under Uncertainty: An Experimental Study," Forthcoming paper in the *American Journal of Agricultural Economics,* November 2006, p. 16-17).

[64] Exhibit Bra-565 (McIntosh, Christopher R., Jason F. Shogren and Erik Dohlman, "Supply Response to Counter-Cyclical Payments and Base Acre Updating under Uncertainty: An Experimental Study," Forthcoming paper in the *American Journal of Agricultural Economics,* November 2006, p. 17).

[65] Many of the regression coefficients in these studies are not statistically significant. *See* Exhibit US-85 (Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter-Cyclical Payments' Production Impacts," *Review of Agricultural Economics-Volume 29, Number 1, 64-86, p. 78). See also* Exhibit US-41 (Goodwin B.K. and Mishra A. "Another Look at Decoupling: Additional Evidence on the Production Effects of Direct Payments," *American Journal of Agricultural Economics* 87(5):1200-1210 (2005)).

[66] For instance, Goodwin and Mishra find that corn and wheat prices have no impact on corn and wheat production. Exhibit US-41 (Goodwin B.K. and Mishra A. "Another Look at Decoupling: Additional Evidence on the Production Effects of Direct Payments." *American Journal of Agricultural Economics,* 87(5):1200-1210 (2005)). *See* also Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments, para. 23).

[67] U.S. Rebuttal Submission, paras. 248-249.

[68] Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments, paras. 36-37).

The study applies established tools of behavioral economics and, as noted above, is made more valuable by its experimental nature. Tools of laboratory experiments have become well established in general economics as well as in agricultural economics over the past 30 years. Vernon Smith's Nobel Prize in 2002 recognized the development of the field.[69] Roth's initial survey paper in the 1995 Handbook of Experimental Economics provides a summary of the tool, which has developed substantially in the last decade.[70] Indeed, in his USDA-sponsored prestigious Waugh lecture, Shogren surveyed the importance of using experiments to measure and test economic parameters in agricultural and resource economics.[71] Against this background, the U.S. attempt to discredit research findings in economics because they derive from controlled experiments lacks any basis.

72. The United States further quotes a portion of the study where the authors offer caveats to their findings. Specifically, the authors note that the model does not address two features: (i) the fact that counter-cyclical payments are made with respect to only 85 percent of base acres, and (ii) the exclusion from the model of the marketing loan program. However, these abstractions to ease modelling may only temper the magnitude of the effects found by the study. They do not change their underlying conclusion, which the authors summarize as follows:

> [o]ur results support some of the criticisms of CCPs and base acre updating. *We find that with CCPs, laboratory decision makers increased their investment in the base crop relative to the baseline case*. Adding updating and policy uncertainty, they continued to rely relatively more on the base crop than under a more policy-neutral environment. The implications of increased base acre plantings are several: lower potential income to producers who choose to reduce their revenue risk; *decreased efficiency of crop markets due to distorted allocation decisions; depressed base crop prices, which further reduces income; and an increased likelihood of subsidy payments*.[72]

73. In sum, the McIntosh, Shogren and Dohlman study provides valuable insights into the significant effects of counter-cyclical payments on production of U.S. upland cotton. While it is based on a controlled laboratory experiment, it analyzes more closely the effects of counter-cyclical payments on the production decisions of U.S. upland cotton farmers than results of empirical studies that analyzed the somewhat different economics implicated by corn, wheat or soybean production in the mid-West of the United States.

65. The United States has cited new empirical research on the production effects of counter-cyclical payments. Could Brazil explain why the fact that these studies do not deal specifically with upland cotton should preclude the Panel from considering the studies as being highly probative?

74. The United States has cited one empirical study on the production effect of counter-cyclical payments, Lin and Dismukes (2007)[73], to support its arguments that counter-cyclical subsidies do not

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[69] *See* Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments, paras. 36-37).

[70] *See* Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments, paras. 36-37).

[71] *See* Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments, paras. 36-37).

[72] Exhibit Bra-565 (McIntosh, Christopher R., Jason F. Shogren and Erik Dohlman, "Supply Response to Counter-Cyclical Payments and Base Acre Updating under Uncertainty: An Experimental Study," Forthcoming paper in the American Journal of Agricultural Economics, November 2006, p. 2-3) (emphasis added).

[73] The United States cited a draft of this study in its First Written Submission, para. 210. The United States cites the published version in its Rebuttal Submission, paras. 229-234.

significantly impact upland cotton production. The other empirical study cited by the United States, Goodwin and Mishra (2005)[74], examines direct payments, not counter-cyclical payments.

75. At the outset, Brazil notes that these studies do not even support the U.S. position. Viewed in their proper context, both studies confirm that counter-cyclical subsidies can significantly impact production.[75] Nevertheless, the studies are not highly probative to these proceedings for a number of reasons.[76] This is in part due to their failure to address the specific effect of upland cotton counter-cyclical subsidies on upland cotton production.

76. Of the counter-cyclical subsidies provided for major U.S. program crops[77], those for upland cotton are likely to have some of the largest effects on production because of (i) the size of the subsidy, (ii) the frequency with which it is paid, (iii) the regions where upland cotton is grown, and (iv) the assertions of upland cotton producer associations such as the NCC that such subsidies are essential to avoid bankruptcy for its members. Each reason is discussed below.

77. *First*, the maximum per-acre counter-cyclical payment for upland cotton is among the largest of the nine major "program crops" in the FSRI Act of 2002. In absolute terms, the maximum counter-cyclical payment for upland cotton results in an average per-acre payment of approximately $75.[78] The maximum counter-cyclical subsidy for the crops examined by Lin and Dismukes results in much smaller per-acre payments, approximately $10 for soybeans, $39 corn and $20 for wheat.[79] The maximum upland cotton counter-cyclical payments is also one of the largest in relative terms, accounting for 19 percent of the upland cotton target price[80], or the institutional price set by U.S. Congress.

78. The evidence before the compliance Panel demonstrates that the vast majority of upland cotton producers grow upland cotton on farms with upland cotton base acres.[81] This planting pattern reflects the high cost of production for upland cotton compared to other crops. The high average $75 per-acre payment for upland cotton is essential for upland cotton producers to meet their costs of production.[82]

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[74] U.S. First Written Submission, para. 213. *See* also U.S. Rebuttal Submission paras. 235-236.

[75] The 2005 version of the Lin and Dismukes study finds that soybean counter-cyclical subsidies would increase soybean acreage if the average soybean farm price was below the loan rate. The study also finds that the "effect of CCPs may go beyond their short-run effects on farmers' acreage decisions; in the longer term there may be structural implications to the extent that these payments keep farmers in business. In addition to commodity loan programs, CCPs are another safety net measure that protects farmers from adverse effects of weak market prices. To farmers who are financially distressed, CCPs could provide help necessary for them to remain in farming." (*see* Exhibit US-34 (Lin, William and Robert Dismukes, "Supply Response Under Risk: Implications for Counter-Cyclical Payments' Production Impact," Selected Paper, American Agricultural Economics Association, July 2005, p. 24-25)). Goodwin and Mishra (2005) contains the results of a survey of U.S. farmers, showing that counter-cyclical payments are important to U.S. farmers and that direct payments are largely used for on-farm expenditures.

[76] For a critique of Lin and Dismukes (2006/2007), *see* Brazil's Rebuttal Submission, paras. 124-127 and Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments, paras. 18-21). For a critique of Goodwin and Mishra (2006), *see* Brazil's Rebuttal Submission, paras. 135-137 and Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments, paras. 22-27).

[77] These include wheat, corn, soybeans, rice, upland cotton, oats, barley, sorghum and peanuts.

[78] Exhibit Bra-675 (Updated Program Crop Comparison, March 2007).

[79] Exhibit Bra-675 (Updated Program Crop Comparison, March 2007).

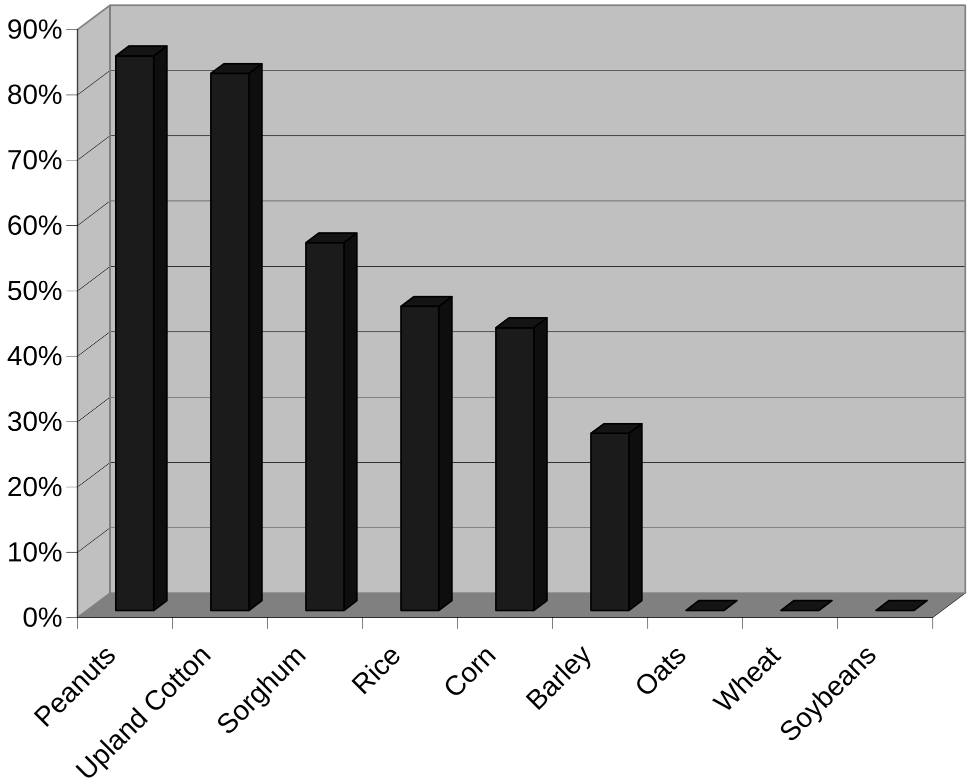
[80] Exhibit Bra-675 (Updated Program Crop Comparison, March 2007).

[81] *See* Brazil's Rebuttal Submission, paras. 153-165; Brazil's Oral Statement, para. 40 and Brazil's Comments on U.S. Answer to Question 29, paras. 46-51.

[82] Brazil's First Written Submission, paras. 156-164; Brazil's Rebuttal Submission, paras. 245-283 and Brazil's Oral Statement, paras. 54-91.

79. *Second*, counter-cyclical subsidies are paid more frequently for upland cotton than for other program crops. For two of the three crops examined by Lin and Dismukes (wheat and soybeans), counter-cyclical subsidies have never been paid. The following chart, which was presented in Brazil's First Written Submission[83], shows the actual amount of counter-cyclical payments provided to crops relative to the theoretically possible maximum amount. The "fill rate" for upland cotton was 82 percent.

Figure 3 – Actual Counter-Cyclical Payments as a Percent of Theoretical Maximum[84]



80. *Third*, the two empirical studies cited by the United States examine the effect of direct and counter-cyclical payments on corn, soybeans and wheat acreage in the mid-West of the United States. As Brazil has explained previously, one would expect low supply elasticities in these regions for these crops.[85] Farmers in the corn belt and north central region grow almost entirely soybeans and corn, and sometimes wheat. By contrast, upland cotton is grown in regions where a number of other substitute crops, including soybeans, rice, corn, sorghum, peanuts, fruits and vegetables, are grown.

81. *Fourth*, the two empirical studies cited by the United States are contrary to the numerous statements in the record reflecting the view of the NCC and its upland cotton producing members that counter-cyclical subsidies are essential to cover their costs of production and to avoid bankruptcy. Representatives of the NCC testified to the U.S. Congress that "during the past three years, many cotton farmers have avoided bankruptcy only because Congress has authorized emergency relief to supplement the FAIR Act's inadequate fixed payments."[86] This statement refers to market loss

[83] Brazil's First Written Submission, para. 276.
[84] Exhibit Bra-493 (Counter-Cyclical Payments Analysis).
[85] Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments, para. 20).
[86] Panel Report, *U.S. – Upland Cotton*, footnote 1471 referring to Exhibit Bra-109 (Testimony (Full) of Robert McLendon, Chairman, NCC Executive Committee, Before the House Agricultural Committee, National Cotton Council (NCC)).

assistance payments, which are the predecessor to counter-cyclical subsidies under the FSRI Act of 2002. Representatives of the NCC have also testified that they need U.S. subsidies generally to "avoid bankruptcy,"[87] "to make ends meet"[88] and basically to "exist."[89] Leaders of the upland cotton industry confirm that counter-cyclical subsidies are the next most important government program for upland cotton farmers besides the marketing loan program.[90] None of the studies cited by the United States focus on the loss-making situation that would confront many upland cotton farmers if counter-cyclical payments were eliminated.

82. In sum, the new literature cited by the United States, consisting of one empirical study on the effect of counter-cyclical subsidies and one empirical study on the effect of direct payments, is not highly probative in this proceeding. In any event, for reasons discussed in prior written submissions[91], the literature largely supports Brazil's arguments that counter-cyclical subsidies significantly impact production. It also supports the conclusion that direct payments affect production.

66. Can Brazil explain the differences between the figures for the amount of counter-cyclical payments allocated to upland cotton provided by Brazil at the meeting of the Panel with the parties (Opening Statement of Brazil, para. 40 and Exhibit Bra 625) and the figures in Table 5 of Brazil's Rebuttal Submission?

83. The figures in Table 5 of Brazil's Rebuttal Submission constitute upland cotton counter-cyclical subsidies allocated according to the "Cotton-to-Cotton" methodology. The Cotton-to-Cotton methodology matches each planted acre of upland cotton with one upland cotton base acre, if available on the same farm. Thus, if a farm has more upland cotton base acres than upland cotton planted acres, or no upland cotton planted acres at all, these excess upland cotton base acres are excluded from the calculation. Similarly, if a farm plants more upland cotton than it holds upland cotton base, no payments are allocated for each acre in excess of the upland cotton base available on the farm.

84. By contrast, the figure in paragraph 40 of Brazil's Opening Statement is based on an allocation of counter-cyclical payments in MY 2005 to upland cotton under "Brazil's Methodology."[92] This methodology allocates certain non-upland cotton counter-cyclical payments to planted acres of upland cotton for which no upland cotton base acre is available on the farm. Since the United States provided the data necessary for this calculation solely for MY 2005, Brazil's figures are similarly limited to MY 2005.

85. Brazil recalls that the original panel found Brazil's "allocation of support delivered under these programmes to one covered commodity appropriate, because it combines elements of the way in which the payments are calculated with the volume of upland cotton which recipients plant."[93]

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[87] Exhibit Bra-109 ("Testimony (full) of Robert E. McLendon, Chairman, NCC Executive Committee, Before the House Ag Committee", February 15, 2001, p. 2).

[88] Exhibit Bra-324 (NCC Chairman's Report by Kenneth Hood, 24 July 2002, p. 2).

[89] Exhibit Bra-3 (Roger Thurow / Scott Kilman, "U.S. Subsidies Create Cotton Glut That Hurts Foreign Cotton Farms," The Wall Street Journal, 26 June 2002, p. A1).

[90] See Brazil's Oral Statement, para. 35 quoting Southwest Farm Press, 17 January 2007, accessed February 2007 at http://southwestfarmpress.com/news/011707-farm-bill/index.html, in Exhibit Bra-624 (Updated Market News and Market Reports About Cotton) ("Status quo for 2007 farm bill good for cotton growers").

[91] For a critique of Lin and Dismukes (2006/2007), *see* Brazil's Rebuttal Submission, paras. 124-127 and Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments, paras. 18-21). For a critique of Goodwin and Mishra (2006), *see* Brazil's Rebuttal Submission, paras. 135-137 and Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments, paras. 22-27).

[92] Panel Report, *U.S. – Upland Cotton*, Table A-6 at para. 7.642.

[93] Panel Report, *U.S. – Upland Cotton*, para. 7.646.

67. Please confirm whether or not the Panel's understanding is correct:

- *"Table 6" in Brazil's First Written Submission was produced using the so-called "Brazil's method" using USDA data*.

86. Brazil can confirm that the compliance Panel's understanding is correct. Brazil notes, however, that the United States had not provided USDA data for MY 2003-2005 at the time of Brazil's First Written Submission. Absent that data, Brazil applied the ratio of total upland cotton counter-cyclical payments to counter-cyclical payments allocated to upland cotton under "Brazil's Methodology" for MY 2002, based on data that the United States provided to the original panel and including in the report of the original panel.[94] Brazil applied this ratio to the actual amount of total upland cotton counter-cyclical payments made in MY 2003-2005.[95] In its Opening Statement, Brazil updated the figures for MY 2005 based on USDA data that the United States provided only for MY 2005.[96]

- *"Table 5" in Brazil's Rebuttal Submission was produced using the so-called "cotton-to-cotton" methodology using USDA data.*

87. Brazil can confirm that the compliance Panel's understanding is correct. Brazil also notes that the figures in Table 5 of Brazil's Rebuttal Submission were calculated using the data in the table in paragraph 224 of the U.S. First Written Submission and average national payment rates and yields.[97]

- *The figures cited in para. 40 of Brazil's opening statement (i.e. "$868 million and $838 million) are produced with the "Brazil's method" as well as the "cotton-to-cotton" methodology, using the data provided by the United States in exhibit US-64.*

88. Brazil can confirm that the compliance Panel's understanding is correct. Brazil notes that Exhibit Bra-625 contains the detailed calculations from which these figures were derived.

68. Please comment on the following statement by the US:

> "The United States understands that Brazil intends the counter-cyclical payment figures shown in 'Table 5' of Brazil's rebuttal submission to supersede the counter-cyclical payment figures shown in 'Table 6' of its first written submission." (US response to question 4 at para. 15)

89. The United States is incorrect in its understanding. Brazil refers the Panel to Brazil's comment on the U.S. answer to question 4.[98] The figures in Table 6 of Brazil's First Written Submission are based on the ratio of counter-cyclical subsidies under "Brazil's allocation methodology" to total counter-cyclical subsidies in MY 2002.[99] By contrast, the figures in Table 5 of Brazil's Rebuttal Submission are based on the "Cotton-to-Cotton Methodology."[100] Brazil does not intend that the figures in Table 6 of its First Written submission be superseded by the figures in Table 5 of its Rebuttal Submission.

69. How does Brazil address the argument of the United States that "the only evidence that Brazil has submitted purporting to examine the price effects of marketing loan and counter-cyclical

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[94] Panel Report, *U.S. – Upland Cotton*, Table A6 at para. 7.642 and Table 2 at para. 7.596.
[95] Brazil's First Written Submission, paras. 116-118.
[96] *See* Brazil's response to question 66, above.
[97] Brazil's Rebuttal Submission, para. 174.
[98] Brazil's 16 March Comments on U.S. Answers to Question 4, para. 15.
[99] Brazil's First Written Submission, para. 116-118.
[100] Panel Report, *U.S. – Upland Cotton*, para. 7.642.

payments specifically are the results of the modelling exercise that it has conducted for purposes of this proceeding"? (Opening Statement of the United States, para. 76)

90. The United States' argument incorrectly ignores the hundreds of exhibits and the circumstantial evidence presented by Brazil in the original proceeding and in this compliance proceeding. Below, Brazil provides a concise resume of that evidence.[101] Professor Sumner's modelling analysis that specifically quantifies the price-suppressing effects of the U.S. marketing loan and counter-cyclical subsidies simply confirms extensive other evidence of significant price suppression in view of the effects of these subsidies on U.S. acreage, production, and export, as well as the dominant role played by the United States in the discovery of world market prices for upland cotton. Professor Sumner's model is the "icing" on the cake, not the cake itself.

91. Brazil – and the compliance Panel – live in the real world characterized by decades of heavily subsidized U.S. upland cotton production and exports. Brazil cannot unilaterally remove the U.S. subsidies to present direct evidence of what would actually happen to U.S. acreage, production, exports, and world prices without those subsidies. Only the United States can do so. It has chosen not to despite the recommendations and rulings of the DSB. To the extent that the United States believes that the only credible "empirical evidence" is that showing what *actually* happens without marketing loan and counter-cyclical subsidies, then the United States is exclusively in control of that evidence.

92. To assist the compliance Panel in appreciating the baseless nature of the U.S. allegations that Brazil presented "no evidence" of significant price suppression except the analysis of Professor Sumner[102], Brazil summarizes below the many hundreds of pages of arguments in its submissions and hundreds of exhibits. However, this summary cannot substitute for a full review of Brazil's evidence in its Written Submissions, Oral Statements and Responses to Questions. Some of that evidence is referenced in the footnotes attached to the summaries of the evidence, below.

93. The most basic facts concerning the U.S. subsidies at issue and the conditions of competition in the world market for upland cotton suffice to establish a causal link between the subsidies and significant price suppression in the world market. It is undisputed that there is a world market for upland cotton. Heavily subsidized U.S. upland cotton competes directly in that world market with upland cotton from Brazilian and other third country producers.[103] It is undisputed that U.S. upland cotton is "like" Brazilian upland cotton as well as like upland cotton produced by many other countries.[104] The price of U.S. upland cotton, like that of other upland cotton producers, is reflected in a world market price, the A-Index.[105] It is also undisputed that there is a closely integrated world market for upland cotton in which U.S. supply accounts for a very large world market share and in which it exercises a substantial proportionate influence on the discovery of the world market price.[106] All of these facts were established by the original panel and affirmed by the Appellate Body. In view of the updated evidence provided by Brazil, they remain valid today.

94. In particular, Brazil has established the following facts:

- The legislative and regulatory provisions of the marketing loan program and the counter-cyclical payment programs have not been altered since the original

[101] U.S. Opening Statement, para. 76.
[102] U.S. Opening Statement, para. 76.
[103] Brazil's First Written Submission, Section 7.4.
[104] Brazil's First Written Submission, Section 7.4.
[105] Brazil's First Written Submission, Section 7.4; Brazil's Oral Statement, para. 148 and Declaration by Andrew Macdonald, Brazil's First Written Submission, Annex II, para. 18.
[106] Panel Report, *U.S. – Upland Cotton*, paras. 7.1285, 7.1311.

proceeding and, like the payments made thereunder, continue to constitute subsidies[107];

- U.S. upland cotton, therefore, continues to be heavily subsidized by marketing loan and counter-cyclical subsidies[108];

- Subsidized U.S. upland cotton competes with and is "like" other upland cotton produced in various parts of the world[109];

- The United States maintains a 40 percent world export market share and accounts for 20 percent of total world production resulting in a substantial proportionate influence on the world market price of upland cotton[110];

- The world market for upland cotton identified by the original panel still functions on the same basis as found by the original panel[111];

- Market participants perceive the A-Index as the world price of upland cotton[112] and ICAC[113] and USDA[114] refer to the A-Index as the world price of upland cotton;

- Upland cotton prices from spot markets in the United States and Brazil are among the constituent price quotes of the A-Index[115], and U.S., Brazilian, A-Index and futures prices continue to move broadly in parallel.[116]

95. These undisputed facts, combined with the undisputed fact that massive price-contingent U.S. marketing loan and counter-cyclical subsidies represent a 40 percent *ad valorem* subsidization rate over the lifetime of the FSRI Act of 2002, *alone* are sufficient for the compliance Panel to find that these subsidies cause significant price suppression in the world market for upland cotton.

96. Billions of dollars of "specific" marketing loan and counter-cyclical subsidies received by thousands of U.S. upland cotton farmers are not spent in clinical isolation within the United States. Instead, the vast majority of U.S. upland cotton production that would not exist but for these billions in U.S. subsidies is exported to almost every third country market in the world.[117] The most basic laws of supply and demand compel a finding that huge subsidies benefiting the production of a

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[107] Brazil's First Written Submission, Section 7.3.

[108] For details, *see* Brazil's First Written Submission, Sections 7.8-7.9; Brazil's Rebuttal Submission, Section 2.3.2; and Brazil's Oral Statement, Sections 2.2-2.3.

[109] Brazil's First Written Submission, Section 7.4.

[110] Exhibit Bra-559 ("Potential Challenges to U.S. Farm Subsidies in the WTO: A Brief Overview," Congressional Research Service Report for Congress, 25 October 2006, p. 5).

[111] Brazil's First Written Submission, Section 7.4.

[112] Brazil's Oral Statement, para. 148 and Declaration by Andrew Macdonald, Brazil's First Written Submission, Annex II, para. 18.

[113] Exhibit Bra-445 (Cotton This Month, ICAC, 1 June, 2006, pp. 1-2).

[114] The USDA's Economic Research Service refers to the A-Index as the "world price." Exhibit Bra-436 (Cotton and Wool Outlook, USDA, 13 March 2006, p.4, accessed October 2006 at http://usda.mannlib.cornell.edu/usda/ers/CWS//2000s/2006/CWS-03-13-2006.pdf).

[115] Brazil's First Written Submission, Section 7.4.

[116] Brazil's First Written Submission, Section 7.6.

[117] Exhibit Bra-676 (USDA Cotton and Wool Outlook, 12 March 2007, p. 17, accessed March 2007 at http://usda.mannlib.cornell.edu/usda/current/CWS/CWS-03-12-2007.pdf). Brazil notes that market reports show a declining U.S. domestic mill use and an increase in imports. If production stays high, the resulting excess supply will increase exports and stocks even more, thereby negatively impacting prices. *See*, *e.g.*, Exhibit Bra-676 (USDA Cotton and Wool Outlook, 12 March 2007, p. 4, accessed March 2007 at http://usda.mannlib.cornell.edu/usda/current/CWS/CWS-03-12-2007.pdf).

fungible commodity product result in higher production and exports, and prevent upland cotton prices from being as high as they otherwise would be in an integrated world market. In other words, this evidence is sufficient to establish significant price suppression amounting the serious prejudice to the interests of Brazil, within the meaning of Articles 5(c) and 6.3(c) of the *SCM Agreement*.

97. Yet, as detailed below, Brazil has presented much more evidence demonstrating that the effects of these two price-contingent subsidies is significant price suppression in the world market. Brazil presented evidence of actual market conditions that are distorted by the effects of the subsidies, as well as evidence allowing the compliance Panel to determine the general magnitude of what U.S. acreage, production, exports, and world market prices would be *but for* U.S. marketing loan and counter-cyclical subsidies. Brazil also presented information regarding the large gap between U.S. upland cotton producers costs of production and market revenues.

98. Brazil's evidence covers the MY 2005 reference period is supplemented by evidence covering the period MY 2003-2006, as well as the reference period 1999-2002 assessed by the original panel. The evidence demonstrates that U.S. planted acreage was generally stable despite low and fluctuating market prices and huge losses based only on market revenue.[118] These facts strongly support the conclusion that U.S. acreage and supply would be lower *but for* the effects of U.S. subsidies. The evidence also shows that production and exports of upland cotton actually increased significantly from MY 2004 to 2005. The evidence also suggests that *but for* the U.S. subsidies, such increases would not have taken place.[119]

99. Ultimately, the totality of the data and evidence provided by Brazil allows the compliance Panel to assess the various key elements[120] highlighted by the original panel as relevant in determining the effects of the subsidies and the existence of significant price suppression caused by the subsidies. Brazil has established the following:

- The <u>nature</u> of the marketing loan and counter-cyclical subsidies remains price-contingent and production- and trade-distorting, as they have not been modified to comply with the recommendations and rulings of the DSB[121]:

  - Above all, mandated price triggers for payments are significantly above prices throughout the lifetime of the FSRI Act of 2002 and thus guarantee constant payments[122];

  - The original panel affirmed it had "no doubt that the [marketing loan] payments stimulate production and exports and result in lower world market prices."[123] For counter-cyclical subsidies, the panel found that "due to their market-price contingency, CCPs may influence production decisions indirectly"[124];

  - The original panel considered it "axiomatic that the nature of a given subsidy may play an important role in determining its effects."[125] The Appellate Body

[118] Brazil's First Written Submission, Section 7.9; Brazil's Rebuttal Submission, para. 211.
[119] Brazil's Rebuttal Submission, para. 348.
[120] These elements were assessed by the original panel. *See, e.g.*, Panel Report, *U.S. – Upland Cotton*, paras. 7.1347-7.1355.
[121] Brazil's Rebuttal Submission, Sections 2.3.1.2-2.3.1.3 and Brazil's Oral Statement, Sections 2.2-2.3.
[122] Brazil's First Written Submission, Section 8.4.
[123] Panel Report, *U.S. – Upland Cotton*, para. 7.1291. The panel examined effects of marketing loan subsidies at paragraphs 7.1290-7.1297.
[124] Panel Report, *U.S. – Upland Cotton*, para. 7.1302.
[125] Panel Report, *U.S. – Upland Cotton*, para. 7.1191.

confirmed the importance of this factor when it held that "a large subsidy closely linked to prices of the relevant product is likely to have greater impact on prices than a small subsidy that is less closely linked to prices"[126]; and

- Studies on subsidy effects[127] and Professor Sumner's analysis[128] confirm the production-enhancing effects of marketing loan and counter-cyclical payments.

- The magnitude of the subsidies continues to be significant:

  - Marketing loan subsidies were $1,269 million in 2005[129], an increase of 41 percent compared to MY 2002[130];

  - Counter-cyclical subsidies for MY 2005 were almost identical to the MY 2002 payments, amounting to a total of $868 million.[131]

  - Recent marketing loan and counter-cyclical subsidies are, thus, higher than in MY 2002 for which the original panel found significant price suppression[132];

  - Marketing loan and counter-cyclical subsidies for upland cotton exceeded subsidies to other crops[133]; and

  - The Appellate Body held that "a large subsidy closely linked to prices of the relevant product is likely to have greater impact on prices than a small subsidy that is less closely linked to prices."[134]

- Marketing loan and counter-cyclical payments cover the gap between producer revenue and production costs.[135] In other words, they stabilize upland cotton producers' revenue in the face of fluctuating market prices:

  - USDA data on actual production costs and market returns shows a significant gap between production costs and market returns, which is filled by U.S.

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[126] Appellate Body Report, *U.S. – Upland Cotton*, para. 461.

[127] With respect to **counter-cyclical payments**, Brazil presented studies in Section 2.3.2.3.1 of Brazil's Rebuttal Submission and further discussed them in Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments). With respect to **marketing loan payments**, *see* USDA's studies in Exhibit Bra-79 ("U.S. Farm Program benefits: Links to Planting Decision and Agricultural Markets") and in Exhibit Bra-222 ("Analysis of the U.S. Commodity Loan Program with marketing Loan Provisions").

[128] *See* Analysis of Effects of U.S. Upland Cotton Subsidies on Upland Cotton Prices and Quantities by Dan Sumner, Brazil's First Written Submission, Annex I; Statement by Professor Daniel Sumner in Section 2.5.2 of Brazil's Oral Statement.

[129] Brazil's 16 March Comments on U.S. Answer to Question 4, para. 14.

[130] Marketing loan subsidies were $898 million in MY 2002, *see* Brazil's First Written Submission, Table 6 at para. 111. In its Oral Statement, Brazil erroneously referred to "29 percent." *See* Brazil's Oral Statement, paras. 29 and 31.

[131] Based on Brazil's methodology. *See* Brazil's Oral Statement, para. 40.

[132] Brazil's First Written Submission, Sections 7.8-7.9; Brazil's Rebuttal Submission, Section 2.3.2 and Brazil's Oral Statement, Sections 2.2-2.3.

[133] Brazil's First Written Submission, Sections 7.7 and 8.4.

[134] Appellate Body Report, *U.S. – Upland Cotton*, para. 461.

[135] When considering a divergence between revenue and costs, the original panel found significant Brazil's evidence that "the effect of the subsidies was to allow the United States producers to sell upland cotton at a price lower than would otherwise have been necessary to cover their total costs." Panel Report, *U.S. – Upland Cotton*, para. 7.1353.

subsidies.[136] In particular, USDA data indicates that upland cotton farmers lost on average $837 per planted acre over the past seven years (MY 1999-2005).[137] Projections of production costs and market returns indicate that this gap between market revenue and cost of production will continue to exist.[138] Brazil asks the compliance Panel why U.S. producers decide to plant upland cotton in the fact of collective losses of $12.4 billion over the past 7 years?[139] The obvious answer is that, no matter what happens to market prices, U.S. price-contingent marketing loan and counter-cyclical subsidies bail out U.S. upland cotton producers.

- ➢ The prospect of receiving subsidies affects producers' planting decisions, as the Appellate Body recognized.[140] Data on expected returns from growing competing crops shows that it is not economically rational to continue growing upland cotton and that, but for these subsidies, growers would switch to other crops.[141] Yet, due to the challenged subsidies, U.S. upland cotton producers are insulated from and do not respond to market price signals. Instead, they continue to plant in anticipation of subsidy payments.[142] Both the graphs provided with Brazil's Oral Statement based on total cost of production[143], as well as the graphs provided by Brazil in its Comments on the U.S. Opening Statement based on variable costs[144] demonstrate this reality; and

- ➢ The original panel found that "United States upland cotton producers rely on … subsidies to cover their cost of production."[145]

- There continues to be a <u>temporal coincidence</u> between price suppression and U.S. price-contingent marketing loan and counter-cyclical subsidies.[146] For example, contrary to the planting decisions of non-U.S. producers who must meet their costs based solely on market revenue, U.S. upland cotton acreage does not react to expected futures prices fluctuations.[147] Consequently, U.S. planted acreage remained relatively stable while increased yields on subsidized acreage resulted in increased production and exports over the lifetime of the FSRI Act of 2002, despite market prices that were low by historical standards.[148]

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[136] *See* Brazil's First Written Submission, Figure 13 in Section 7.11.
[137] Brazil's Oral Statement, para. 57.
[138] Brazil's First Written Submission, Figure 28 in Section 8.6.
[139] Brazil's Oral Statement, para. 58.
[140] The Appellate Body found that U.S. upland cotton producers were "aware that if actual prices were ultimately lower, they would be 'insulated' by government support, including not only marketing loan program payments but also counter-cyclical payments, which were based on a target upland cotton price." Appellate Body Report, *U.S. – Upland Cotton*, para. 445.
[141] Brazil's Rebuttal Submission, Sections 2.2.2 and 2.3.6 and Brazil's Oral Statement, Section 2.4.
[142] Brazil's First Written Submission, Section 7.11; Brazil's Rebuttal Submission, Sections 2.2.2 and 2.3.6; Brazil's Oral Statement, Section 2.4.
[143] Brazil's Oral Statement, Figures 1 to 6.
[144] Brazil's Comment on the U.S. Opening Statement, Section 4.
[145] Panel Report, *U.S. – Upland Cotton*, footnote 1471.
[146] For more details on this discussion, *see* Brazil's response to question 70, below.
[147] *See* Brazil's Rebuttal Submission, Figure 9.
[148] Brazil's First Written Submission, Section 7.5 and Brazil's Rebuttal Submission, Section 2.3.3.2. The United States recognized this fact. *See* U.S. First Written Submission, para. 285.

100. In addition to actual data, Brazil provided analysis from institutions such as the World Bank[149], the Food and Agricultural Organization[150], and the Overseas Development Institute[151] to demonstrate the supply-enhancing and price-suppressing effects of marketing loan and counter-cyclical subsidies.

101. The abundant and diverse evidence provided by Brazil shows the significant effect that U.S. marketing loan and counter-cyclical subsidies have on U.S. upland cotton plantings. The resulting extra supply, whether in the form of exports or temporary stocks, in turn affects the world market price for upland cotton, which is determined by the equilibrium between supply and demand. Prices fall when the amount of supply exceeds demand and rise when demand exceeds current levels of supply. As changes in both supply and demand affect price levels, a supply-enhancing subsidy evidently impacts prices negatively.[152] Recent market reports confirm this. O.A. Cleveland stated that prices "struggle under the pressure of excessive carryover stocks into 2008. … For now the potential for a nine million bale carryover will keep a lid on the market"[153] and that "with prospects of ending stocks rising to 8.2 to 8.5 million bales come July 31, 2007, both old crop and new crop prices have little possibility of moving higher."[154]

102. Moreover, the factors cited by the original panel in assessing significance[155] continue to exist for MY 2003-2005.[156] As the original panel explained, significance can be assessed in light of the market and product at issue.[157] The size of the fungible U.S. upland cotton supply results in a substantial proportionate influence on world market prices. In the world market for upland cotton, even price effects much smaller than those established by Brazil would be "significant" in light of the large volume of upland cotton traded and the generally small profit margins of upland cotton producers.[158] Professor Sumner[159], Andrew Macdonald[160] and other market analysts confirm that the subsidies still have a significant price-suppressing effect. Professor Sumner's 2006 model, consistent with USDA studies relied upon by the original panel, found for MY 2005 that marketing loan and counter-cyclical subsidies sustained about 2.5 million acres of upland cotton resulting in over 4 million bales of surplus production and exports and caused world market prices to be 6 cents per

[149] Brazil's First Written Submission, Section 7.12.2 and Brazil's Rebuttal Submission, Section 2.3.7 referring to Exhibit Bra-481 (Anderson, Kym and Valenzuela, Ernesto "WTO's Doha Cotton Initiative: A tale of Two Issues," Development Research Group, World Bank, February 2006).

[150] Brazil's Rebuttal Submission, Section 2.3.7 referring to Exhibit Bra-55 (Poonyth, Daneswar, Alexander Sarris, Ramesh Sharma, and Shanguan Shui, "The impact of Domestic and Trade Policies on the World Market," FAO Commodity and Trade Policy Research Working Paper No. 8).

[151] Brazil's Rebuttal Submission, Section 2.3.7 referring to Exhibit Bra-578 (Gilson, Ian *et al.*, "Understanding the Impact of Cotton Subsidies on Developing Countries," ODI).

[152] For details on the functioning of the world market for upland cotton, *see* statements of Andrew Macdonald Statements in Brazil's Further Submission before the original panel, Annex II; Brazil's First Written Submission, Annex II; Brazil's Oral Statement, Section 2.8.

[153] Exhibit Bra-677 (Cotton Marketing Weekly, 9 March 2007, accessed March 2007 at http://www.cottonexperts.com/solutions/cottonmktweekly.html).

[154] Exhibit Bra-678 (Cotton Marketing Weekly, 16 February 2007, accessed March 2007 at http://www.cottonexperts.com/solutions/cottonmktweekly.html).

[155] Panel Report, *U.S. – Upland Cotton*, paras. 7.1316-7.1333.

[156] Brazil's First Written Submission, Section 7.13; Brazil's Oral Statement, Section 2.6.

[157] Panel Report, *U.S. – Upland Cotton*, para. 7.1329.

[158] Brazil's Closing Statement, Section 7.

[159] Analysis of Effects of U.S. Upland Cotton Subsidies on Upland Cotton Prices and Quantities by Dan Sumner, Brazil's First Written Submission, Annex I and Section 7.12.1.

[160] Statement by Andrew Macdonald in Brazil's Oral Statement, para. 150.

pound lower.[161] Thus, the challenged U.S. subsidies (1) increase acreage and the resulting production, stocks and exports, and (2) significantly suppress prices.

103. In sum, Brazil's evidence establishes that marketing loan and counter-cyclical subsidies, in view of their nature and magnitude and in light of the prevailing conditions of competition in the world market for upland cotton significantly suppress the world market prices for upland cotton. While the failure of the United States to implement fully the recommendations and rulings of the DSB prevents Brazil and the compliance Panel from directly observing how much prices are suppressed, such price suppression can be measured through a counterfactual *but for* analysis such as the one conducted by the original panel. As the United States has not taken any measures to amend or change marketing loan and counter-cyclical payment programs, this compliance Panel should adopt the same conclusions as the original panel and Appellate Body.

104. Indeed, the original panel did not have any "smoking gun" empirical evidence in which the United States admitted that its subsidies cause significant price suppression in the world market for upland cotton. Instead, in Sections VII:G.3(j) ("Is there price suppression in the same world market?") and VII:G.3(k) ("The effect of the subsidy" and "Is there a causal link") of its report, the original panel examined a wide variety of circumstantial evidence. Brazil's evidence and argument in these proceedings similarly demonstrate significant price suppression through a wide variety of updated evidence that continues to support many of the findings by the original panel. They, therefore, can and should be adopted by the compliance Panel. Indeed, there is no legal or factual basis for this compliance Panel to accept the various U.S. attempts to have it effectively reverse the original panel's findings that were affirmed by the Appellate Body and adopted by the DSB.[162] Brazil's significant price suppression argumentation and evidence adopt the approach taken by the original panel, although it has done so by establishing causation in a "unitary" format.[163]

105. Finally, Brazil notes that it has presented considerable evidence that Step 2 subsidies, and their removal, did not have the effect of diminishing, or cancelling out, the significant price suppression"[164] caused by marketing loan and counter-cyclical subsidies.[165] Brazil established that the removal of the Step 2 subsidies will actually *increase* counter-cyclical subsidies and only very minimally reduce marketing loan subsidies.[166] Brazil also established that the repeal of Step 2 subsidies has not eliminated or reduced the pressure on world prices from excess U.S. production,

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[161] *See* Brazil's Oral Statement, para 37. *See also* Analysis of Effects of U.S. Upland Cotton Subsidies on Upland Cotton Prices and Quantities by Dan Sumner, Brazil's First Written Submission, Annex I and Section 7.12.1.

[162] Many of the panel's findings appealed by the United States were rejected by the Appellate Body. *See* Appellate Body report, *U.S. – Upland Cotton*, paras. 419-484. As underlined by the Appellate Body in *U.S. – Softwood Lumber VI (21.5),* "Article 21.5 panels can be expected to refer to their original panel reports, in particular, when matters before them are closely related to the matters before the original panel. […] doubts could arise about the objective nature of an Article 21.5 panel's assessment if, on a specific issue, that panel were to deviate from the reasoning in the original panel report in the absence of any change in the underlying evidence in the record and explanation" (paras. 103-105). Or, in the United States' words, in para. 180 of the United States' First Written Submission, "[T] the findings in the original proceeding formed the basis for the compliance by the United States with the DSB recommendations and rulings. […] those findings are taken as a given purpose of this Article 21.5 proceeding. Brazil cannot declare those findings of the original panel to be wrong or of no effect."

[163] Brazil's First Written Submission, paras. 55-63.

[164] Panel Report, *U.S. – Upland Cotton*, para. 7.1350. *See* Brazil's response to question 74, below.

[165] Brazil First Written Submission, paras. 191-209; Brazil Rebuttal Submission, paras. 48-90; Brazil's Oral Statement, paras. 135-144 and 156-162; Brazil's Closing Statement, paras. 9-14 and Brazil's Comments on the U.S. Oral Statement, paras. 5-9.

[166] Brazil's First Written Submission, paras. 197-198, Brazil's Rebuttal Submission, paras. 57-65 and Brazil's Oral Statement, paras. 136-140.

stocks, and exports generated by marketing loan and counter-cyclical subsidies.[167] Nor does the removal of Step 2 result in any significant or long-term reduction of U.S. exports. Indeed, the Vice-President of the NCC recently predicted that U.S. exports would increase significantly in MY 2007 over MY 2006 exports.[168] Brazil demonstrated that 2005 exports exhibit distorted data as a result of an unusually high surge of exports just prior to the termination of the Step 2 program.[169] Thus, the United States'. claims that exports in MY 2006 fall because of the repeal of Step 2 subsidies are unfounded.

106. In sum, Brazil's arguments and evidence demonstrate "without doubt" that the U.S. marketing loan and counter-cyclical subsidies cause significant price suppression in the world market for upland cotton.

70. How does Brazil respond to the United States' rebuttal that Brazil has not even established a temporal correlation between payment of subsidies and significantly suppressed prices during the life of the FSRI, that is from marketing year 2002 to 2005? More specifically, please address the United States' claim of the stability of US plantings, US share of world production, US share of world exports and the world price of cotton during this period.

107. A temporal "coincidence" between the payment of subsidies, increased U.S. exports, and a drop in world prices during the period MY 1999-MY 2002 was one of many factors and evidence that the original panel examined and found relevant for its causation findings.[170] In updating evidence that the original panel relied on, Brazil demonstrated that, as in MY 1999-2002, there was also a temporal coincidence in the period MY 2002-2005 between the payment of massive marketing loan and counter-cyclical subsidies and continued high levels of planted acreage.[171] Brazil further demonstrated a temporal coincidence between continued high levels of U.S. subsidized acreage in MY 2002-2005 (generating record high yields) and absolute levels of U.S. production that increased by 41 percent and exports that surged by 55 percent.[172] Brazil also demonstrated the temporal coincidence between the payment of massive marketing loan and counter-cyclical subsidies and stubbornly low world market prices during MY 2002-MY 2005 that remained 20 percent below their 1980-1998 average.[173]

108. Thus, as a factual matter, the U.S. assertion that there were not "coincidences" between (a) increased U.S. production and exports *and* (b) large U.S. marketing loan and counter-cyclical subsidies is wrong. It is fact that, over the lifetime of the FSRI Act of 2002, U.S. exports increased 55 percent and U.S. production increased 41 percent. And it is fact that at the same time, U.S. marketing loan and counter-cyclical subsidies increased by 21 percent in MY 2005 compared to

[167] Brazil's Oral Statement, paras. 157-162, Brazil's Closing Statement, paras. 9-14 and Brazil's Comments on the U.S. Oral Statement, paras. 10-12.

[168] Exhibit Bra-679 ("US Cotton Industry To Face Challenges In Global Market," 2006 AgWeb.com, accessed March 2007 at http://www.cattlenetwork.com/content.asp?contentid=103318) quoting Garry Adams, Vice President of the National Cotton Council, ("Looking to the 2007-08 marketing year, however, Adams said the NCC sees U.S. exports recovering to 16.22 million bales as foreign mill use increases.").

[169] Brazil's Rebuttal Submission, paras 77-79; Brazil's Oral Statement, para. 143 and Brazil's Closing Statement, paras. 11-14.

[170] *See*, *e.g.*, Panel Report, *U.S. – Upland Cotton*, paras. 7.1260-7.1303, 7.1380-7.1333 and 7.1339-7.1363.

[171] *See* Brazil's response to question 63, above.

[172] Exhibit Bra-447 (Upland Cotton Supply and Use, October 2006).

[173] The average A-Index price during MY 1980-1998 was 73.36 cents per pound. The average A-Index price during MY 2002-2005 was 58.92 cents per pound. *See* Exhibit Bra-673 (Upland Cotton Prices, March 2007).

MY 2002, and by 54 percent between MY 2002 and MY 2004.[174] Brazil further demonstrated that while there were higher yields during MY 2002-2005, these yields took place on planted acreage that benefited from massive subsidies, and that *but for* these subsidies, U.S. production and acreage would have been lower.[175]

109. These temporal "coincidences," in isolation, suggest a relationship between the massive marketing loan and counter-cyclical subsidies and suppressed U.S. and suppressed world market prices.

110. Such coincidences, in and of themselves, are of course not sufficient to establish causation. Nor did the original panel base its analysis even primarily on such coincidences. Rather, it saw the coincidences – two facts occurring at the same time – as another piece of evidence suggesting that subsidies significantly suppress world market prices.[176]

111. Brazil now turns to the United States' assertion that the U.S. *share* of world upland cotton production, and *share* of world exports did not increase and that this would be evidence of a lack of causation. This argument is without merit. One key flaw in the U.S. argument is that it ignores the fact that *absolute* levels of U.S. upland cotton production and *absolute* levels of U.S. upland cotton exports increased substantially despite low market prices and despite the fact that U.S. upland cotton producers have among the highest production costs in the world.[177] It was only in light of these considerable increases in production and exports that the United States was able to maintain its market shares at times when worldwide demand for and production of upland cotton increased considerably. These continued high market shares occurred at the same time that U.S. price-contingent subsidies increased covering massive losses of U.S. upland cotton producers. So, contrary to the U.S. argument, the stable *share* of U.S. production and exports does not demonstrate the *absence* of a temporal coincidence. Rather, the large absolute increases in production and exports establish the existence of a very strong coincidence.

112. Further, the United States claim that the stability of U.S. acreage demonstrates the lack of any "temporal coincidence" (and hence causation) is also without merit. Brazil refers the compliance Panel to its response to question 63, above, where the issue of stable acreage is addressed in more detail. Brazil also notes that the original panel did *not* find that U.S. acreage increased during the reference period of MY 1999-2002. In fact, U.S. acreage declined by 6 percent between MY 1999-2002.[178] And the original panel also found that U.S. "production may have been driven upward by high yields" during that time. Yet, these two "negative" coincidences did not prevent the original panel from finding a "strong temporal coincidence between the United States subsidies and the drop in United States prices, the drop in – and suppression of – world market prices, the increase in United States exports."[179]

113. Moreover, contrary to the situation before the original panel, *planted acreage* did not decline between MY 2002-2005. Instead, it *increased* by 2 percent.[180] This is an even stronger "coincidence" (or relationship) between planted acreage and subsidies than existed before the original panel. Further, the original panel placed considerable weight on the fact that A-Index prices were 29.5

[174] Brazil's First Written Submission, Table 6 at para. 111, as amended by updated marketing loan subsidy amounts (*see* Brazil's 16 March Comments on U.S. Answer to Question 4, para. 14) and an updated counter-cyclical subsidy amount in MY 2005 (*see* Brazil's Oral Statement, para. 40).

[175] Brazil's First Written Submission, para. 175; Brazil's Rebuttal Submission, paras. 226-231.

[176] Panel Report, *U.S. – Upland Cotton*, paras 7.1351-7.1352.

[177] Brazil's First Written Submission, para. 162. *See also* Exhibit Bra-480 (Survey of the Cost of Production of Raw Cotton, ICAC, November 2004).

[178] Exhibit Bra-447 (Upland Cotton Supply and Use, October 2006).

[179] Panel Report, *U.S. – Upland Cotton*, para. 7.1352.

[180] Exhibit Bra-447 (Upland Cotton Supply and Use, October 2006).

percent lower in MY 1999-2002 on average than during the period between MY 1980-1998. This same "coincidence" existed during the period MY 2002-2005, with A-Index prices 20 percent lower than during the period MY 1980-1998.[181]

114. An examination of changes in U.S. acreage relative to changes in planting period futures prices further supports the existence of a temporal coincidence between U.S. marketing loan and counter-cyclical subsidies and suppressed world market prices. As shown by Brazil[182], in five out of the last eight years, changes in U.S. acreage have moved in different directions from changes in futures prices, although one would expect – everything else being equal – that market-based producers adjust planting in line with changes in expected prices. Noticeably, changes in non-U.S. acreage and futures prices have moved in the same direction in seven out of eight years.[183]

115. Finally, while the United States claims that farmers' price expectations at the time of planting are the key factor in establishing causation, it ignores one of the most important "temporal coincidences" in the record. In the spring of 2005, New York futures prices predicted the second lowest harvest time prices in 10 years. U.S. producers responded by *increasing* planted acreage by 4.2 percent.[184] These same producers had received more than $2.5 billion in marketing loan and counter-cyclical subsidies just the year before and received more than $2 billion in MY 2005.[185] By contrast, the Brazilian producers responded to predicted lower upland cotton prices in 2005 by planting 27 percent fewer acres.[186] Similarly, non-U.S. acreage declined by 5 percent in MY 2005 as compared to MY 2004.[187] These temporal coincidences are important pieces of evidence suggesting the strong effects of the U.S. subsidies in suppressing world market prices. The effect of the price-contingent subsidies in "insulating" U.S. producers from and in "numbing" their reaction to market price signals in MY 2005 was a record amount of U.S. production. This results were predictable in light of the supply and demand dynamics in an integrated world cotton market for a fungible, commodity product – low world market prices.[188]

116. In sum, the United States' repeated assertion that Brazil has not provided evidence of relevant temporal coincidences is simply wrong. Brazil refers the compliance Panel to its response to question 69, above, and also notes that it provided data covering these various coincidences during MY 2002-2005 in its Written Submissions and Opening Statement – evidence which remains largely undisputed.[189]

71. In the original case, the Panel concluded that the analysis covering "the six-year period from 1997-2002 ... lends itself to an assessment of the medium- to longer-term examination of developments in the United States upland cotton industry" (see para. 7.1354 of the original panel report). Thus, total costs of production were the costs considered appropriate by the Panel. Would total costs of production continue to be relevant should the compliance Panel decide to use only

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[181] The average A-Index price during MY 1980-1998 was 73.36 cents per pound. The average A-Index price during MY 2002-2005 was 58.92 cents per pound. *See* Exhibit Bra-673 (Upland Cotton Prices, March 2007).

[182] Brazil's Rebuttal Submission, Table 9 at para. 224.

[183] Brazil's Rebuttal Submission, Table 9 at para. 224.

[184] Brazil's Oral Statement, paras. 62-67; Exhibit Bra-447 (Upland Cotton Supply and Use); Exhibit Bra-621 (Upland Cotton Expected Marketing Loan Payments Based on Futures Prices).

[185] Brazil's First Written Submission, Table 6 at para. 111, as amended by updated marketing loan subsidy amounts (*see* Brazil's 16 March Comments on U.S. Answers to Question 4, para. 14) and an updated counter-cyclical subsidy amount in MY 2005 (*see* Brazil's Oral Statement, para. 40).

[186] Exhibit Bra-629 (Brazilian Harvested Acreage, Producer, Supply & Distribution Database, FAS, USDA).

[187] Exhibit Bra-570 (Producer, Supply & Distribution Database, FAS, USDA).

[188] For details, *see* Brazil's Oral Statement, para. 62.

[189] Brazil's First Written Submission, Sections 7.4-7.6 and 7.9-7.10; Brazil's Rebuttal Submission, Section 2.3.5 and Brazil's Oral Statement, Sections 2.2-2.4 and 2.6-2.7.

marketing year 2005 as the reference period for analysis? Or would variable costs of upland cotton farming in marketing year 2005 now be the relevant information to consider?

117. Brazil considers that total costs continue to be highly relevant. Brazil urges the compliance Panel to adopt one of the primary findings of the original panel's causation analysis relating to "total cost of production." The original panel found as follows:

> [The] divergence between the United States producers' total costs of production and revenue from sales of upland cotton since 1997 … supports the proposition that United States upland cotton producers would not have been economically capable of remaining in the production of upland cotton had it not been for the United States subsidies at issues and that the effect of the subsidies was to allow United States producers to sell at a price lower than would otherwise have been necessary to cover their total costs. … We believe that the existence of this gap between upland cotton producers' total production costs and market revenue, on the one hand, and the effect of the subsidies, on the other hand, was to sustain a higher level of output than would have occurred in the absence of the United States subsidies at issue.[190]

118. There have been no fundamental changes in the conditions of competition or any other relevant factor that would compel this compliance Panel to reject these findings and conclusions. Long-term total costs were, and continue today, to be highly relevant for assessing the present effects of subsidies.

119. Further, as the original panel found, "[c]onsideration of developments over a period longer than one year, while not necessarily required (at least in Articles 5(c) and 6.3(c)) provides a more robust basis for a serious prejudice evaluation than merely paying attention to developments in a single recent year."[191] The original panel further noted that "having found that the subsidies exist and have been provided over a longer period of time than one year, it would be inappropriate to look at trends only in the last year to arrive at any conclusion on serious prejudice [because] … *the market may well already be distorted in a given year due to subsidies*."[192]

120. Thus, even if the compliance Panel uses only MY 2005 as a reference period, both variable and longer-term total costs would be relevant information to consider. In examining the effects of marketing loan and counter-cyclical subsidies in the MY 2005 reference year, the compliance Panel cannot conduct its counterfactual analysis in a vacuum. Over the long term, *i.e.*, over several years, the "typical" upland cotton farmer must meet his or her total costs of production or go out of business. When deciding what to plant in MY 2005, the typical farmer must make planting decisions to generate sufficient revenue to meet full variable costs, as well as to make sufficient payments to creditors demanding ongoing payment of long-term costs. Assuming no marketing loan and counter-cyclical subsidies had been received between MY 2000-2005, the typical U.S. upland cotton farmer in production since MY 2000 had a $663 per acre deficit.[193]

121. Thus, in the counterfactual, a farmer has two different, but related cost concerns at the time of planting in MY 2005: *first*, to meet the full variable costs of producing the crop such as seed, land, fertilizer, labor, and energy costs; and *second*, ensuring that sufficient funds were available to service fixed costs such as mortgage and equipment. Without generating sufficient revenues to meet this second set of costs, there would be no facilities or equipment to grow upland cotton in the first place. Thus, the U.S. assertion that farmers' only concern in MY 2005 was to cover variable costs ignores the reality of an ongoing long-term cost deficit that, at a minimum, would have be financed each and

[190] Panel Report, *U.S. – Upland Cotton*, para. 7.1354.
[191] Panel Report, *U.S. – Upland Cotton*, para. 7.1199.
[192] Panel Report, *U.S. – Upland Cotton*, para. 7.1199 (emphasis added).
[193] Brazil's First Written Submission, para. 158.

every year. Of course, with marketing loan and counter-cyclical subsidies, upland cotton farmers not only covered their costs, they also achieved a healthy profit.[194]

122. Whichever cost measurement is used, a comparison of expected market returns and production costs in MY 2005 suggest that much less cotton would have been produced *but for* marketing loan and counter-cyclical subsidies. In its Rebuttal Submission, Brazil showed that the average acre planted to upland cotton in MY 2005 was able to cover its variable cost of production by 1 cent per pound.[195] Considering the wide range of cost structures for various types of upland cotton producers, this means that a large minority of upland cotton producers were unable to cover their variable costs of production in MY 2005. Moreover, considering that futures prices were predicting even lower prices than those achieved in MY 2005, even more producers did not expect to be able to cover their variable costs of production.[196]

123. Even for farms that are able to cover their variable costs, the elimination of upland cotton marketing loan and counter-cyclical subsidies would result in significantly less production, even if the compliance Panel's reference period was confined to MY 2005. As explained by Professor Sumner in Brazil's Oral Statement, "the supply equations [Professor Sumner's] model, FAPRI's acreage allocation equations, USDA's supply models and statistical analysis of crop supply are all consistent with the principle that acreage of a crop declines when expected revenue falls relative to costs."[197]

72. Brazil has argued that the adjustment in cotton stocks should not be included in the simulation of a large and permanent reduction in subsidies to cotton. Please respond to the following argument:

> If the simulation were a comparative static analysis in which a baseline is compared to a counterfactual outcome in some long-run state, modelling such adjustments would be unnecessary. But such adjustments should be taken into account given that the model is used to simulate the average impact on the world price of cotton (among other variables) on specific periods of time (MY 2002-05 or MY 2006-08) and not in the long run.

124. For the specific time periods mentioned in the question, the demand-side question of Professor Sumner's simulation analysis is the following: how would the quantity of upland cotton demanded have responded to a fully anticipated and permanent removal of the upland cotton subsidy programs at issue. To properly assess this question, the modeller must specify the appropriate elasticity of demand for upland cotton that is applicable to this specific counterfactual situation.

125. Upland cotton market prices and stocks fluctuate for many reasons. For the purposes of the assessment relevant to this dispute, the demand elasticity includes those reductions in stocks that would have occurred in response to the permanent and expected price increase caused by the removal of the subsidy programs at issue. Under this question, even for a particular time period, upland cotton

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[194] Brazil's Oral Statement, paras. 54-91.

[195] Brazil's Rebuttal Submission, para. 269. Measurement of variable costs includes operating, land and labour costs because a farmer can choose to incur them on an annual basis, while capital recovery costs, which are variable to some degree, are not included.

[196] Brazil's Rebuttal Submission, para. 274. Brazil notes that in its Comments on Brazil's Oral Statement, the United States asserts that upland cotton producers expected to be able to cover their variable costs of production every year during MY 2002-2007. To reach this conclusion, the United States excluded variable costs associated with land and labor, used yields that were far higher than what farmers could have possibly expected (for instance, in MY 2002, the United States asserts that farmers expected to achieve an average yield of 723 pound per planted acre, approximately five percent higher than the all-time record high yield at the time) and used futures prices adjusted for a 5 cent cash basis that is not supported by the data (*See* Exhibit US-139).

[197] Brazil's Oral Statement, para. 95.

exporters and mill users would not reduce their stock to the extent that they would if a price increase was not fully anticipated and thought to be temporary. Significant short-run adjustments in stocks occur when price shocks are part of the normal fluctuations in the market and may occur if the policy change were expected to be temporary. It is this sort of response in stocks to changes in prices that are measured by econometric analysis of historical data. These responses concern the natural tendency to reduce stock during temporarily high prices and to build stocks during temporarily low prices.

126. Thus, even though the simulation is being applied to a counterfactual analysis of a particular time period, measured responses of stocks to temporary price swings do not represent changes in quantity demanded that should be added to demand response to a *permanent* and *anticipated* reduction in subsidies.

127. By contrast, if subsidies were expected be removed for a few years and then reinstated, the price increase would be expected to be temporary and stockholders would have great incentive to reduce stocks while prices were high and build back stocks after prices fell again.

73. How does Brazil respond to the argument made by the United States in paragraph 79 of its Opening Statement that:

> "to the extent a counterfactual assessment is undertaken, it is only to assess what the price equilibrium would be at present if marketing loan and counter-cyclical payments had been lower, different or did not exist. Article 6.3(c) does not ask what prices will look like in the short-run adjustment period if the marketing loan and counter-cyclical payments are suddenly eliminated... Brazil's argument that it is necessary to look at the short-run effects of total elimination of the programs cannot be accurate as a textual matter."

More specifically:

a) Why did Brazil not consider it appropriate to include simulations that involve reductions rather than elimination of the subsidy programmes?

128. Brazil does not consider that an assessment of reductions of the marketing loan rate or a reduced target price for counter-cyclical subsidies would be appropriate in these compliance proceedings to resolve Brazil's claims of inconsistency pursuant to Articles 5 and 6.3 of the *SCM Agreement*. When the United States finally amended the basket of price-contingent measures on 1 August 2006, it did not partially reduce marketing loan payments or counter-cyclical payments. Had it done so, the compliance Panel would properly examine whether such *reduced* marketing loan rates or *reduced* target price for counter-cyclical payments were sufficient to eliminate fully the serious prejudice claimed by Brazil. It is not Brazil's role – or that of the compliance Panel – to theorize or investigate what levels of reductions of target price, loan rates, or other eligibility criteria for receiving such subsidies the United States should or should not make to eliminate fully the serious prejudice caused to Brazil. Rather, in this compliance proceeding, the compliance Panel must examine the serious prejudice caused by the non-reduced marketing loan and counter-cyclical subsidies. These subsidies are the measures before the compliance Panel – not some modified or reduced form of these subsidies.

129. Article 6.3 requires a counterfactual examination of effects *but for* "the subsidy." This does not involve assessing effects of a "lower" or "changed" subsidy, but "effects" of "*the* subsidy," *i.e.*, the measure at issue. An assessment of a reduced subsidy would not enable the compliance Panel to determine whether the full "effect of the subsidy" amounts to serious prejudice or adverse effects to the interests of the complaining Member. It would simply reveal fewer effects than are actually caused by the subsidy at issue.

130. An assessment of the full effects of the subsidy is consistent with the findings of the original panel and the Appellate Body, which assessed the effects of the full amount of all price-contingent subsidies. It is also consistent with the counterfactual "but for" approach adopted by the panel *Korea – Commercial Vessels*. Specifically, that panel held as follows:

> [T]he text of Article 6.3(c) implies a "but for" approach to causation in respect of price suppression/depression. Price suppression is the situation where prices have been restrained by something, and price depression is the situation where prices have been pushed down by something. So the question to be answered is whether the "something" is subsidization. Looking at a counterfactual situation, *i.e.*, trying to determine what prices would have been in the absence of the subsidy, seems to us the most logical and straightforward way to answer this question.[198]

131. Further, the counterfactual assessment must determine what the effect of removing the subsidy would be today – not years from today. Article 6.3 of the *SCM Agreement* requires the assessment of whether "the effect of the subsidy," "is" "significant price suppression."[199] From a textual point of view, this requires assessing how the challenged subsidy causes *present* "significant price suppression" under market conditions during the reference period. The analysis does not involve examining the serious prejudice that may exist years later over a sufficiently long time for any shock to result in a new equilibrium. This assessment necessarily is of a short-term, not long-term nature.

132. These general principles are even more applicable in Article 21.5/Article 7.8 proceedings. Any Member that retains or amends the challenged subsidy measure (or "basket of measures") still maintains "the subsidy." Articles 7.8 and 7.9 of the *SCM Agreement* require the *full* removal of all adverse effects (assuming no withdrawal of the subsidy) within only six months. This short time period exists to protect the complaining Member that has already endured years of market distortions through adverse effects. As a textual matter, it is, thus, entirely appropriate for this compliance Panel to examine the adverse effects of "the subsidy" through a counterfactual analysis that assesses the present effects of eliminating the entire subsidy.

133. With these principles in mind, Brazil emphasizes that Professor Sumner's model is fully appropriate for the question at issue before the compliance Panel.

b) If simulations of such scenarios are performed, would the current values of the elasticities chosen (particularly the supply elasticities) to simulate the elimination of marketing loan and counter-cyclical programmes continue to be appropriate? Please kindly provide an explanation for the chosen answer.

134. The parameters in Professor Sumner's model were specified for cases of permanent and anticipated elimination of subsidies. The full removal of subsidies is the most appropriate use of the model in this dispute. Yet, the model can also be used to assess less than full removal.

135. Generally, Professor Sumner's model was developed to apply the same elasticity parameters to subsidy reductions rather than subsidy elimination. There is no strong evidence that responses are not proportional to the amount of price change or change in revenue caused by permanent and expected changes in policy incentives. Naturally the model would show that price increases from partial removal of subsidies will be smaller than the price increase from full subsidy removal. However, the model's assumption that responses are proportional to the price increase would still be valid. Quantity demanded and foreign quantity supplied both respond to endogenous increases in market price. Constant elasticity models are traditional in this context.

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[198] Panel Report, *Korea – Commercial Vessels*, para. 7.612.
[199] *See* Brazil's Closing Statement, paras 17-20.

136. That said, the U.S. supply elasticity may be even larger for partial subsidy removal for two reasons.

137. *First*, farmers may interpret a partial removal of subsidies as an indicator that further reductions are more likely in the near future. In that case growers would face more policy uncertainty and begin the process of full adjustments by disinvestments in machinery, shifting additional land to alternative crops and otherwise anticipating more changes to come.

138. *Second*, in some regions of the United States there are quantitative limits to the amount of land and other resources that are likely to shift out of upland cotton. A partial elimination of subsidies may be enough to encourage all upland cotton land in a region that has feasible alternatives to make the shift to other uses. In that case, full subsidy elimination would not cause any more land to shift out of upland cotton. These two reasons suggest that it would be useful to explore using a larger supply elasticity under simulations of partial subsidy removal.

74. Brazil's view is that the data that the Panel must consider for its claim of present serious prejudice should be that covering the latest marketing year for which complete information is available, MY 2005, and where credible, evidence after 31 July 2006. Since in MY 2005, payments under Step 2 continued to be made by the United States (payments which the original Panel found to have contributed to adverse effects) how shall the Panel ascertain that any adverse effects observed in marketing year 2005 are due solely to the two subsidy measures which are the subject of the present serious prejudice claim – marketing loan and counter-cyclical payments?

139. Consistent with the approach taken by all prior panels examining the effects of subsidies under Articles 5 and 6 of the *SCM Agreement*, the compliance Panel should examine whether marketing loan and counter-cyclical subsidies cause significant price suppression by means of a counterfactual analysis. As in the original proceeding, this counterfactual analysis involves assessing whether any factors (other than the challenged subsidies) "would have the effect of attenuating this causal link, or of rendering not 'significant' the effect of the subsidy."[200] In these implementation proceedings, Step 2 subsidies in MY 2005 constitute such a non-attribution factor.[201] With respect to the Step 2 subsidy, the question is whether it had "the effect of diminishing, or cancelling out, the significant price suppression"[202] caused by marketing loan and counter-cyclical subsidies.

140. In other words, the compliance Panel must assess whether other factors, including the Step 2 subsidy, operate to diminish, cancel out or render insignificant the effects of U.S. marketing loan and counter-cyclical subsidies. This is very similar to the analysis that the original panel performed with respect to direct payments and crop insurance subsidies.[203] Indeed, the fact that both price-contingent subsidies and *non*-price contingent subsidies were provided in the *same* marketing year (MY 2002) did not prevent the original panel from focusing its significant price suppression analysis *only* on the effects of the price-contingent subsidies.

141. Brazil asks this compliance Panel to adopt the same analytical approach that the original panel adopted with respect to MY 2002. This involves focusing on *only* the effects of marketing loan and counter-cyclical subsidies in MY 2005, and assessing whether the effects of *other* subsidies, including Step 2, attenuate the causal link.

142. Brazil has suggested that the compliance Panel conduct this analysis by using many of the same factors examined by the original panel in finding significant price suppression and causation by

[200] Panel Report, *U.S. – Upland Cotton*, para. 7.1356.
[201] Brazil's Oral Statement, para. 135.
[202] Panel Report, *U.S. – Upland Cotton*, para. 7.1350.
[203] Panel Report, *U.S. – Upland Cotton*, para. 7.1350.

means of a "unitary" analysis.[204] The original panel found that "it is important for the establishment of 'current' serious prejudice that such prejudice would be established to exist up to, and including, a recent point in time."[205] Brazil emphasizes that the appropriate reference period to conduct the counterfactual is MY 2005. This is the marketing year for which complete data is available. The original panel considered that complete data was required for its assessment when it stated that: "MY 2002 is a relevant year for our serious prejudice inquiry. It represents a recent period for which essentially complete data exists."[206]

143. Brazil recognizes that because of the repeal of Step 2 on 1 August 2006, it is also appropriate to set forth relevant evidence concerning the effects of marketing loan and counter-cyclical subsidies after that date. However, given the importance of comparing full year data, the compliance Panel should place primary emphasis on complete MY 2005 data. In isolating the effects of marketing loan and counter-cyclical subsidies, it should assess if other subsidies such as the effects of Step 2, direct payments, crop insurance, and export credit guarantee subsidies, among other factors such as China's demand and India's exports break the causal link between the subsidies and significant price suppression.

144. Indeed, Brazil has focused a considerable portions of its evidence on isolating the effects of marketing loan and counter-cyclical subsidies.[207] This evidence, which is primarily focused on MY 2005, but also includes data from MY 2006, is more than sufficient to allow the compliance Panel to have a firm evidentiary basis for concluding that the collective effect of marketing loans and counter-cyclical subsidies is significant price suppression and an increase in the U.S. world market share.

145. Brazil has also demonstrated that the effects of Step 2 subsidies in MY 2005 were modest compared to the effects of the two challenged subsidies – marketing loan and counter-cyclical payments.[208] Brazil provided considerable data for the period after the repeal of Step 2 that shows that marketing loan and counter-cyclical subsidies continue to significantly suppress world market prices for upland cotton.[209] Brazil has also demonstrated that the fundamental conditions of competition in the world market for upland cotton have not significantly changed since the repeal of the Step 2 subsidy – upland cotton continues to be a fungible commodity and the United States continues to exercise a substantial proportionate influence on the world market price for upland cotton.[210] Before the original panel as well as before this compliance Panel, Brazil also presented evidence simulating the effects of subsidies on the world market for upland cotton.[211]

146. Further, the compliance Panel has the benefit of the original panel's "non-attribution" analysis in which it addressed the various factors other than the price-contingent subsidies. The original panel made the following conclusion:

> [A]lthough some of these factors may have contributed to lower, and even suppressed, world upland cotton prices during MY 1999-2002, they do not attenuate

[204] Brazil's First Written Submission, Section 7.2.
[205] Panel Report, *U.S. - Upland Cotton*, para. 7.1198.
[206] Panel Report, *U.S. - Upland Cotton*, para. 7.1198.
[207] Brazil's First Written Submission, Sections 7.4-7.13; Brazil's Rebuttal Submission, Sections 2.2.2-2.3.8; Brazil's Oral Statement, Sections 2.2-2.8; Brazil's Closing Statement, Sections 4-7 and Brazil's Comments on the U.S. Oral Statement, Sections 2-5.
[208] Brazil's First Written Submission, Section 7.14; Brazil's Rebuttal Submission; Section 2.2 and Brazil's Oral Statement, Section 2.7.
[209] Brazil's Rebuttal Submission, Sections 2.2.1, 2.2.4 and 2.3; Brazil's Oral Statement, Sections 2.4 and 2.6.
[210] Brazil's Oral Statement, Sections 2.7-2.8; Brazil's Closing Statement, Section 4 and Brazil's Comments on the U.S. Oral Statement, Section 2.
[211] Brazil's First Written Submission, Section 7.12.

> the genuine and substantial causal link that we have found between the United States mandatory price-contingent subsidies at issue and the significant price suppression. Nor do they reduce the effect of the mandatory price-contingent subsidies to a level which cannot be considered "significant".[212]

147. Brazil has demonstrated that factors such as Step 2, direct payments, Chinese demand and supply, and Indian exports have not attenuated the genuine and substantial relationship of cause and effect between marketing loan and counter-cyclical subsidies and significant price suppression in the world market for upland cotton.[213] Variations in Chinese demand, Indian exports, or the repeal of Step 2 may well be responsible for certain price movements in the world market for upland cotton. But fluctuations in the world market price of upland cotton are irrelevant to Brazil's claim of significant price suppression. The focus of the analysis is on determining whether world market prices would be higher without the two challenged subsidies, regardless of whether those world market prices rise or fall.

148. Finally, Brazil references the summary of its evidence and arguments set out in its response to question 69, above, and in its prior submissions.

2. Increase in world market share - Article 6.3(d) of the *SCM Agreement*

Questions to the United States

75. Could the United States explain further the textual basis of its argument that "Article 6.3(d) is not concerned with absolute market share and whether or not in any given year a member's market share would have been lower if subsidies were removed"? (Rebuttal Submission of the United States, para. 401)

Questions to Brazil

76. What is the view of Brazil on the argument of the United States that an inquiry under Article 6.3(d) of the SCM Agreement requires two distinct elements: first, a demonstration of an increase in the world market share of a Member as compared to the average share it had during the previous period of three years, and, second, a demonstration that this increase in world market share compared to the average share the Member had during the previous period of three years is part of a consistent trend over a period when subsidies have been granted? (Rebuttal Submission of the United States, para. 399)

149. Brazil disagrees with this new interpretation of "consistent trend" in Article 6.3(d) of the *SCM Agreement*, as recently advanced by the United States. There is no textual basis for the U.S. argument that "the data must show that a Member's market share is consistently increasing over the previous three-year average."[214] Article 6.3(d) provides as follows:

> (d) the effect of the subsidy is *an increase* in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and *this increase follows* a consistent trend over a period when subsidies have been granted.[215]

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[212] Panel Report, *U.S. – Upland Cotton*, para. 7.1363.
[213] Brazil's First Written Submission, Section 7.15; Brazil's Rebuttal Submission, Sections 2.2.4 and 2.3.8.
[214] U.S. Rebuttal Submission, para. 403.
[215] Emphasis added.

150. Contrary to its previous arguments in both the original proceeding[216] and in its First Written Submission[217], the United States now claims that the final element of a "consistent trend" in Article 6.3(d) requires proof that there have been increases in every year since the subsidies have been granted. Such increases are to be measured, according to the United States, on a three-year rolling average.[218] This new claim has no legitimate textual basis. Indeed, the United States attempts to read the separate element of a three-year average into the element of a "consistent trend." However, the separate element of a three-year average solely serves to determine the data against which to compare the market share of the year for which the assessment is made.

151. The proper assessment of a claim under Article 6.3(d) begins, first, with the determination of whether there has been *an increase* in the world market share. Such a determination necessarily must be conducted with reference to a particular year. The requirement for an "increase" (or reference) year follows from the requirement to compare market share with the *average share* a Member had over the "previous period of three years." With respect to the first element, the analysis ends here. Article 6.3(d) does not contemplate a series of "increase," or reference, years for which multiple increases have to be demonstrated. It requires only an increase for the year at issue. In this case, MY 2005 is the "increase," or reference, year and marketing years 2002-2004 are the previous period of three years used to assess whether there is an increase in the U.S. market share in MY 2005.

152. The key elements in the text of Article 6.3(d) relevant to the U.S. argument is the term "an increase" in the first line, and the phrase "this increase" in the next to last line. The "increase" referred to in both instances in the text is the same, *i.e.*, an increase in world market share in the most recent year (the reference period of MY 2005, in this dispute). Other than determining whether there is *an* increase, the text of Article 6.3(d) does not require quantification of the increase.

153. The final step of the Article 6.3(d) assessment includes a consistent trend. Contrary to the U.S. argument, this step involves determining whether the increase in the world market share follows a "consistent trend" over a period in which the subsidies have been granted. This is *different* from a consistent increase. Brazil notes that the phrase "this increase follows" immediately precedes the phrase "a consistent trend." The requirement that an "increase" follow a "consistent *trend*" is by no means identical to the requirement the increase be an uninterrupted "consistent increase" every single year that subsidies have been granted, as argued by the United States. A "trend" implies that there will be periods in which market share may increase *or* decrease. What is important is the overall direction of the trend, *i.e.*, that it increases.

154. The ordinary meaning of the text of Article 6.3(d) does not require an annual increase in the three-year rolling average for a finding of a "consistent trend." Indeed, the United States offers no reason why the drafters would explicitly state that there should be "an increase … compared to the average share it had during the previous period of three years" and then implicitly impose the requirement for an additional *increase* based on a rolling three-year average for *every* year. Under the U.S. theory, it is not enough to show an increase in the most recent year compared to the previous three-year average. Instead, under the U.S. interpretation, there must be an increase for every year since the initiation of the subsidies. The U.S. interpretation makes the actual textual requirement of

[216] None of the earlier U.S. arguments relating to Article 6.3(d) in this or the original proceeding asserted that the concept of a "consistent trend" required proof of an increase measured by a three-year rolling average. Rather, the U.S. argued that there was a requirement for an annual increase compared to the prior year's *actual* world market share. *See, e.g.*, U.S. Further Submission, September 30, 2003, para. 101 ("In two of five years, the U.S. share of world export trade has decreased rather than increased; in a third year, the share was stable. Thus, Brazil has failed to make a *prima facie* case of inconsistency with Article 6.3(d)").

[217] U.S. First Written Submission, paras. 337-343 (which do not indicate the U.S. view that the "consistent trend" requires assessment of a rolling three year average).

[218] U.S. Rebuttal Submission, para. 403 ("In other words, to make a claim under Article 6.3(d), the data must show that a Member's market share is consistently increasing over the previous three-year average.").

showing an increase in the most recent year a nullity. This is because the increase would have to exist for every year since the subsidy was granted. It would have been easy for the drafters to impose this requirement directly, for example by using the following language:

> the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity for every year in which the subsidies have been granted as measured by a moving three-year average market share.

Of course, no such text exists in Article 6.3(d).

155. Contrary to the new U.S. arguments, the "consistent trend" referred to in Article 6.3(d) does not require proof that a Member's market share is consistently increasing over the previous three-year average. The three-year average in the text of Article 6.3(d) is relevant *only* to determine whether there is *an* increase in the market share in a reference year (*i.e.*, MY 2005 in this case). There is no basis in the text to transform this single three-year average into a *rolling* three-year average back to the time of the initial provision of subsidies. Indeed, there is no basis to read this language into the notion of a "consistent trend" in the first place. As noted above, negotiators could easily have drafted such text. But they did not. Only a *single* three-year average is provided for in the text.

156. The invalidity of the U.S. argument is further supported by the fact that Article 6.3(d) addresses only the limited category of "primary products or commodities." Commodities or primary products are particularly susceptible to fluctuations in production, based on weather-related factors, which will significantly impact the world market share of a subsidizing Member. The use of the word "consistent trend," as opposed to U.S.-imposed substitute phrase "consistent increase," reflects the drafters appreciation of this reality. The United States interpretation, on the other hand, would make Article 6.3(d) non-operational even where massive price-contingent subsidies are provided so long as subsidizing Member's market share falls for one year during a much longer period over which subsidies have been granted. This is contrary to the object and purpose of Article 6.3(d), which is to ensure that adverse effects are not caused by subsidies for primary products or commodities.

157. Finally, Brazil notes that it demonstrated why 1998 is a proper year to begin the analysis of whether the trend has been "consistent,"[219] and why the overall increase of the trend since 1998 meets the "consistent trend" test. Such proof is proper evidence of a "consistent trend," as required by Article 6.3(d).

77. In this connection, could Brazil respond to the argument of the United States that Brazil has not shown that either of these elements are met with respect to the marketing loan and counter-cyclical payment programs"? (Rebuttal Submission of the United States, paras. 399-403)

158. Brazil disagrees with the United States for the reasons set forth in its answer to question 76 above, as well as for the reasons set forth in paragraphs 346-358 of Brazil's Rebuttal Submission and paragraphs 214-236 of Brazil's First Written Submission.

C. CLAIM OF BRAZIL REGARDING THREAT OF SERIOUS PREJUDICE

Questions to both parties

78. Could both parties comment on the statements of Canada that "(a)t issue is whether these programmes....threaten to cause serious prejudice simply by virtue of their existence" and that "(c)ertain subsidy programs, by their very nature, give rise to a constant likelihood of support that results in a permanent threat of serious prejudice"? (Third Party Submission of Canada, paras. 9-10)

[219] Brazil's First Written Submission, paras. 227-229.

159. In Brazil's view, it may be possible that, as a theoretical matter, certain types of subsidy programs simply due to their nature and existence cause a "permanent threat of serious prejudice." As Articles 5 and 6 of the *SCM Agreement* focus on *effects* of subsidies and not on the *existence* (as would be the case for, *e.g.*, prohibited subsidies), however, as a practical matter, *additional* proof of threat of serious prejudice would be required. This evidence must show a significant likelihood that the subsidy causes serious prejudice in the future. For example, in addition to the nature and existence of a statutory and regulatory instruments, such evidence could include facts regarding the subsidizing Member's producers established history of significant production and/or exports of the subsidized product, or that without the subsidies, producers would not be able to cover their long-term costs of production.[220]

160. In this dispute, Brazil has challenged the marketing loan and counter-cyclical payment programs under the FSRI Act of 2002 and the mandatory and price-contingent payments thereunder as causing a threat of serious prejudice.[221] In its First Written Submission, Brazil argued, *inter alia*, that:

> The FSRI Act of 2002 contains no limits on the amount of upland cotton that can be produced by upland cotton farmers receiving marketing loan and counter-cyclical payments. The mandatory nature of these large trade-distorting subsidies, coupled with the commanding U.S. share of world production and exports, creates a permanent and structural threat of serious prejudice to the interests of other Members, including Brazil. This threat will continue until the expiry or substantial alternation of the FSRI Act of 2002, as it applies to upland cotton.[222]

161. In this dispute, Brazil does not claim that the mere "existence" of the marketing loan and counter-cyclical payment programs under the FSRI Act of 2002 causes a threat of serious prejudice. For example, Brazil argued that the "structure, design and operation, *i.e.*, the very nature, of the U.S. marketing loan and counter-cyclical programs provide evidence that these subsidies cause a significant threat of serious prejudice …."[223] In paragraph 260 of its First Written Submission, Brazil set out the criteria that it believes are relevant to assess claims of a threat of serious prejudice. It applies these criteria by providing evidence in its First Written Submission. This evidence includes the provisions of the FSRI Act of 2002 providing for mandatory and price-contingency marketing loan and counter-cyclical payments, along with evidence of projected payments, costs of production, price effects, and the commanding U.S. share of world production and exports. The evidence collectively supports a finding that the subsidies cause a threat of serious prejudice.[224]

162. Finally, Brazil would note its agreement with the United States' observation in *EC – Selected Customs Matters* that certain claims under the covered agreements are "not readily classifiable in the categories of 'as such' and 'as applied.'"[225] Brazil's threat of serious prejudice claim in this dispute is not labeled either as a "per se" or "as applied" claim. Rather, Brazil challenges subsidies that have not been changed during the implementation period and that cause, and will continue to cause, adverse effects to the interests of Brazil.

79. Could the parties state their views on the analysis of the ordinary meaning of the term "threat" in paras. 15-28 of the Third Party Submission of Canada?

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[220] *See* Panel Report, *U.S. – Upland Cotton*, paras. 1495-1497.
[221] Brazil's First Written Submission, paras. 237-314.
[222] Brazil's First Written Submission, para. 242.
[223] Brazil's First Written Submission, para. 262 (emphasis supplied).
[224] Brazil's First Written Submission, paras. 237-314.
[225] Appellate Body Report, *EC – Selected Customs Matters*, para. 165.

163. Brazil agrees with the well-reasoned analysis of Canada concerning the appropriate legal considerations for assessing a *threat* in the context of a serious prejudice claim, as set forth in paragraphs 15-28 of its Third Party Submission. This analysis complements Brazil's analysis of the appropriate legal standard for threat of serious prejudice claims, as set forth in paragraphs 246-261 of the First Written Submission of Brazil.

Questions to the United States

80. How does the United States address the argument of Japan that in view of the different purposes of Parts III and V of the SCM Agreement the standard for determining threat of material injury in Article 15.7 of the SCM Agreement is an inappropriate standard for determining the existence of a threat of serious prejudice under Part III of the SCM Agreement? (Third Party Submission of Japan, paras. 8-12.) '

81. How does the United States respond to the argument of Australia that "it is beside the point for the United States to argue that the programmes under consideration are due to expire in late 2007"? (Third Participant Oral Statement of Australia, para. 13)

82. Could the United States comment on the projections of marketing loan and counter-cyclical payments in Table 26 of Brazil's First Written Submission and on the projections of prices and subsidy payments in Table 27 of Brazil's First Written Submission? Could the United States explain how the data in these Tables support its argument that producers are likely to expect low or no marketing loan payments in MY 2007? (Rebuttal Submission of the United States, para. 418)

Questions to Brazil

83. How does Brazil address the argument of the United States that footnote 13 of the SCM Agreement "does not indicate that where a panel finds that a Member is causing present serious prejudice through the use of a subsidy, the panel automatically also finds that the Member is threatening to cause serious prejudice in the future through the use of the same subsidy"? (Rebuttal Submission of the United States, footnote 624)

164. Brazil notes that the United States has not properly understood Brazil's arguments concerning the relationship between "present" serious prejudice and "threat" of serious prejudice occurring in the future. Brazil does not argue that, by virtue of footnote 13 of the *SCM Agreement*, a finding of "present" serious prejudice necessarily "includes" a finding of a threat of serious prejudice in the future. Indeed, Brazil's First Written Submission quoted the original panel's analysis in which it stated that "[w]e believe that 'threat' of serious prejudice refers to something distinct from serious prejudice."[226] It also quoted the original panel's statement that "present serious prejudice would more often be *preceded in time* by a prejudice that threatens to become serious, and serious prejudice would be the realization of a threat of serious prejudice."[227] With respect to the *future*, as opposed to *past* threat, Brazil's position is that a finding of "present" serious prejudice (as distinguished from "threat" of serious prejudice) caused by marketing loan and counter-cyclical subsidies for upland cotton is compelling evidence that a serious prejudice will continue to be caused by the same subsidies in the future.

165. Brazil does wish to take this opportunity to clarify a statement made in paragraph 241 of its First Written Submission which appears to have generated some confusion.[228] To the extent that

[226] Brazil's First Written Submission, para. 238 *quoting* Panel Report, *U.S. – Upland Cotton*, para. 7.1495.
[227] Panel Report, *U.S. – Upland Cotton*, para. 7.1497.
[228] The sentence is as follows: Brazil notes that it withdraws this contingency in case the compliance Panel were to not agree with the original panel that its present serious prejudice findings includes a finding of

Brazil suggested in the first part of the second sentence of paragraph 241 that the original panel found that its present serious prejudice finding includes a finding of threat of serious prejudice *in the future*, that is not correct. Accordingly, Brazil withdraws the following statement in paragraph 241 of its First Written Submission: "… the compliance Panel were to not agree with the original panel that its present serious prejudice finding includes a finding of threat of serious prejudice in the future …." In this regard, Brazil refers the Panel to its response to question 84, below.

84. Could Brazil confirm that its claim of threat of serious prejudice is submitted on a contingent basis i.e., that it does not request the Panel to make a finding on this claim if the Panel make a finding of present serious prejudice? How is the contingent character of this "threat of serious prejudice" claim reflected in Brazil's request for the establishment of a panel?

166. Brazil's intention in raising a "contingent" threat of serious prejudice claim was to signal that the Panel could exercise judicial economy on this claim if it made a finding of "present" serious prejudice. However, this compliance Panel is empowered to make determinations with respect to any and all claims asserted by Brazil that the Panel believes are necessary to secure a positive solution to a dispute pursuant to Article 3.7 of the DSU. Indeed, Brazil's request for establishment of a panel includes a threat of serious prejudice claim without any limitations or contingencies. Thus, the stated contingency as set out in paragraph 241 of Brazil's First Written Submission does not limit the compliance Panel's terms of reference. Moreover, Brazil has requested that the compliance Panel make all necessary findings of fact regarding Brazil's threat of serious prejudice claim in the event of an appeal. In view of these factors and notwithstanding the previously articulated contingency, Brazil requests that the compliance Panel make a determination with respect to Brazil's threat of serious prejudice claims if it considers that resolution of such claims will contribute to a positive solution to this dispute.

85. Could Brazil explain its request that the Panel "make factual findings with respect to its 'threat of serious prejudice' claim to allow the Appellate Body to complete the analysis, in case it were to disagree with the compliance panel's interpretation"? (First Written Submission of Brazil, para. 241) What are the precise "factual findings" which Brazil requests the Panel to make in this regard?

167. Brazil refers the compliance Panel to its answer to question 84 above. It notes, first, that, to the extent that the compliance Panel were to make a determination with respect to Brazil's threat of serious prejudice claims, Brazil's request in paragraph 241 of Brazil's First Written Submission regarding factual findings would not be necessary.

168. Second, to the extent that the compliance Panel were to exercise judicial economy regarding Brazil's threat of serious prejudice findings, Brazil requests that the compliance Panel nevertheless make factual findings that would allow the Appellate Body to make a threat of serious prejudice finding. These factual findings would be necessary in the event that the Appellate Body were to determine that the compliance Panel has erred (for whatever reason) in making a finding that the marketing loan and counter-cyclical subsidies cause "present" (as opposed to "threat of") serious prejudice.

169. Brazil requests the compliance Panel to make the factual findings summarized in paragraph 244 of Brazil's First Written Submission, as amplified and supported by the evidence referenced in Sections 8.3-8.9 (as well as Section 7) of Brazil's First Written Submission, Sections 2.2-2.3.8 of the Rebuttal Submission of Brazil, Sections 2.2-2.8 of the Brazil's Opening Statement, Sections 3-7 of the Brazil's Closing Statement, Sections 2-5 of Brazil's Comments on U.S. Oral Statements, and in Brazil's Answers to the questions 89, 69 and 70.

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threat of serious prejudice in the future or that its present serious prejudice findings do not require changes to the statutory provisions setting up these subsidy programs.).

86. How does Brazil address the argument of the United States that the definition of "threat" of injurious effects in Article 15.7 of the SCM Agreement and Article 4.1(b) of the Agreement on Safeguards "in terms of their close proximity in time and their high probability of occurring" reflects the ordinary meaning of the word "threat" and that, as such, Article 15.7 of the SCM Agreement and Article 4.1(b) of the Agreement on Safeguards provide "useful contextual guidance" for the interpretation of "threat" of serious prejudice?

170. In Brazil's view, it is not appropriate to import into Part III of the *SCM Agreement* the "clearly foreseen and imminent" standard of Articles 15.7 of the *SCM Agreement* and Article 4.1(b) of the *Agreement on Safeguards*. Brazil's First Written Submission set forth in detail its concern with importing the threat standard from Article 15.7 of the *SCM Agreement* into Part III of the *SCM Agreement*.

171. Article 4.1(b) and 2 of the *Agreement on Safeguards* as well as Article 15.7 of the *SCM Agreement* deal primarily with the threat posed by a potential surge of imports. For example, a key focus for investigating authorities in investigating a threat of injury pursuant to the provisions of Article 15.7(ii) is whether there is a "significant rate of increase of subsidized imports", and Article 15.7(iii) requires examination of increased capacity "indicating the likelihood of substantially increased subsidized exports to the importing Member's market …."

172. By contrast, Articles 5(c) and 6.3 as well as footnote 13 of the *SCM Agreement* deal with the likelihood of adverse effects – not subsidized imports – occurring sometime in the future. The original panel found that "[t]he text of Articles 5 and 6 of the *SCM Agreement* support the conclusion that it is the effects of United States subsidies – not the effects of the 'subsidized product' – that are at issue in a claim of price suppression under Article 6.3(c)" and that the "references in Articles 5(c) and 6.3(c) to the 'effect of the subsidy' contrast with the language used in countervailing duty provisions in Part V of the Agreement."[229]

173. Unlike a situation involved in an Article 15.7 of the *SCM Agreement* or Article 4.1 of the *Agreement on Safeguards* investigation, where goods may be sitting in a warehouse ready to be shipped across borders, the effects of subsidies in causing "adverse effects" may take much longer to materialize. For example, a subsidy provided today to build a factory that would triple the world's supply of a particular good may not yet generate quantities of output or exports that are sufficient to cause displacement or impedance until three years later. The adverse effects of such a subsidy, however, may be able to be "foreseen." Yet, as they may not occur until three years later, they would fail the "clearly foreseen and imminent" standard in a countervailing duty ("CVD") investigation. Similarly, subsidies mandated to be granted for future deliveries of large capital goods with a long production lead-time may result in a threat that is "clearly foreseen," but would not be "imminent" because the subsidies would not be paid until delivery of the good two or three years later.

174. Another important reason explaining that the "threat" standard in Part III of the *SCM Agreement* should be different from the "threat" standard in Article 15.7 of the *SCM Agreement* and Articles 4.1(b) and 2 of the *Agreement on Safeguards* is the distinct nature of the remedies involved. Articles 15.7(ii) of the *SCM Agreement* and Articles 4.1(b) and 2 of the *Agreement on Safeguards* provide rules governing the unilateral imposition of remedies following domestic national proceedings – not challenges to subsidies in multilateral WTO dispute settlement. Countervailing duty and safeguard rules also discipline investigating authorities' imposition of provisional limited actions to stem the imminent surges of imports.[230] These provisional remedies provided for in the rules allow domestic authorities expeditiously to stop goods at the border. Correspondingly, the rules require that future surges of imports be "clearly foreseen and imminent." This makes perfectly sense

[229] Panel Report, *U.S. – Upland Cotton*, para. 7.1227.

[230] Article 6 of the *Agreement on Safeguards* and Articles 17.1(b) and 15.7 in connection with footnote 45 of the *SCM Agreement*.

in light of the rapid nature of the remedy that may be unilaterally imposed. If CVD or safeguard investigations by domestic authorities were governed by anything less than an "imminent" standard, the rapid and unilateral nature of the remedy could significantly restrict the flow and import of goods.

175. By contrast, multilateral dispute settlement actions challenging subsidies under Part III of the *SCM Agreement* offer no immediate remedy to resolve the adverse effects caused or threatened by subsidies. Complaining Members, such as Brazil in this dispute, are forced to wait years before subsidizing Members causing adverse are required to make changes to their subsidy measures under Article 7.8 of the *SCM Agreement*.

176. Correspondingly, the threat standard under Part III of the *SCM Agreement* should not prevent a non-subsidized Member from seeking protection until a competing subsidized good from another Member is just about to be produced, exported, or imported. The threat standard for CVD measures of "clearly foreseen and imminent" in Article 15.7 and the associated CVD remedy provide precisely the type of unilateral immediate relief that does *not* exist in Part III of the *SCM Agreement*. In view of the length of a multilateral proceeding, imposition of a "clearly foreseen and imminent" standard will effectively guarantee that Members will be forced to suffer serious prejudice before they are able to obtain any relief.

177. The original panel recognized this problem in noting that "[i]f a Member were unable to bring [a threat] action against subsidies until they were actually paid, this would undermine the object of preventing adverse effects to its interests."[231] This rationale suggests that a threat claim should be able to be brought even before a subsidy is *paid* – let alone before a subsidized good is produced and about to be exported. But that right of self-protection in a multilateral proceeding under Part III of the *SCM Agreement* would become empty if a "clearly foreseen and imminent" standard were adopted for threat of serious prejudice claims.

178. The length of time it takes to pursue WTO dispute settlement requires a more flexible threat standard such as a "significant likelihood" of threat – not an "*imminent* likelihood" of threat. Such a standard would be consistent with both the slower pace of WTO dispute settlement procedures and of the associated remedies, as well as with the time it takes for effects of certain types of subsidies to materialize.

179. Further, as Brazil has explained in detail in its First Written Submission, there is yet another reason that the "clearly foreseen and imminent" standard from Article 15.7 should *not* be imported into Part III of the *SCM Agreement*. This is because it would be inappropriate to require a complaining Member to demonstrate a "change in circumstances" that was "clearly foreseen and imminent."[232] Many subsidy programs, such as the marketing loan and counter-cyclical subsidies, continue without any "changes" year after year. Nor do the fundamental aspects of conditions of competition in many commodity markets change over the short to medium term. Yet, such subsidies, when coupled with appropriate conditions of competition in the relevant market, may cause a threat of serious prejudice without there necessarily being a "change in circumstances."

180. Thus, the concept of "threat" must be examined within the particular context of each WTO Agreement in which it is found. It is not appropriate to simply import into Part III of the *SCM Agreement*, which provides remedies for the *effects* of subsidies, an elaborated meaning of threat that is applicable to imminent *surges of imports* in the context of the *Agreement on Safeguards* or Part V of the *SCM Agreement*. Threat of adverse *effects* need not necessarily be "imminent" or "clearly foreseen" in the same very short term, as suggested by the United States. The threat of adverse effects caused by subsidies may well be of a distinctly more qualitative nature than the threat of injury posed by goods literally waiting to be shipped across a border. Instead, the ordinary

[231] Panel Report, *U.S. – Upland Cotton*, para. 7.191.
[232] Brazil's First Written Submission, paras. 254-258.

meaning of the term "threat" could similarly encompass the concept of a significant "likelihood" that adverse effects will occur in the future as Brazil has argued.[233]

181. Brazil emphasizes that it is not asking the compliance Panel to adopt a standard that would require panels to base threat findings on allegation, conjecture or remote possibility. In paragraph 260 of its First Written Submission, Brazil proposed criteria that ensure that any finding of threat with respect to the type of annual agricultural subsidies at issue in this dispute will be based a firm evidentiary basis. However, the effects of subsidies demonstrated by this evidence necessarily have a longer time-frame than the effects from a shipment of subsidized goods at issue in a unilateral Article 15.7 proceeding. Thus, for the reasons set forth above and those already articulated by Brazil (and Canada in its Third Party Submission), Brazil does not believe that the standards of either Article 15.7 of the *SCM Agreement* or Article 4.1(b) of the *Agreement on Safeguards* should be imported into an assessment of threat of serious prejudice in Part III of the *SCM Agreement*.

87. Could Brazil comment on the argument of the United States that the standard of "significant likelihood" is without support in the text of the SCM Agreement or in the GATT/WTO dispute settlement reports cited by Brazil? (Rebuttal Submission of the United States, paras. 406, 410,413)

182. Brazil acknowledges that the term "significant likelihood" is not found in the *SCM Agreement* or any other WTO Agreement. However, this does not prevent the compliance Panel from adopting the interpretation advanced by Brazil. Indeed, there are many terms and descriptions for legal standards and concepts developed by panels and the Appellate Body that are not found explicitly in the text of the WTO Agreements but are inherent to the interpretive task under Article 3.2 of the DSU.

183. One relevant example is the "genuine and substantive relationship of cause and effect" causation standard.[234] Moreover, with respect to actionable subsidy claims under Article 6.3 of the *SCM Agreement*, panels have described many standards that are not found in the text of Part III, including the concept of a "reference period,"[235] a "but for" or "counterfactual" causation analysis[236], "nature" and "magnitude" of the actionable subsidies standard[237], and "non-attribution."[238]

184. Examples from other WTO Agreements include the "rational basis" standard[239] for interpreting the term "base on" in 3.1 of the *SPS Agreement*, the words "shall use as a basis"[240] in Article 2.4 of the *TBT Agreement*, the "total average cost of production" test[241] in Article 9.1(c) of the *Agreement on Agriculture*, the "sudden, sharp, and recent" standard[242] for assessing imports under Article 2.1 of the *Agreement on Safeguards*, the use of a market benchmark for benefit[243] under Article 1 of the *SCM Agreement*, the like product criteria of physical characteristics, consumer perceptions, end use[244], the "design structure and architecture" standard[245] in Article III:2 of GATT 1994, and the "necessity"[246] and "least trade restrictive measure"[247] standards of Articles XX(b) and XX(d) of GATT 1994, among others.

[233] Brazil's First Written Submission, paras. 246-261.
[234] Appellate Body Report, *U.S. – Softwood Lumber VI (21.5)*, para. 132.
[235] Panel Report, *U.S. – Upland Cotton*, para. 7.1195.
[236] Panel Report, *Korea – Commercial Vessels*, paras 7.613-7.616.
[237] Appellate Body Report, *U.S. – Upland Cotton*, para.467.
[238] Panel Report, *Korea – Commercial Vessels*, para. 7.617.
[239] Appellate Body Report, *EC – Hormones*, paras. 160-166.
[240] Appellate Body Report, *EC – Sardines*, para. 245.
[241] Appellate Body Report, *Canada – Dairy (21.5 I)*, para. 88.
[242] Appellate Body Report, *Argentina – Footwear*, para. 131.
[243] Appellate Body Report, *Canada – Aircraft*, para. 157.
[244] Appellate Body Report, *EC – Asbestos*, paras. 101-102.
[245] Appellate Body Report, *Japan – Alcohol II*, section H.2(c).
[246] Appellate Body Report, *Korea – Various Measures on Beef*, paras. 161-162.
[247] Appellate Body Report, *Dominican Republic – Import and Sale of Cigarettes*, para. 54.

185. As discussed in Brazil's response to question 86 above, the U.S. arguments do not address the *sui generis* nature of "effects"-based claims under Part III of the *SCM Agreement*. Indeed, the United States entirely ignores the "effects"-based nature of these claims by simply importing an "imminent" "changes in circumstances" threat standard designed to discipline actions by investigating authorities regarding restrictions on imports of goods. Brazil believes that the appropriate concept of threat in an Article 6.3 claim is captured in the phrase "significant likelihood" that serious prejudice will occur in the future. This phrase – or some other similar term – is better suited to capture the threat caused by the longer-term and slowly materializing effects of many subsidies. Brazil invites the compliance Panel to use or articulate another phrase or description of the applicable standard if it captures the special nature of the effects-based enquiry of Article 6.3 of the *SCM Agreement*.

88. Does Brazil agree or disagree with the proposition advanced by the United States that "[a] panel may consider the ordinary meaning of a term as reflected in a particular provision to interpret the same term in another provision (especially of the same agreement) without the need for an express cross-reference." (Rebuttal Submission of the United States, para. 411, footnote 635)

186. In the particular context of Part III of the *SCM Agreement*, Brazil disagrees with the U.S. argument that the absence of a cross-reference to Article 15.7 of the *SCM Agreement* in Footnote 13 is irrelevant. The U.S. argument assumes that the nature, object and remedy of the assessment of threat in Article 15.7 are identical or substantially similar to the nature, object and remedy of threat in Article 6.3 of the *SCM Agreement*. Brazil has demonstrated in its responses to questions 86-87, above, and in its First Written Submission, that this is not the case. Therefore, the absence of a cross-reference *is* important to reveal the intent of negotiators to treat a multilateral claim of threat of serious prejudice differently from a unilateral countervailing duty remedy.

187. The United States incorrectly compares the absence of a cross-reference in footnote 13 to Article 15.7 with the absence of a cross-reference to the term "export subsidy" in Article 3.1(a) of the *SCM Agreement* to Article 1(e) of the *Agreement on Agriculture*.[248] While there was no explicit cross reference between these two provisions, the Appellate Body's decision in *U.S. – FSC* focused on the identical phrase "contingent upon export performance" in Article 1(e) of the *Agreement on Agriculture* and Article 3.1(a) of the *SCM Agreement*.[249] The Appellate Body found that "[a]lthough there are differences between the export subsidy disciplines established under the two Agreements, those differences do not, in our view, affect the common substantive requirement relating to export contingency. Therefore, we think it appropriate to apply the interpretation of export contingency that we have adopted under the *SCM Agreement* to the interpretation of export contingency under the *Agreement on Agriculture*."[250]

188. By contrast, there are substantive differences between Article 6.3 and Article 15.7 of the *SCM Agreement* that do affect the common substantive requirement relating to "threat." Brazil has explained those differences in its answers to questions 86-87, above. In addition, the original panel emphasized that there were many aspects of the disciplines in Part V of the *SCM Agreement* that were not able to be imposed into Part III of the *SCM Agreement*.[251] These differences are many, but among the most important identified by the original panel were the different remedy provisions and the fact that the focus of an Article 6.3 claim was on the effects of subsidies – not the effects of subsidized imports.[252]

[248] U.S. Rebuttal Submission, para 411, footnote 653.
[249] Appellate Body Report, *U.S. – FSC*, para 141.
[250] Appellate Body Report, *U.S. – FSC*, para. 141.
[251] Panel Report, *U.S. – Upland Cotton*, paras. 7.1167-7.1177, 7.1179-7.1181 and 7.1189.
[252] Panel Report, *U.S. – Upland Cotton*, paras. 7.1170 (differences in remedies) and 7.1227 (effects v. subsidized imports).

89. Brazil argues that marketing loan and counter-cyclical payments for upland cotton are designed "in such a manner that payments would be made in consistently large amounts". (First Written Submission of Brazil, para. 270)

a) Could Brazil in this regard discuss the data in Table 27 of Brazil's First Written Submission that show an increase in the projected farm price and AWP over the period MY 2006 - 2010 and a decline in projected marketing loan payments?

189. The data in Figure 27 of Brazil's First Written Submission reflect deterministic projections of outlays (also known as point estimates). As explained by USDA, "deterministic projections, by their nature, tend to underestimate outlays."[253] A comparison of the most up to date (February 2007) USDA deterministic and stochastic projections of upland cotton budget outlays shows that this underestimation is very significant. For instance, while the point projection of marketing loan subsidies falls to zero in MY 2009, the stochastic estimate remains at $468 million. The respective U.S. government data is shown in Table 2 below:

Table 4 – USDA Projections of Upland Cotton Marketing Loan and Counter-Cyclical Subsidies[254]

		2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
						million dollars					
ML	**Point**	$757	$238	$21	$0	$1	$24	$72	$166	$169	$266
	Stochastic	$757	$798	$515	$468	$477	$542	$592	$729	$732	$875
CCP	**Point**	$1,376	$1,075	$875	$774	$774	$875	$975	$1,075	$1,075	$1,175
	Stochastic	$1,376	$1,028	$860	$769	$769	$860	$947	$1,028	$1,075	$1,175
Total	**Point**	$2,132	$1,313	$895	$774	$775	$898	$1,047	$1,241	$1,244	$1,441
	Stochastic	$2,132	$1,826	$1,376	$1,237	$1,246	$1,403	$1,540	$1,756	$1,807	$2,050

190. In addition to showing that deterministic projections underestimate subsidy outlays, the above table is important in at least two other respects. First, it shows that even the point estimates of marketing loan subsidies are expected to increase after 2009, through the end of the baseline in MY 2015. This suggests that USDA expects the AWP to be below the loan rate of 52 cents per pound after 2009. Second, and most important, USDA projects marketing loan and counter-cyclical subsidies to be well in excess of $1 billion indefinitely. This confirms Brazil's assertion that marketing loan and counter-cyclical subsidies are designed "in such a manner that payments would be made in consistently large amounts."[255]

191. Brazil notes that no other program crop is projected to receive significant amounts of marketing loan or counter-cyclical payments in future years. A recent USDA statement by USDA fully supports this conclusion:

> While program crop prices are generally expected to remain firm or increase over the next few years, <u>upland cotton is an exception</u>. The combination of increases in upland cotton yields per acre and declining U.S. upland cotton textile production is

[253] Exhibit Bra-460 (Explanatory Notes for Stochastic Budget Outlay Estimates, Farm Service Agency, accessed October 2006 at http://www.fsa.usda.gov/Internet/FSA_File/msrexplain.doc).

[254] Exhibit Bra-639 (Commodity Estimates Book for FY 2008 President's Budget, pp. 52, 71, 74-75, 79-80, 82, 84, 87 and 92, accessed February 2007 at https://www.ccc2.net/ccc2app/2008PresBud/PresBud2008.htm). Brazil notes that projected CCP subsidies <u>are not</u> allocated.

[255] Brazil's First Written Submission, para. 270.

expected to limit price gains and result in substantial cotton program expenditures, compared to other commodities.[256]

192. Brazil agrees with USDA's most recent assessment. This evidence supports the conclusion that year after year, upland cotton subsidies are essential to supplement significantly the average farmer's market revenue. Indeed, the NCC recently urged Congress to provide for disaster assistance to U.S. upland cotton producers arguing that "'[a] large number of U.S. cotton producers have dealt with crop disasters in either or both of the 2005 and 2006 crop years.' … 'With production costs expected to remain high, many U.S. cotton producers will need assistance in order to maintain their operations.'"[257] The evidence suggests that what has been true in the past will remain so in the future.

193. Finally, it is important to recognize that the magnitude of the marketing loan subsidies, which reflects total payments over the particular marketing year, are but one of the key aspects of the nature of these subsidies. Of course, total marketing loan payments are important evidence because they demonstrate how year after year, the marketing loan subsidies play a crucial role in maintaining the revenue and financial well-being of high-cost U.S. upland cotton producers. But even if overall marketing loan payments are relatively low in a particular year, this does not mean that such subsidies have not had an important influence on U.S. upland cotton producers' planting decisions.

194. This is because there is a separate and equally important aspect of marketing loan subsidies that contributes to significant U.S. upland cotton acreage, production and exports. This aspect involves the *expectations* of future marketing loan (and counter-cyclical payments) that farmers have at the time of planting. Brazil has demonstrated how the expectations of low upland cotton prices at the time of harvest (based on February prices of the December futures contract price) in many marketing years, such as MY 2005 and 2006, have *not* led to cutbacks in acreage.[258] The reason is that explained by the Appellate Body – upland cotton producers know that even if expected prices stay low, their revenue will be protected fully by the marketing loan and counter-cyclical payments.[259]

b) How does Brazil respond to the argument of the United States that "by MY 2008, the projection is of no marketing loan payment at all"? (Rebuttal Submission of the United States, para. 419).

195. It is remarkable that the United States claims that there will be "no marketing loan payment at all" when projections by the U.S. government itself (*see* Table 4 above) show marketing loan subsidies of $758 million in MY 2007 and $515 million in MY 2008.[260] The United States assertion that "by MY 2008, the projection is of no marketing payments at all," is based on deterministic estimates of world prices in future years. As explained above, "deterministic projections, by their

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[256] Exhibit Bra-671 (U.S. Department of Agriculture's 2007 Farm Bill Proposal, p. 14, accessed March 2007 at http://www.usda.gov/documents/07finalfbp.pdf).

[257] Exhibit Bra-680 ("NCC urges disaster assistance for cotton producers," High Plains / Midwest AG Journal, 15 March 2007, accessed March 2007 at http://www.hpj.com/archives/2007/mar07/mar19/NCCurgesdisasterassistancef.cfm?title=NCC%20urges%20disaster%20assistance%20for%20cotton%20producers).

[258] Brazil's First Written Submission, paras.137-143; Brazil's Rebuttal Submission, paras. 214-225; Brazil's Oral Statement, paras 60-81 and Brazil's Comments on the U.S. Oral Statement, paras.18-27.

[259] Appellate Body Report, *U.S. – Upland Cotton*, para. 445. *See also*, Brazil's response to question 62, above.

[260] Exhibit Bra-639 (Commodity Estimates Book for FY 2008 President's Budget, pp. 52, 71, 74-75, 79-80, 82, 84, 87 and 92, accessed February 2007 at https://www.ccc2.net/ccc2app/2008PresBud/PresBud2008.htm).

nature, tend to underestimate outlays."[261] It is for this reason that USDA, FAPRI and the U.S. Congressional Budget Office all use stochastic projections to estimate budget outlays.[262]

196. Indeed, USDA's MY 2006 estimate of $757 million in marketing loan payments appears to be low based on the current adjusted world price AWP. The current AWP for upland cotton is 43.5 cents per pound[263] and the average AWP for the first seven months of MY 2006 is 43.7 cents per pound.[264] This implies an average marketing loan subsidy of 8.3 cents per pound in the first seven months of MY 2006, or $836 million in total.[265] Marketing loan payments of $836 million are roughly similar to the $898 million in marketing loan payments made in MY 2002[266] that were considered by the original panel.

197. However, based on past experience and USDA data, $836 million is even conservative. Under the marketing loan program, farmers are able to choose when to exercise their marketing loan payment.[267] Because of this flexibility and the obvious incentive of farmers to maximize their marketing loan payments, marketing loan subsidies on a per-pound basis are usually larger than the per-pound difference between the loan rate and the average annual AWP. USDA explains that "the loan program may overcompensate when production is marketed at prices above the level used to lock in the loan benefit."[268] In fact, since MY 1999, actual upland cotton marketing loan payments have been, on average, 3.8 cents larger that the difference between the average AWP and loan rate.[269] Therefore, marketing loan subsidies in MY 2006 are likely to be significantly larger than $836 million.

D. EXPORT CREDIT GUARANTEES

1. Outstanding export credit guarantees

Questions to the United States

90. *The United States states, in para. 50 of its Opening Statement, that:*

> ... nothing in the *SCM Agreement* provides that "withdrawing" a "subsidy" allegedly "taking the form of a program" "includes an obligation to abstain from performing on commitments outstanding under that program as of the deadline for implementation." That argument improperly equates "performing on commitments under the program" with the "subsidy" itself. Such an equation was appropriate in *Brazil – Aircraft (21.5),* where Brazil continued to issue new WTO-inconsistent bonds even after the period of implementation on the basis that it had pre-existing contractual obligations

[261] Exhibit Bra-460 (Explanatory Notes for Stochastic Budget Outlay Estimates, Farm Service Agency, accessed October 2006 at http://www.fsa.usda.gov/Internet/FSA_File/msrexplain.doc).

[262] Exhibit Bra-460 (Explanatory Notes for Stochastic Budget Outlay Estimates, Farm Service Agency, accessed October 2006 at http://www.fsa.usda.gov/Internet/FSA_File/msrexplain.doc).

[263] For the week of 23 March 2007, *see* http://www.fsa.usda.gov/Internet/FSA_File/cotton_rates.htm.

[264] Exhibit Bra-673 (Upland Cotton Prices, March 2007).

[265] USDA's estimate of U.S. production in MY 2007 has been revised upward to 20.973 million bales, the third largest amount in history. 20.973 million bales * 480 pounds per bale * 0.08 dollars per pound = $836 million.

[266] Brazil's First Written Submission, Table 6 at para. 111.

[267] *See* Brazil's First Written Submission, paras. 65-67. *See also* Exhibit Bra-681 (Upland Cotton Direct and counter-cyclical Payment Program and Marketing Assistance Loans, Farm Service Agency Fact Sheet, March 2006, accessed March 2007 at http://www.fsa.usda.gov/FSA/printapp?fileName=pf_20060301_insup_en_cottdcp06.html&newsType=prfactsheet).

[268] Exhibit Bra-682 (Risk Management, 2007 Farm Bill Theme Paper, May 2006, p. 2, accessed March 2007 at http://www.usda.gov/documents/Farmbill07riskmgmtsum1.doc).

[269] Exhibit Bra-683 (Marketing Loan Subsidies and Average AWP).

to do so. However, it is not accurate here, where the guarantees are not themselves prohibited subsidies.

Would the United States please clarify what it meant in the underlined sentence?

91. In paragraph 342 of its First Written Submission, Brazil indicates that the total amount of guarantees under the GSM 102, GSM 103 and SCGP programs outstanding on 1 July 2005 amounted to $8.5 billion.

(a) Does the United States agree with the figure provided by Brazil?

(b) Please indicate what proportion of that amount concerns exports of unscheduled products? (please distinguish between principal and interests)

(c) Please indicate what proportion of that amount concerns exports of scheduled products, and in particular rice (please distinguish, in each case, between principal and interest).

Questions to Brazil

92. Is it of any relevance to the Panel's assessment of Brazil's claims concerning "outstanding" export credit guarantees that what was at issue in Brazil – Aircraft (21.5) was the issuance, after the implementation date, of new bonds, and that bonds which had been issued prior to the implementation date could be redeemed for a number of years thereafter (see para. 46 of the US' Opening Statement at the panel meeting).

198. In *Brazil – Aircraft (21.5)*, Canada did not claim that Brazil was precluded from making future payments with respect to PROEX bonds issued prior to the implementation date. Rather, Canada claimed that the obligation in Article 4.7 of the *SCM Agreement* prevented Brazil from issuing new PROEX bonds after the end of the implementation period pursuant to letters of commitment concluded prior to that date. Both the panel and the Appellate Body ruled that Brazil could not issue new bonds after the implementation date because this amounted to the continued grant of prohibited subsidies, contrary to Articles 3.1(a), 3.2 and 4.7 of the *Agreement*. The parallel in this dispute, with respect to ECGs outstanding on 1 July 2005, is at a more abstract level – the obligation to abstain from performing on commitments outstanding under a program as of the deadline for implementation.

199. This obligation flows from the text of the *SCM Agreement*. Under Article 3.2 of the *SCM Agreement*, "[a] Member shall neither grant nor maintain" prohibited subsidies. The obligation in Article 4.7 of the *Agreement* to withdraw a subsidy, therefore, extends to both the "grant" of new subsidies and the "maintenance" of existing subsidies. As the Appellate Body held in *U.S. – FSC (21.5 II)*, the obligation to "fully" withdraw a prohibited subsidy is not achieved if the Member "*leaves* the entirety or part of the original prohibited subsidy *in place*".[270]

200. In this dispute, the United States has "le[ft] the entirety" of the outstanding prohibited ECGs "in place" after the implementation date. On the United States' view, it is entitled to "maintain" the prohibited ECGs throughout the life of the loan that is guaranteed. Thus, following the end of the implementation period, and at any time during the remaining life of the loan, the United States could make payments pursuant to a prohibited subsidy. By continuing to perform on its commitments under the prohibited subsidies, the United States "maintains" them unchanged. The United States has, therefore, failed to comply fully with its obligation under Article 4.7 to withdraw these subsidies.

[270] Appellate Body Report, *U.S. – FSC (21.5 II)*, para. 84.

201. Brazil reiterates that its claim is entirely prospective in nature. In essence, Article 4.7 prevents the United States from taking any *prospective action*, *after* the implementation date, to perform on its commitments under prohibited subsidies that it maintains unchanged.

93. The Panel notes that Exhibit Bra-516 indicates outstanding amounts for GSM 5 as of 30 June 2006 rather than as of 30 June 2005 as indicated in footnote 523 of Brazil's First Written Submission. Please explain.

202. Instead of Exhibit Bra-516, the correct exhibit, which includes data as of 30 June 200**5**, is Exhibit Bra-586. Brazil apologizes for this inadvertent error, which has no material impact on Brazil's claim. As corrected, footnote 523 of Brazil's First Written Submission should read as follows:

> [523] The exact amount, including interest arrears of USD 50.7 million, is USD 8,543,477,674. *See* Exhibit Bra-515 (Total Exposure under P.L. 480 Title 1 & GSM Programs as of June 30, 2005). Brazil notes, however, that this figure includes USD 41.58~~65~~ million of ECGs under a program titled "GSM 5". Brazil notes that if outstanding GSM 5 ECGs (including interest arrears) are excluded, the exact amount of GSM 102, GSM 103 and SCGP ECGs outstanding on 30 June 2005 was USD 8,501,899,803~~28,537~~. *See* Exhibit Bra-586~~516~~ (Commodity Credit Corporation Guarantee Loan Program Summary for FAS as of June 30, 2005).

2. Legal Bases for Brazil's export subsidies claims

Question to the United States

94. The United States has noted that the original Panel's findings (that the export credit guarantees at issue constituted prohibited export subsidies) were based on item (j). The United States has also asserted that it has based itself on item (j) in implementing the DSB recommendations with respect to export credit guarantees. Please clarify whether the Panel should understand the United States' argument in this respect as an argument concerning the scope of the present proceeding.

3. "Benefit" under Articles 1.1 and 3.1(a) of the *SCM* Agreement

Questions to both parties

95. Brazil has taken the position that "different parties to a transaction involving a GSM 102 ECG derive different benefits from the GSM 102 ECG, each of which is potentially subject to assessment under Article 1.1(b) of the SCM Agreement" and has indicated that it is, in this proceeding, "primarily concerned" with the benefit received by the US exporter in the form of below-market fees (para. 404, Brazil's Rebuttal). The United States has challenged Brazil's approach of focusing on fees to the exclusion of other elements of the total cost of the loan. Please explain, referring to the provisions of the SCM Agreement and WTO jurisprudence (if any applicable), your position as to whether: (1) export credit guarantees and other types of subsidies may involve more than one type of benefit and/or recipient; (2) whether it is up to the complaining Member to decide which benefit it chooses to challenge.

203. In this question, the compliance Panel asks whether (i) ECGs and other types of subsidies may involve more than one type of benefit and/or recipient; and, (ii) if so, whether the complainant can choose which benefit/recipient to challenge. The background to this question appears to be the United States' argument that it is not sufficient for Brazil to prove that a benefit is conferred on the U.S. exporter through the provision of a loan guarantee on better-than-market terms. Instead, it

argues that Brazil must prove that this guarantee also resulted in a benefit to a foreign bank by lowering the "total costs of funds" involved in the transaction.[271]

204. Under Article 1.1, a "subsidy" exists when a "financial contribution" confers "a benefit". The word "a" indicates that it is sufficient that any form of benefit is conferred. Further, in terms of the wording of the "benefit" requirement in Article 1.1(b), it suffices that "a benefit" is conferred on *any* entity in connection with goods produced by the granting Member.[272] Thus, a subsidy is proved to exist if a government provides goods or services to a producer or exporter on better-than-market terms. It is not necessary for the complainant to prove that a government's financial contribution also confers "a benefit" on other entities, including foreign entities. Nor is it necessary to prove that the cumulative impact of the financial contribution is to confer a benefit on *all* entities affected by the contribution.

205. Although it suffices to prove that "a benefit" is conferred on one entity, Article 1.1 does not require that "a benefit" be conferred *exclusively* on one entity. Instead, the language of sub-paragraph (b) is sufficiently open-ended to accommodate the possibility that a financial contribution confers a benefit on several entities.

206. There are many situations in which a financial contribution confers a benefit on more than one entity. A financial contribution may reduce a company's costs of producing and selling goods, for example, costs of research, inputs, production, marketing, or transport. The benefit conferred by such financial contributions may be passed through, in whole or in part, to downstream producers and consumers through lowered prices. This is specifically recognized in the rules governing the price effects of subsidies in Article 6 of the *SCM Agreement*.

207. There are several examples in the case-law of a single financial contribution that benefits more than one recipient. In *Brazil – Aircraft (21.5 II)*, Brazil was found to provide subsidies to *purchasers* of Brazilian civil aircraft in the form of interest rate buy-downs that lowered the financing costs on the export of Brazilian products. The purchaser was found to benefit from reduced interest charges. Additionally, the financial contribution benefited the Brazilian *producer* of civil aircraft, which was able to export its products with improved financing. Further, a benefit accrued to the *lenders* that provided the financing in question.[273]

208. In that dispute, the compliance panel considered that the crucial enquiry was whether the Brazilian *producer* of the goods benefited from the financial contribution.[274] The evidence showed that the *lender* received the payments under the bonds. Lenders might, as a result, offer improved financing terms to purchasers which, in turn, might benefit the Brazilian producer. However, there was no evidence that lenders, in fact, offered improved credit terms to purchasers and, thus, no evidence that the bonds resulted in overall reduced finance costs for purchasers. Instead, the panel *assumed* that it was "*very unlikely* that lenders will not pass on at least part" of the financial contribution to purchasers through better credit terms.[275] Otherwise, it said, "borrowers could simply

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[271] U.S. First Written Submission, para. 138.

[272] Appellate Body Report, *Canada – Aircraft*, para. 154 ("Logically, a 'benefit' can be said to arise only if a person, natural or legal, or a group of persons, has in fact received something.") and Appellate Body Report, *U.S. – CVDs on Certain EC Products*, para. 108 (Characterizing paragraph 154 of its report in *Canada – Aircraft*, the Appellate Body stated that "when referring to 'a recipient' in *Canada – Aircraft*, we did not exclude the possibility that 'a recipient' could include both a firm and its owner. A 'group of persons' could include a group of 'natural persons', or a group of 'natural and legal persons', or a group exclusively of 'legal persons'.").

[273] *See generally* Panel Report, *Brazil – Aircraft (21.5 II)*, paras. 5.27-5.29.

[274] Panel Report, *Brazil – Aircraft (21.5 II)*, para. 5.27.

[275] Panel Report, *Brazil – Aircraft (21.5 II)*, footnote 44.

choose other lenders".[276] The panel also *assumed* that there was a *prima facie* case that *producers* benefited from the payments if purchasers of the aircraft benefited.[277]

209. In *U.S. – Softwood Lumber IV*, Canada provided standing timber to *timber harvesters*. In a countervailing duty investigation, the United States found that all of this subsidy was provided to processed lumber products, even though some of the *lumber processors* were *not* harvesters of standing lumber. Both the panel and the Appellate Body held that the United States acted inconsistently with the *SCM Agreement* by failing to establish whether, in fact, the lumber processors benefited from the financial contribution given to the harvesters.[278] Further, the entire premise of the U.S. investigation was that the benefit could pass-through to yet another recipient, the U.S. consumer of Canadian lumber products, through lower lumber prices.

210. In *U.S. – CVDs on Certain EC Products,* the panel and Appellate Body held that, in a privatization transaction, the benefit under Article 1.1(b) from a subsidy provided to a state-owned company may pass through to the privatized company, if the price paid for the company is below fair market value or the transaction is not at arm's length.[279] In that event, a benefit would also be bestowed on the shareholders of the privatized company, which paid less for the company's equity than its fair market value.

211. In each of these situations, the *SCM Agreement* contemplates that a single financial contribution could provide different types of "benefit" to multiple recipients. However, in order to demonstrate the existence of a subsidy, it suffices to show that the initial recipient received a "benefit". Moreover, where that party receives a "benefit", it is not necessary to examine whether the "benefit" is subsequently passed through or extinguished as a result of other transactions. Nor is it necessary to assess the cumulative impact of the financial contribution on all entities affected by it.

212. Indeed, even if the entire "benefit" passes through from an initial recipient to other recipients, a subsidy is still granted to the initial recipient. For example, in *U.S. – Softwood Lumber IV*, even if the entire benefit had passed from the harvesters to the lumber producers, a complainant can still prove that "a benefit" was conferred on harvesters under Article 1.1(b) of the *SCM Agreement*. If the initial grant of that subsidy had been contingent upon export performance, the subsidy would be prohibited, regardless of whether the benefit subsequently passed through to other recipients.

213. In this dispute, the situation is similar. As the CCC has itself recognized, the provision of cheap ECGs through the GSM 102 program provides benefits to several different commercial parties. USDA's Foreign Agricultural Service ("FAS") notes that "[p]rogram benefits are shared between U.S. exporters and bankers and foreign importers and bankers. To work effectively, all parties must derive some benefit or they will not use the program."[280] Moreover, in a publication regarding GSM ECGs, under the title "Benefits to Participants," FAS notes that "[u]nder the GSM credit guarantee programs all participants can benefit. … The GSM export credit guarantee programs are designed for everyone to benefit."[281]

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[276] Panel Report, *Brazil – Aircraft (21.5 II)*, footnote 44.

[277] Panel Report, *Brazil – Aircraft (21.5 II)*, footnote 42.

[278] Appellate Body Report, *U.S. – Softwood Lumber IV*, paras. 146-147 and Panel Report, *U.S. – Softwood Lumber IV*, paras. 7.91 and 7.93-7.99.

[279] *See generally* Appellate Body Report, *U.S. – CVDs on Certain EC Products* and Panel Report, *U.S. – CVDs on Certain EC Products*.

[280] Exhibit Bra-588 (Agricultural Export Credit Guarantee Programs Assessment, ExpectMore.gov, Section 1.5, accessed January 2007 at http://www.whitehouse.gov/OMB/expectmore/detail.10002020.2005.html).

[281] Exhibit Bra-589 (FAS Online, *Keys to Successful Trade*, section regarding "Benefits to Participants," accessed January 2007 at http://www.fas.usda.gov/excredits/videotxt.html).

214. Most importantly, as the United States has acknowledged in these proceedings, the CCC provides a service to the U.S. producer/exporter through the provision of an ECG in a situation where no commercial operator is willing to provide the same service.[282] This shows the existence of a *per se* "benefit" in that transaction between the U.S. government and the producer/exporter. Further, the price of the ECG is below the price charged by the United States' own Export-Import Bank for comparable products.[283] This confirms the existence of a benefit in the initial transaction. As a result, by providing a financial contribution to U.S. producers/exporters on better-than-market terms, the United States grants a subsidy to these producers/exporters. That subsidy is prohibited because it is contingent upon export performance.

215. As noted above, in *Brazil – Aircraft (21.5 II)*, the compliance panel considered that the crucial issue was whether the Brazilian *producer* received a benefit. The existence of a benefit to other parties was considered unimportant. In this dispute, Brazil has proved that the U.S. producer/exporter receives a benefit from the provision of a financial service on better-than-market terms. That suffices to demonstrate the existence of a subsidy.

216. In addition to the U.S. producer/exporter receiving a benefit, the U.S. government explains that, in the usual course of events, the grant of a GSM 102 ECG to the exporter bestows benefits on other parties that are engaged in separate transactions involving the exported U.S. goods:

- FAS states that the U.S. bank is able to provide a loan to a foreign bank on profitable terms with virtually no risk because the loan is backed by the U.S. Government.[284]

- FAS also notes that the foreign bank secures funds from the U.S. bank on, at the very least, better credit terms than would otherwise be available because the loan is backed by the U.S. Government.[285] Finally, FAS states that the importer obtains credit[286], on terms better than could otherwise be secured[287]; the largest participant in the GSM program characterizes the "benefit" to an importer as "better financing terms!!!"[288]

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[282] U.S. 9 March Comments on Brazil's Oral Statement, para. 29 ("[E]xport credit guarantees and other similar loan guarantees are now and have always been instruments provided predominantly – if not exclusively – by governments and international financial institutions, as opposed to purely private banking institutions.").

[283] Brazil's First Written Submission, paras. 381-406. *See also Id*., Annexes III (Statement of Professor Rangarajan Sundaram) and IV (Methodology for Comparison of GSM 102 Fees with Fees for ExIm Bank Products), and Exhibits Bra-536 and Bra-537.

[284] Exhibit Bra-589 (FAS Online, *Keys to Successful Trade*, section regarding "Benefits to Participants," accessed January 2007 at http://www.fas.usda.gov/excredits/videotxt.html). ("The U.S. bank's risk of loss is reduced, and the banks profit from letter of credit and loan servicing fees.").

[285] Exhibit Bra-588 (Agricultural Export Credit Guarantee Programs Assessment, ExpectMore.gov, Section 1.1, accessed January 2007 at http://www.whitehouse.gov/OMB/expectmore/detail.10002020.2005.html). (GSM ECGs "make commercial credit available *at a reduced cost* to higher risk markets.") (emphasis added). *See also* Exhibit Bra-589 (FAS Online, *Keys to Successful Trade*, section regarding "Benefits to Participants," accessed January 2007 at http://www.fas.usda.gov/excredits/videotxt.html) ("The importer's bank benefits from the competitive cost of capital on its dollar borrowing, by being able to provide a service to its customers, and from earning fees on letters of credit and other services."). In fact, the GSM 102 regulations provide that the benefit is even more dramatic, since the program "operate[s] in cases where credit is necessary to increase or maintain U.S. exports to a foreign market and where U.S. financial institutions would be unwilling to provide financing without CCC's guarantee." Exhibit Bra-519 (7 C.F.R. § 1493.10(a)(2), GPO Access Online, January 2006, accessed July 2006 at http://www.gpoaccess.gov/cfr/index.html).

[286] Exhibit Bra-589 (FAS Online, *Keys to Successful Trade*, section regarding "Benefits to Participants," accessed January 2007 at http://www.fas.usda.gov/excredits/videotxt.html) ("The importer benefits by obtaining U.S. agricultural products, most likely with *deferred payment*.") (emphasis added).

[287] Exhibit Bra-588 (Agricultural Export Credit Guarantee Programs Assessment, ExpectMore.gov, Section 1.1, accessed January 2007 at

217. In *Brazil – Aircraft (21.5 II)*, the panel found that it was "very unlikely" that payments to the lender did not also benefit the purchaser because, otherwise, the purchaser would simply go to a different lender. In this dispute also, the foreign obligors have a choice of CCC-approved U.S. banks[289], and can, therefore, ensure that the guarantee results in lower finance costs that would be available commercially. Indeed, USDA's FAS states that the ECG programs "make commercial credit available at a reduced cost to higher risk markets[290], clarifying the U.S. government's view that the U.S. bank passes along to the foreign obligor at least a portion of the reduced cost of borrowing enabled by the GSM 102 ECG. FAS separately confirms that benefits of a CCC ECG are indeed passed along from the U.S. bank to the foreign bank, as well as from the foreign bank to the importer.[291]

218. From the perspective of the U.S. government, the specific terms and conditions attaching to the other transactions are of no importance at all, provided only that they occur. In other words, the U.S. government neither verifies nor controls the financing costs of the loan transactions that it guarantees. In *Brazil – Aircraft (21.5 II)*, the panel attached importance to the fact that the granting Member, Brazil, did not place any "limitation" on the terms of the underlying financing between the lender and purchaser to prevent the PROEX payments from conferring a benefit.[292] Similarly, far from limiting the financing terms of the other transactions, the United States is wholly ignorant of the details surrounding them. Its exclusive interest is to provide the U.S. producer/exporter with a service that facilitates the exportation of U.S. agricultural products, and it provides that service on terms that are highly preferential, if not unique.

219. From the perspective of the U.S. producer/exporter, the specific terms and conditions of the other transactions are also irrelevant. Its sole interest is to ensure that the importer buys its U.S. products. To that end, it purchases a guarantee from the U.S. government that enables the importer to obtain funding to purchase U.S. goods. The U.S. producer/exporter is not involved in the negotiation of the separate transactions between the importer and the foreign bank, and between the foreign bank

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http://www.whitehouse.gov/OMB/expectmore/detail.10002020.2005.html). (GSM ECGs "make commercial credit available *at a reduced cost* to higher risk markets.") (emphasis added).

[288] Exhibit Bra-684 (CoBank presentation, p. 7, accessed March 2007 at http://www.cottoninc.com/2005EFSConferencePresentationsSingapore/FinancingUSACottonImportsUnderGSM/). The deal flow chart on page 11 of this presentation confirms that the reference on page 7 to "your company" is a reference to the importer. Brazil notes that CoBank's views on this matter are well-informed, as it enjoys "60% market share of GSM loans globally". *See Id*., p. 2.

[289] *See* Exhibit Bra-525 ("U.S. Financial Institutions Approved To Be Assignees Under CCC's Export Programs," USDA FAS Online, accessed October 2006 at http://www.fas.usda.gov/excredits/USbanks.html).

[290] Exhibit Bra-588 (Agricultural Export Credit Guarantee Programs Assessment, ExpectMore.gov, Section 1.2, accessed January 2007 at http://www.whitehouse.gov/OMB/expectmore/detail.10002020.2005.html) (emphasis added). *See also* Exhibit Bra-685 (USDA FAS publication, "Will you get paid for the sale you just made", p. 4, accessed March 2007 at http://www.fas.usda.gov/excredits/LOANS.PDF) (Characterizes a benefit from the ECG programs as the ability of foreign banks to "share the benefits of longer terms and lower rates" with importers; if the foreign bank itself did not get lower rates from the U.S. bank, it would have nothing to "share" with the importer).

[291] *See* Exhibit Bra-685 (USDA FAS publication, "Will you get paid for the sale you just made", p. 4, accessed March 2007 at http://www.fas.usda.gov/excredits/LOANS.PDF) (Characterizes a benefit from the ECG programs as the ability of foreign banks to "share the benefits of longer terms and lower rates" with importers; if the foreign bank itself did not get lower rates from the U.S. bank, it would have nothing to "share" with the importer.). Importers also have choices when considering which foreign bank to use. *See* Exhibit Bra-526 (GSM Program Foreign Bank Obligors, USDA FAS Online, accessed September 2006 at http://www.fas.usda.gov/excredits/foreignbanks.html).

[292] Panel Report, *Brazil – Aircraft (21.5 II)*, para. 5.32 ("PROEX III payments may, *in the absence of some limitation placed by Brazil on the degree of concessionality of export credits supported by interest rate equalization*, be expected to allow purchasers … to obtain export credits on terms more favourable than those available to them in the commercial market.") (emphasis in original).

and the U.S. lending bank. Its interests are not affected, in the least, by the foreign obligors' costs of funds.

220. In this dispute, Brazil has focused on the initial transaction between the U.S. government and the U.S. producer/exporter regarding the purchase of financial services to facilitate exportation of U.S. agricultural products. To the extent that the U.S. producer/exporter receives a financial contribution from the U.S. Government on better-than-market terms, the United States confers a benefit on that producer/exporter under Article 1.1(b), regardless of whether that transaction also confers a benefit on third parties in separate transactions that are facilitated by the first transaction.

221. Brazil's focus on the terms and conditions of the initial transaction between the U.S. government and the U.S. producer/exporter is fully consistent with the requirement in Article 1.1(b) to prove that "a benefit" is conferred. It is not necessary for Brazil to prove, in addition, that the U.S. government also conferred a consequential benefit on a foreign borrower through reduced finance costs.

96. The parties differ as to whether different types of loans can be compared as long as they have the same "average life." What support (economic literature, etc.) exists for your position on this issue?

222. In his statement at the Panel meeting, Professor Sundaram offered a simplified example to illustrate the lack of comparability, in terms of credit risk, between the bullet loan in the single valid data point offered by the United States, and credit extended under GSM 102.[293] The U.S. assertion of comparability hinges on the bullet loan's "average life" being sufficient to capture its riskiness. Professor Sundaram's example demonstrates that the U.S. "average life" argument is incorrect.

223. In sum, Professor Sundaram demonstrated that two loans do not become equivalent in their credit-riskiness simply because they have the same average lives; patterns of default must be taken into account. The compliance Panel will recall that the U.S. example involves a two-year bullet loan, while a GSM 102 loan is a three-year amortizing loan. One reason differing risks of default must be taken into account is that at any point in time, the principal exposures between the two-year bullet loan and the three-year amortizing loan can be different. The amortizing loan will have a lower principal exposure than the bullet loan between years one and two, and a higher principal exposure between years two and three. The United States would have the Panel believe that if one "averages" out the lives of these two loans, the higher and lower exposures will offset one another. As Professor Sundaram explained, this is not necessarily so, because the likelihood of default in the two periods (between years one and two, on the one hand, and between years two and three, on the other) may be different. For example, while a company may be solvent and pose relatively low risk of default in the short term, its long-term prospects might be uncertain, and thus its risk of default enhanced.

224. The compliance Panel asks for support for this explanation – more specifically, support for the conclusion that two-year bullet loans and three-year non-amortizing loans are not equivalent, and that averaging out the lives of the two loans does not make them so, in light of the varying risks of default. As the compliance Panel can appreciate, the finance and economics literature does not generally contain references to negatives; that is, it does not state and prove "non-theorems". Thus, while there are a number of instruments to which spreads on bullet loans are not equivalent – amortizing loans with "average lives" being one of them – the literature generally focuses instead on theorems addressing instruments to which spreads on bullet loans are equivalent.

225. To respond to the Panel's question, therefore, Professor Sundaram prepared an expert statement attached as Exhibit Bra-686 to these responses. Professor Sundaram's statement first

[293] Brazil's Oral Statement, paras. 212-214 and 219-222.

explains graphically why at any point in time, the principal exposures between the two-year bullet loan and the three-year amortizing loan can be different, which in turn illustrates why the two loans pose potentially differing risks of default. With references to the finance and economics literature on pricing, Professor Sundaram then employs the fundamental valuation principle of "risk-neutral valuation" to derive exact equations connecting spreads on bullet and amortizing bonds, demonstrating that the two are not equivalent.

Questions to the United States

97. Assuming that the Panel accepts the United States' argument that "benefit" is to be assessed on the basis of the "total costs of funds", what do you consider Brazil must establish in order to meet its burden of proof in that respect? Must Brazil prove that a benefit is conferred in all instances (all transactions and all recipients)? In most instances?

98. Does the United States dispute the accuracy of Brazil's comparison of GSM 102 fees with Exim Bank fees? Does the United States agree that ExIm Bank and GSM 102 guarantees are (at least in certain circumstances) similar or comparable?

99. Please comment on Brazil's argument that the GSM 102 fees are not sufficiently scaled to take into account country risk (i.e. they vary only minimally according with country risk) (see, inter alia, paras. 410-412 Brazil's First Written Submission).

Questions to Brazil

100. Assuming the Panel were to agree with the United States that the proper benchmark to determine "benefit" is the "total cost of funds" of the transactions, what elements of evidence has Brazil provided the Panel in this respect (other than evidence from the Regulations that the programme targets situations where no credit would be available on the market)? In answering, please address the United States' argument at para. 133 of its First Written Submission that "Brazil has made no attempt to provide such specific information on individual loan costs and fees or to identify comparable commercial loans and their terms".

226. The United States asserts that to implement its rigid "total cost of funds" approach to Article 14(c)[294], Brazil would need to provide data regarding "individual loan costs and fees" and "to identify comparable commercial loans and their terms".[295] Brazil is not in the position of an investigating authority in a countervailing duty proceeding, with the powers provided by Part V of the *SCM Agreement* to secure, through questionnaires and verification visits, this type of data. The United States itself does not know the rates at which lending is secured with and without GSM 102 ECGs, as it noted in the original proceedings[296], and as evidenced in these proceedings by its need to invoke second- or third-hand knowledge of alleged lending from third parties.[297] (This alone illustrates the severable nature of the transaction between the CCC and the U.S. exporter – the only terms of which the U.S. government is aware are those associated with the purchase of the GSM 102 ECG.)

[294] U.S. First Written Submission, para. 138.

[295] U.S. Rebuttal Submission, para. 137.

[296] *See, e.g*., Panel Report, *U.S. – Upland Cotton*, Annex I-8 (U.S. 22 December 2003 Answers to Panel Questions, para. 109 ("CCC has no role in the arrangements between the foreign bank issuing the letter of credit and the importer, which is typically the account party under the letter of credit.")).

[297] *See* U.S. [[ ]] examples at paragraphs 119-130 of the United States' First Written Submission. [[ ]] interest in cooperating with the United States in this dispute might be motivated by the fact that its lending business would be substantially impacted by the findings Brazil seeks. [[ ]]. Exhibit Bra-[[ ]] [[ ]].

227. Indeed, no complaining Member in a dispute under Part II of the *SCM Agreement* enjoys such authority or such unfettered access to data. This is likely one reason why Article 14 does not, as a matter of law, apply directly to a dispute under Part II of the *SCM Agreement*.[298] Even in countervailing measures disputes, the Appellate Body has limited the rigid application of the quantification "guidelines" in Article 14. In *U.S. – Softwood Lumber IV*, the Appellate Body relied on the term "guidelines" to inject flexibility into the provision.

228. In that dispute, the Appellate Body agreed with the United States "that the use of the term 'guidelines' in Article 14 suggests that paragraphs (a) through (d) should not be interpreted as 'rigid rules that purport to contemplate every conceivable factual circumstance'."[299] Thus, according to settled case-law, Article 14 does not prescribe hard and fast rules, even in countervailing measure disputes, to which the provision is explicitly applicable.

229. *Outside* the context of countervailing measure disputes, this flexibility is just as important to preserve. The original panel's analysis is telling in this regard. Although recognizing the need to appreciate the "general order of magnitude" of the subsidies at issue for the purposes of assessing their adverse effects in a dispute under Part III of the *SCM Agreement*[300], the original panel, citing the "unilateral" nature of countervailing duty investigations, forcefully *rejected* the United States' request that it transfer the "quantitative focus and more detailed methodological obligations of Part V into the provisions of Part III of the *SCM Agreement*."[301]

230. Preserving this flexibility is even more important in disputes under Part II of the *SCM Agreement* (unlike in a dispute under Part V, where a duty must be calculated), where the amount of benefit need not be determined with precision. Rather, a showing of *some* benefit suffices. In a dispute under Part II, only the existence of a "benefit" under Article 1.1(b) must be established, and not the quantity of that benefit. The original panel considered that imposing the "quantitative focus and more detailed methodological obligations of Part V" of the *SCM Agreement* on disputes preceding under Part III of the *Agreement* was not appropriate, even where assessing the "magnitude" of the subsidy was required.[302] For a dispute under Part II of the *Agreement*, where *no* assessment of the "magnitude" of the subsidy is required, there is no basis whatsoever to impose the "quantitative focus and more detailed methodological obligations of Part V …. "[303]

231. Moreover, the "factual circumstances"[304] in these proceedings under Part II of the *SCM Agreement* are such that a "particularized showing"[305], utilizing data concerning "individual loan costs and fees" or "comparable commercial loans and their terms"[306], is not necessary. Proof of some "benefit" can be established under Article 1.1(b) of the *SCM Agreement* in this dispute without the type of evidence on which the United States insists. In proceedings involving claims against government guarantees under Parts II and V of the *SCM Agreement*, panels have already ruled twice

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[298] Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 92. *See also* U.S. First Written Submission, para. 132 ("… Article 14(c) applies, by its terms, only 'for the purposes of Part V' of the *SCM Agreement* …"). For Brazil's views on the proper interpretation of Article 14(c) in a dispute under Part II of the *SCM Agreement*, *see* Brazil's Rebuttal Submission, paras. 400-413; Brazil's Oral Statement, paras. 193-208; Brazil's Closing Statement, paras. 28-29; Brazil's 6 March Answers to Questions, paras. 54-57 and Brazil's 16 March Comments on U.S. Answers, paras. 120-122.

[299] Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 92.

[300] Panel Report, *U.S. – Upland Cotton*, para. 1194.

[301] Panel Report, *U.S. – Upland Cotton*, para. 1177. *See also Id*., para. 1167.

[302] Panel Report, *U.S. – Upland Cotton*, para. 1177. *See also Id*., para. 1167.

[303] Panel Report, *U.S. – Upland Cotton*, para. 1177. *See also Id*., para. 1167.

[304] Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 92.

[305] U.S. 6 March Response to Question 41, para. 80.

[306] U.S. Rebuttal Submission, para. 137.

that evidence of the type insisted on by the United States is not necessary to show that a benefit exists.[307]

232. In this response, Brazil demonstrates that even if "the proper benchmark to determine 'benefit' is the 'total cost of funds' of the transactions", there is sufficient evidence of record, relevant to the "factual circumstances" [308] at hand or otherwise, sufficient to prove a "benefit" under Article 14(c) of the *SCM Agreement*.

a. Recipient of a GSM 102 ECG does not secure credit

233. Even assuming the relevance of the Article 14 guidelines to a dispute under Part II of the *Agreement*, it is not at all clear that Article 14(c) applies in the case of a GSM 102 ECG.

234. Article 14(c) presupposes that "the firm receiving the guarantee" is also "the firm that borrows funds and "pays on a loan". As the United States has reminded the Panel, however, a GSM 102 ECG is provided to and paid for by the U.S. exporter, and not "the firm" that seeks or secures credit.[309] The benefit to the U.S. exporter is severable, and measurable by the degree to which GSM 102 fees are below relevant benchmarks.[310] As a factual matter, therefore, Article 14(c) is not directly applicable to GSM 102. While rigidly following an Article 14(c) approach might be appropriate in some circumstances, doing so here would mask an important "benefit" to a U.S. exporter, risking that "the subsidy disciplines in the *SCM Agreement* … could be undermined or circumvented."[311]

b. GSM 102 foreign obligors could not otherwise secure credit

235. The panel in *EC – DRAMs* agreed that a government guarantee confers a "benefit" *per se* if without the guarantee, commercial lending would not have been available.[312] Brazil has demonstrated, using official, normative statements by the U.S. government concerning GSM 102, that the program enables financing that could not otherwise be secured at market. Specifically, the GSM 102 regulations state that GSM 102 operates "where U.S. financial institutions would be unwilling to provide financing without CCC's guarantee" and "where the guarantee is necessary to secure financing of the export."[313] USDA FAS' self-assessment of the program states that the program is for use where "obligors are too risky for the private sector, but are marginally creditworthy."[314] FAS' self-assessment goes on to characterize GSM 102 as targeting countries that are "not considered to be investment grade."[315]

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[307] Panel Report, *EC – CVDs on DRAMs*, para. 7.189; Panel Report, *Canada – Aircraft Credits and Guarantees*, para. 7.345.

[308] Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 92.

[309] U.S. Rebuttal Submission, para. 107.

[310] Brazil's Oral Statement, paras. 205-208; Brazil's Rebuttal Submission, paras. 402-413.

[311] Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 100.

[312] Panel Report, *EC – CVDs on DRAMs*, para. 7.190.

[313] Exhibit Bra-519 (7 C.F.R. § 1493.10(a)(2), GPO Access Online, January 2006, accessed July 2006 at http://www.gpoaccess.gov/cfr/index.html) (emphasis added).

[314] Exhibit Bra-588 (Agricultural Export Credit Guarantee Programs Assessment, ExpectMore.gov, Section 1.1, accessed January 2007 at http://www.whitehouse.gov/OMB/expectmore/detail.10002020.2005.html) (emphasis added).

[315] Exhibit Bra-588 (Agricultural Export Credit Guarantee Programs Assessment, ExpectMore.gov, Section 1.5, accessed January 2007 at http://www.whitehouse.gov/OMB/expectmore/detail.10002020.2005.html) (emphasis added). *See also Id.*, Section 2.1 ("The GSM-102/103 programs are primarily targeted to non-investment grade countries (ICRAS grades D-E).") (emphasis added). *See also* Exhibit Bra-685 (USDA FAS publication, "Will you get paid for the sale you just made," p. 4, accessed March 2007 at http://www.fas.usda.gov/excredits/LOANS.PDF) (Quoting a U.S. bank as saying that "[t]he GSM programs help us accommodate the financing of U.S. agricultural exports

236. In other words, GSM 102 ECGs are used where commercial lending would not otherwise be available on any terms. In these factual circumstances, as in *EC – DRAMs*, no quantitative assessment under the standard in Article 14(c) is required to show that a "benefit" is conferred on a foreign obligor. Where official, normative statements by the U.S. government demonstrate that GSM 102 ECGs secure credit for foreign obligors that would otherwise not be available, those ECGs, by definition, lower the "total cost of funds"[316] involved in the transaction.

237. Commentators have noted that, in such cases, the evidence demanded by the United States to implement its rigid "total cost of funds" approach to Article 14(c) is not obtainable:

> In some cases … it may be difficult to determine the rate of interest which would have been paid in the absence of the guarantee … especially in those instances in which the program in question is initiated to resolve a market failure, or in cases in which the program has supplanted a private sector market.[317]

Interest rates charged for U.S. dollar-denominated "comparable commercial loans", within the meaning of Article 14(c), are not "observable" for the simple reason that, according to the United States' own evaluation, such loans are not available. Outside the context of this litigation, the United States has repeatedly confirmed that without a GSM 102 ECG, target foreign obligors *could not secure commercial credit*.

c. The US acknowledges that GSM 102 ECGs reduce borrowing costs

238. Official, normative statements by the U.S. government outside the context of this litigation confirm that GSM 102 ECGs reduce foreign obligors' borrowing costs.

239. The compliance Panel will recall that from the perspective of the U.S. bank, a GSM 102 ECG means that a foreign obligor is essentially risk-free; the GSM 102 ECG means that the foreign obligor carries the same credit rating as the U.S. government. This enables the U.S. bank to offer the foreign obligor better credit terms than it would or could without the GSM 102 ECG, for the simple reason that a better credit rating enables a cheaper loan.

240. Official, normative statements by the U.S. government demonstrate that this is precisely what happens. USDA's FAS states that "[t]hese programs make commercial credit available at a reduced cost to higher risk markets."[318] In other words, the U.S. government considers that the U.S. bank passes along to the foreign obligor at least a portion of the reduced cost of borrowing enabled by the GSM 102 ECG. In other publications, FAS has confirmed that U.S. banks pass along benefits to foreign obligors.[319] The largest participant in the GSM program, CoBank, also characterizes the

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to emerging markets which, without the USDA guarantee, would be off limits for most banks and exporters.") (emphasis added).

[316] U.S. First Written Submission, para. 138.

[317] Towe, Christopher M. "Government Contingent Liabilities and the Measurement of Fiscal Impact", IMF Working Paper, 1990. This paper is available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=884863.

[318] Exhibit Bra-588 (Agricultural Export Credit Guarantee Programs Assessment, ExpectMore.gov, Section 1.2, accessed January 2007 at http://www.whitehouse.gov/OMB/expectmore/detail.10002020.2005.html) (emphasis added).

[319] *See* Exhibit Bra-685 (USDA FAS publication, "Will you get paid for the sale you just made", p. 4, accessed March 2007 at http://www.fas.usda.gov/excredits/LOANS.PDF) (Characterizes a benefit from the ECG programs as the ability of foreign banks to "share the benefits of longer terms and lower rates" with importers; if the foreign bank itself did not get lower rates from the U.S. bank, it would have nothing to "share" with the importer).

"benefit" to an importer as "better financing terms!!!"[320] If the U.S. bank fails to pass a portion of the "benefit", the list of CCC-approved U.S. banks is long[321], and the foreign obligor will go to another CCC-approved U.S. bank to secure the savings enabled by the GSM 102 ECG. (Even without the type of official, normative statements cited above, Brazil was subjected to a similar pass-through assumption in *Brazil – Aircraft (21.5 II)*.[322])

d. GSM 102 fees are below relevant benchmarks

241. In *Canada – Aircraft Credits and Guarantees*, a case under Part II of the *SCM Agreement*, the panel concluded that where government guarantee fees are not market-based, it is "safe to assume" that the government guarantee lowers the cost of commercial credit, or in the United States' terms, that the guarantee lowers the "total cost of funds" involved in a transaction.[323] The panel did not insist on a rigid application of Article 14(c) with evidence to prove that the total cost of funds was, in fact, reduced by cheap guarantees.

242. In these proceedings, Brazil has demonstrated, on a country-by-country, tenor-by-tenor basis, that GSM 102 fees are dramatically below fees for similar products offered by the U.S. ExIm Bank.[324] Unlike the comparison the United States asks the compliance Panel to require, the ExIm Bank exercise undertaken by Brazil identified financial instruments that approached as closely as possible the characteristics of GSM 102 ECGs, both in terms of the structure of the underlying loans and the effects of the coverage. The fees for these instruments could be calculated in a transparent manner, and the parameters for such calculation could be set so as to parallel exactly the characteristics of the GSM 102 ECGs. The Panel, the United States and any other observer can readily replicate Brazil's comparison, without the need to issue countervailing duty questionnaires or conduct verifications.

243. For a number of reasons, Brazil's ExIm Bank comparison is likely overly generous to the United States.[325] Nonetheless, it offers a useful reference point for the Panel in assessing the benefit to U.S. exporters from GSM 102 ECGs. For that reference point to be useful, the Panel need not, as the United States curiously asserts, "assume that Ex-Im Bank guarantees are provided at below-market rates."[326] For the purpose of these particular proceedings, the Panel can assume that the ExIm Bank products used in Brazil's comparison exercise are consistent with market.[327]

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[320] Exhibit Bra-684 (CoBank presentation, p. 7, accessed March 2007 at http://www.cottoninc.com/2005EFSConferencePresentationsSingapore/FinancingUSACottonImportsUnderGSM/). The deal flow chart on page 11 of this presentation confirms that the reference on page 7 to "your company" is a reference to the importer. Brazil notes that CoBank's views on this matter are well-informed, as it enjoys "60% market share of GSM loans globally". *See Id.*, p. 2.

[321] *See* Exhibit Bra-525 ("U.S. Financial Institutions Approved To Be Assignees Under CCC's Export Programs," USDA FAS Online, accessed October 2006 at http://www.fas.usda.gov/excredits/USbanks.html).

[322] *See* Panel Report, *Brazil – Aircraft (21.5 II)*, para. 5.31 (footnote 44) ("Neither party has suggested that lenders might not, in response to the offer of PROEX III support, offer improved terms of conditions for export credits offered to buyers of Brazilian regional aircraft. We consider that it is very unlikely that lenders will not pass on at least part of the PROEX III payments in the form of better credit terms. Otherwise, borrowers could simply choose other lenders.").

[323] Panel Report, *Canada – Aircraft Credits and Guarantees*, para. 7.345.

[324] Brazil's First Written Submission, paras. 381-406. *See also Id.*, Annex III (Statement of Professor Rangarajan Sundaram); Annex IV (Methodology for Comparison of GSM 102 Fees with Fees for ExIm Bank Products), and Exhibits Bra-536 and Bra-537.

[325] *See* Brazil's First Written Submission, paras. 382-385, 389, 391-392, Annex III (Statement of Professor Rangarajan Sundaram, paras. 17-24), Annex IV (Methodology for Comparison of GSM 102 Fees with Fees for ExIm Bank Products, paras. 6-8, 10-12).

[326] U.S. 16 March Comments on Brazil's Answer to Question 41, para. 145.

[327] *See* Brazil's Oral Statement, para. 183. With respect to paragraph 146 of the United States' 16 March comments on Brazil's Answer to Question 41, if the United States considered that in undertaking its ExIm Bank comparison exercise, Brazil had benchmarked to instruments "with the highest fees", the

244. The ExIm Bank fee comparison is sufficient to discharge Brazil's burden in a dispute under Part II of the *SCM Agreement*, under the interpretation of Article 14(c) set out by the Appellate Body in *U.S. – Softwood Lumber IV*[328], and the panels in *Canada – Aircraft Credits and Guarantees*[329] and *EC – DRAMs*.[330]

245. The conclusion by the panels in *Canada – Aircraft Credits and Guarantees* and *EC – DRAMs* that below-market guarantee fees translate into lower costs for commercial credit, and thus a lower total cost of funds, is rooted in basic financial economics. The U.S. position – that below-market GSM 102 fees might not translate into lower costs for commercial credit – runs counter to these basic principles of financial economics. To explain, Brazil reveals the absurdity of the U.S. position.

246. The Panel will recall that according to the United States, a complainant in a dispute challenging government guarantees must prove that the total cost of financing, including the premium and interest charges on a guaranteed loan, is less than the total cost of financing either (i) with a commercial guarantee or (ii) without any guarantee.

247. In the first of these two situations, the United States argues, in essence, that the interest that the lender charges on a loan guaranteed by the U.S. government could be higher than the interest it charges on a loan guaranteed by a commercial enterprise. Thus, for the United States' argument to be correct, a cheap U.S. government premium must be offset by higher loan charges, as exemplified in the table below:

	CCC Guarantee	Commercial Guarantee
Premium	5	15
Interest Charges	95	85
Total Cost	100	100

248. In this example, identically-situated borrowers obtain similar guarantees, one from the U.S. government, and the other from a commercial entity. With the backing of these guarantees, funds are borrowed from the same commercial bank on the same terms, except for interest charges. The U.S. government guarantee is markedly cheaper than its market counterpart. As a result, for the total cost of funds to be equal, the lending bank must charge *more* for a loan backed by the U.S. government than for a loan backed by a commercial entity.

249. This is an absurd argument because, irrespective of the credit rating of the commercial guarantor, a loan backed by the U.S. government will present a lower risk to the lending bank – the U.S. bank in the GSM 102 scenario. As a result, that bank will inevitably charge the foreign obligor a reduced cost of borrowing on a loan that presents a lower risk. As noted above, if the bank does not do so, the foreign obligor will simply go to another lender to secure the savings enabled by the government guarantee (at least in the case of GSM 102, where the list of CCC-approved U.S. banks is

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United States had many opportunities over the course of this dispute, subsequent to Brazil's First Written Submission, to propose comparable instruments with lower fees. Although the United States suggests otherwise, this situation is not unique to the current proceedings; a defending Member is always free to challenge the representativeness of a benchmarking instrument, if it is willing to take on the burden of doing so and does so within the timeframe required by a panel's working procedures.

[328] Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 92.

[329] Panel Report, *Canada – Aircraft Credits and Guarantees*, para. 7.345.

[330] Panel Report, *EC – CVDs on DRAMs*, para. 7.189 ("[i]f the government charges less than a market fee for its guarantee in light of the specific circumstances of the case, there would be a benefit to the recipient.").

long[331]). Thus, if the U.S. government guarantee is priced better-than-market, the total cost of financing for the guaranteed loan will almost certainly also be better-than-market.[332]

250. The existence of a benefit in the second situation indicated above, where there is no guarantee, can be illustrated by *assuming* that ExIm Bank guarantees *do not* confer benefits under Article 14(c) because they are priced at their "market" value and do not alter the total cost of funds – *i.e.*, ExIm Bank's fees precisely offset the interest savings resulting from ExIm Bank's guarantee.[333]

251. On that generous assumption, the financing costs in the "no guarantee" situation are the sum of the ExIm Bank premium and the interest charged by the lending bank on a loan guaranteed by ExIm Bank. Because CCC and ExIm Bank guarantees are both provided by the U.S. government, the risk to the lending bank of loans backed by each of these guarantees is identical, and the interest charges on the loans would also be identical.

252. Because GSM 102 fees are considerably lower than their ExIm Bank counterparts, and because the interest charges on loans backed by these two guarantees are the same, the total cost of funds in a CCC-guaranteed transaction must be lower than the total cost of funds in an ExIm Bank-guaranteed transaction. Assuming that ExIm Bank fees are equal to the Article 14(c) benchmark, the total cost of funds in a CCC-guaranteed transaction must also be lower than the cost of funds in a transaction without any guarantee, as illustrated by the table below:

	CCC Guarantee	ExIm Bank Guarantee	No Guarantee
Premium	5	15	0
Interest Charges	85	85	100
Total Cost	90	100	100

253. This explains why previous panels have regarded guarantee fees as an appropriate benchmark for determining the existence of a "benefit", without enquiring into the "total cost of funds". For these reasons, it is "safe to assume" that a government guarantee lowers the cost of commercial credit, or in the United States' terms, that the guarantee lowers the "total cost of funds" involved in a transaction[334], where Brazil has demonstrated that GSM 102 fees are below relevant benchmarks.

e. <u>GSM 102 repayment terms are below market</u>

254. Relevant jurisprudence provides that where government guarantee fees are not consistent with market, it is "safe to assume" that the government guarantee lowers the cost of commercial credit.[335] This principle can be extended to other elements of a government guarantee that are below-market, such as repayment terms.

[331] *See* Exhibit Bra-525 ("U.S. Financial Institutions Approved To Be Assignees Under CCC's Export Programs," USDA FAS Online, accessed October 2006 at http://www.fas.usda.gov/excredits/USbanks.html).

[332] *See* Panel Report, *Brazil – Aircraft (21.5 II)*, para. 5.31 (footnote 44) ("Neither party has suggested that lenders might not, in response to the offer of PROEX III support, offer improved terms of conditions for export credits offered to buyers of Brazilian regional aircraft. We consider that it is very unlikely that lenders will not pass on at least part of the PROEX III payments in the form of better credit terms. Otherwise, borrowers could simply choose other lenders.").

[333] With reference to paragraphs 145-146 of the United States' 16 March Comments on Brazil's Answers to Questions, Brazil notes that the results of its analysis do not change if one assumes that ExIm Bank guarantees are provided *at* market rates, and *not below* market rates. As explained in Brazil's First Written Submission, this assumption is likely to be too generous to the United States.

[334] Panel Report, *Canada – Aircraft Credits and Guarantees*, para. 7.345.

[335] Panel Report, *Canada – Aircraft Credits and Guarantees*, para. 7.345.

255. The benefit from a financial instrument must be assessed not only with reference to interest rates or fees, but also with reference to the repayment terms extended the borrower to service its debt. As Brazil noted in its First Written Submission, not even other U.S. government entities offer credit protection instruments for agricultural export transactions with tenors exceeding 180 days or, exceptionally, 360 days.[336] In contrast, GSM 102 ECGs are available for agricultural export transactions with repayment terms stretching out to three years.[337]

256. This difference involves a considerable benefit relative to the market. The Chairman of the Board of CoBank stated in Congressional testimony that GSM 102's three-year tenor "is critical to the program's success," and that the program "provides for tenors that are typically unavailable in the market and this is a crucial strength of the program."[338] In the absence of GSM 102, such long repayment terms would be unavailable, even if the U.S. exporter turned to ExIm Bank for similar protection (in which case, of course, the U.S. exporter would also have to pay considerably higher fees).

257. Added to the evidence concerning the inadequacy of GSM 102 fees, the below-market nature of GSM 102 repayment terms gives the Panel yet further grounds to conclude that it is "safe to assume"[339] that a GSM 102 lowers the cost of commercial credit, or in the United States' words, lowers the "total cost of funds" involved in a transaction.

f. GSM 102 fees are insufficient to cover long-term costs

258. Once again, as noted above, the jurisprudence holds that where government guarantee fees are not consistent with market, it is "safe to assume" that the government guarantee lowers the cost of commercial credit.[340] In these proceedings, making that assumption is particularly safe, since the record includes ample evidence demonstrating that GSM 102 fees are not even high enough to meet the program's costs over the long term.

259. For example, the record includes evidence that GSM 102 fees are below the minimum premium rates ("MPRs") provided in the Organization for Economic Co-operation and Development's ("OECD") Arrangement on Officially Supported Export Credits (the "Arrangement")[341], in which the United States is a Participant.[342] Citing item (j) of the Illustrative List of Export Subsidies, the OECD explains that the Arrangement's benchmark rates, including MPRs, are set "to ensure that Participants to the Arrangement charge premium rates in addition to interest charges that … are not inadequate to cover long-term operating costs and losses associated with the provision of export credits."[343] The

[336] Brazil's First Written Submission, paras. 391-392. *See* also Brazil's Rebuttal Submission, paras. 434-436.

[337] Brazil's First Written Submission, paras. 334 and 355.

[338] *See* Exhibit Bra-528, ("GSM Programs Benefit U.S. Agriculture and the Rural Economy." Testimony of Otis Molz, Chairman of the Board of CoBank, to the U.S. Senate Committee on Agriculture, Nutrition and Forestry, 18 July 2000 (emphasis added), accessed November 2006 at http://agriculture.senate.gov/Hearings/Hearings_2000/Untitled/00718mol.htm).

[339] Panel Report, *Canada – Aircraft Credits and Guarantees*, para. 7.345.

[340] Panel Report, *Canada – Aircraft Credits and Guarantees*, para. 7.345.

[341] Exhibit Bra-546 (OECD document TD/PG(2005)38/FINAL, 5 December 2005, Arrangement on Officially Supported Export Credits – 2005 Revision, accessed November 2006 at http://webdomino1.oecd.org/olis/2005doc.nsf/43bb6130e5e86e5fc12569fa005d004c/23013c0293535d25c12570cf003e35ed/$FILE/JT00195558.PDF).

[342] *See* Exhibits Bra-548 and Bra-549. *See also* Brazil's First Written Submission, paras. 438-440.

[343] Exhibit Bra-547 (OECD document TD/PG(2004)10/FINAL, 6 July 2004, para. 1, Premium and Related Conditions: Explanation of the Premium Rules of the Arrangement on Officially Supported Export Credits (the Knaepen Package), accessed November 2006 at http://webdomino1.oecd.org/olis/2004doc.nsf/43bb6130e5e86e5fc12569fa005d004c/a2c08162302d3415c1256ec9003919f1/$FILE/JT00167196.PDF).

Arrangement's MPRs are on average 106 percent greater than GSM 102 fees, meaning that GSM 102 fees are strikingly "inadequate to cover long-term operating costs and losses associated with the provision of export credits".

260. This fact is not only relevant to the assessment of GSM 102 under item (j). It is also relevant to whether GSM 102 ECGs confer benefits. The Panel will recall that the CCC borrows from, and is backed by the full faith and credit of, the United States Treasury.[344] As a result, it enjoys a cost of funds significantly lower than that borne by a market-based financial institution. Yet as the OECD MPR analysis demonstrates, GSM 102 fees are not even high enough for the CCC to turn a "profit" on the low cost of funds it enjoys as a U.S. government agency backed by the full faith and credit of the United States Treasury.[345]

261. To survive over the long term, a market-based entity would need to charge fees high enough to do more than simply break even – it would need to make a profit on costs higher than those faced by GSM 102, and the profit would have to offer a sufficient return to attract capital from investors. Proof that GSM 102 fees are too low to cover the U.S. government's already-low cost base over the long term is further proof that those fees are also below market.

262. Brazil has also offered other evidence regarding the failure of GSM 102 to meet its costs over the long term. In particular, Brazil notes CCC's forward-looking assessment of the amount by which costs and losses for the "cohorts" of GSM 102 ECGs newly issued in FY 2006, FY 2007 and FY 2008 will, over the long term, exceed fees, penalties and recoveries.[346] Using the same methodology, CCC's 2006 financial statements record its conclusion that when ECGs outstanding on 31 September 2006 are closed, the CCC expects to suffer a net loss of USD 220 million.[347] The original panel relied on the same evidence for an earlier period.[348]

g. <u>Conclusion</u>

263. In conclusion, Brazil respectfully submits that it would be contrary to the text of Article 14 of the *SCM Agreement*, as interpreted by the Appellate Body and two panels, as well as to the original panel's *rejection of* the United States' attempts to transfer the "quantitative focus and more detailed methodological obligations of Part V" to other Parts of the *SCM Agreement*[349], to "agree with the United States that the proper benchmark to determine 'benefit' is the 'total cost of funds' of the transactions,"[350] without taking account of the "factual circumstances"[351] at hand. Prior adopted panel and Appellate Body reports create "legitimate expectations" among WTO Members, and should be taken into account by panels when they are relevant to the resolution of a dispute.[352]

264. If the compliance Panel nonetheless adopts a "rigid" [353] interpretation of Article 14(c) embodying the "total cost of funds" approach advocated by the United States to arrive at a precise amount of "benefit" conferred, Brazil believes that, consistent with the Panel's duty to make an objective assessment of the matter and to assist the parties in achieving a positive solution to this dispute[354], the Panel should make factual findings regarding the various "factual circumstances"[355]

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[344] Panel Report, *U.S. – Upland Cotton*, para. 7.858.
[345] Panel Report, *U.S. – Upland Cotton*, paras. 7.857-7.858.
[346] Brazil's First Written Submission, paras. 433-437. *See also* Exhibit US-71.
[347] Exhibit Bra-585 (Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2005 and 2006, Report No. 06401-21-FM, November 2006).
[348] Panel Report, *U.S. – Upland Cotton*, paras. 7.842-7.843 and 7.855.
[349] Panel Report, *U.S. – Upland Cotton*, para. 1177. *See also Id*., para. 1167.
[350] Question 100 from the Panel.
[351] Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 92.
[352] Appellate Body Report, *U.S. – Softwood Lumber V*, para. 111.
[353] Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 92.
[354] *See* Articles 3.7 and 11 of the DSU.
[355] Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 92.

noted by Brazil in these proceedings and summarized above, including factual findings regarding Brazil's ExIm Bank comparison exercise. In case of an appeal, this would enable the Appellate Body to complete the analysis in the event that it reverses an erroneous interpretation of Article 14(c).

101. Brazil argues that "[w]here guarantees are reserved for circumstances in which credit would not otherwise be available, there is no "comparable commercial loan absent the government guarantee," within the meaning of Article 14(c) of the SCM Agreement." (Brazil First Written Submission, para. 375). The Panel understands this argument of Brazil to focus on the foreign obligor. Brazil elsewhere indicates that it is principally concerned, in this proceeding, with the benefit to the US exporter (fees). Are these two arguments at tension?

265. The arguments offered by Brazil and cited by the compliance Panel are not in tension. Brazil has satisfied the "export subsidy" element of its claim under Article 10.2 of the *Agreement on Agriculture* in a number of ways. As noted in Brazil's response to question 95 and as indicated in the Panel's question, however, Brazil's "principal[] concern[]" is with, and the bulk of its evidence on this element of its claim relates to, the benefit conferred by GSM 102 on a U.S. exporter. Nonetheless, as described in its response to question 100, Brazil has also offered evidence to demonstrate that a benefit is conferred on foreign obligors. These arguments speak to different benefits attendant to a GSM 102 ECG, and neither contradict or undermine one another. In this sense, they are not "in tension".

4. Item (j) of the Illustrative List

Questions to both parties

102. What, in your view, explains the different results achieved by the two methods advocated, on the one side, by the United States in paragraphs 87-89 of its First Written Submission and by Brazil in Exhibit Bra-613 (other than the United States' criticism that Brazil has not taken recoveries corresponding to pre-1992 guarantees into account in its "cash basis" accounting calculations, of which the Panel is already aware)?

266. Exhibit Bra-613 uses a retrospective, cash-basis accounting methodology. Although the starting point for the methodology used to arrive at the results in paragraphs 87-89 of the U.S. First Written Submission is a forward-looking projection of future results, discounted back to present value terms, application of re-estimates effectively converts the process to a retrospective, cash-basis accounting methodology.

267. The differing results are likely due to the fact that Exhibit Bra-613 tracks cash results over the entire ECG portfolio on a fiscal year basis (*i.e.*, cash results on all ECGs issued post-1991 are combined), while the data in paragraphs 87-89 of the U.S. First Written Submission reflect results broken down on a cohort-by-cohort basis.

268. In principle, application of re-estimates to initial estimates of long-term results on the cohort of ECGs actually issued in a given year should eventually converge on cash basis results. This will only be the case, however, if all cohorts subject to the analysis are closed. This is because the re-estimates, while intended to "'take into account all factors that may have affected the estimate of each component of the cash flows, including prepayments, defaults, delinquencies, and recoveries,' to the extent that those factors have changed since the initial estimate was made,"[356] are not definitive until a cohort is "closed". Only two of the cohorts included in the chart at paragraph 87 of the U.S. First Written Submission were, at the time of filing, closed (1994 and 1995). Data for the remaining 12 open cohorts do not reflect final cash results, and instead continue, particularly for more recent

[356] Panel Report, *U.S. – Upland Cotton*, para. 7.843.

cohorts, largely to reflect a forward-looking projection of future results, discounted back to present value terms.

269. As in the original proceedings, the United States argues to the compliance Panel that every cohort will eventually show a profit when final re-estimates are made, the cohort closed, and cohort-specific cash results effectively posted. This argument was rejected in the original proceedings. As in the original proceedings, not all of the cohorts (including some relatively "old" cohorts, such as 1997 and 1998) are currently showing a profit.[357] Indeed, six of the 14 cohorts tracked by the United States are not showing profits. As noted by the original panel, the evidence does not establish "that cohort reestimates over time, will necessarily not give rise to a net cost to the United States government."[358]

270. Moreover, militating against the U.S. position are CCC's 2006 financial statements, which are audited by the global accounting firm KPMG LLP. Employing the same net present value ("NPV") methodology used to generate the estimate and re-estimate data tracked in paragraph 87 of the U.S. First Written Submission, the financial statements record the CCC's conclusion that when ECGs outstanding on 31 September 2006 are closed, the CCC expects to suffer a net loss of USD 220 million.[359]

103. To what extent is evidence pertaining to guarantees issued under the three programmes (GSM 102, GSM 103 and SCGP) under the prior fee schedule relevant to the Panel's analysis of the revised GSM 102 programme under item (j)?

271. Brazil believes that evidence related to the past performance of the three CCC ECG programs is of limited relevance to an assessment of the adequacy of the amended GSM 102 fee schedule. In the present case, evidence about the structure and design of the GSM 102 program, and forward-looking or future-oriented assessments of the GSM 102 program's performance on its own, are particularly important.

272. In this regard, Brazil recalls CCC's prediction that the "cohorts" of GSM 102 ECGs issued in FY 2006 and FY 2007 (and thus under the amended GSM 102 fee schedule) will suffer losses over the long term. Specifically, using the net present value methodology required by the Federal Credit Reform Act ("FCRA"), CCC projects losses of USD 125 million and USD 114 million, respectively, for GSM 102 ECGs issued in FY 2006 and FY 2007 (before accounting for the costs of administering the program); these projected losses amounted to 5.05 percent of the value of GSM 102 ECGs to be issued in FY 2006, and 4.48 percent of the value of GSM 102 ECGs to be issued in FY 2007.[360]

273. This evidence is GSM 102 specific. The FCRA NPV calculation used to arrive at these projections of losses on ECGs actually issued in a given year is critical, whether or not re-estimates are made over time. U.S. law requires NPV projections because they "measure more accurately the costs of Federal credit programs" than does cash-basis accounting.[361]

274. Brazil has offered other evidence, using both NPV and cash-basis accounting methodologies, that are not restricted to GSM 102. Although data for GSM 103 and SCGP are included in these analyses, the contribution of these two programs is not likely to change the results; the Panel will

[357] *See* chart at paragraph 87 of the U.S. First Written Submission.

[358] Panel Report, *U.S. – Upland Cotton*, paras. 7.853 (and note 1028).

[359] Exhibit Bra-585 (Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2005 and 2006, Report No. 06401-21-FM, November 2006).

[360] Brazil's First Written Submission, paras. 433-437.

[361] Exhibit Bra-545 (2 U.S.C. § 661(1)).

recall that as of 1 July 2005, GSM 102 ECGs accounted for 93 percent of all outstanding CCC ECGs.[362]

275. Under the first such analysis, Brazil referred to the CCC's 2006 financial statements, audited by the global accounting firm KPMG LLP, which demonstrate that the CCC does not anticipate covering the costs and losses of the ECG programs across all outstanding cohorts of ECGs issued since the inception of FCRA accounting. In its audited 2006 financials, the CCC has concluded that when ECGs outstanding on 31 September 2006 are closed, the CCC expects to suffer a net loss of USD 220 million.[363] Brazil recalls that the original panel used the comparable figures from the CCC's earlier financial statements as support for its finding that the ECG programs met the terms of item (j).[364] In short, this is not a "profitable" program.

276. Under a second analysis, Brazil employed cash results of GSM 102, GSM 103 and SCGP to show that the programs are not breaking even. As shown in Exhibit Bra-613, Brazil replicated the approach relied upon by the original panel, updating the results of its cash basis accounting methodology to include data for FY 2003-2005. Over the period FY 1993-2005, this analysis demonstrates program receipts of USD 2.9 billion, against program disbursements of USD 3.6 billion, for a net loss of over USD 689 million. This shows that, in terms of historical performance, CCC's ECG programs did not break even over the long term.

277. In spite of its limited direct relevance, such data suggests that a revised schedule under which fees have increased 46 percent[365] but still remain below a statutorily-enforced one-percent cap is not likely to make the programs break even in the long term, much less turn them into the profitable enterprise alleged by the United States.

278. A simplified exercise demonstrates this conclusion. If the figures in the column "Premiums collected" in Exhibit Bra-613 are replaced with the same numbers *multiplied by 1.46* (to reflect the average fee increase of 46% effected by the U.S. measures taken to comply, as asserted by the United States), the result would still be a net loss of over USD 574 million. If the trade-weighted increase of 23% calculated by the United States[366] is used instead, the net loss would have been approximately USD 632 million.[367] These figures do not depart significantly from the losses incurred with the fees actually charged over the period covered in Exhibit Bra-613.

104. Must a risk-based fee necessarily take into account foreign obligor risk? Please discuss and provide any relevant support for your position. Can foreign obligor risk be treated differently than country risk in this respect, and if so, why?

279. As stated in paragraphs 496-498 of Brazil's Rebuttal Submission, as long as a foreign obligor receives a credit rating inferior to that of its sovereign, the GSM 102 fee for a transaction involving that foreign obligor should include a premium above and beyond that associated with country risk. Brazil notes that none of the CCC-approved foreign banks enjoys a credit rating superior to that of its

[362] *See* Brazil's Rebuttal Submission, paras. 14-15 and Brazil's First Written Submission, para. 339.

[363] Exhibit Bra-585 (Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2005 and 2006, Report No. 06401-21-FM, November 2006).

[364] Panel Report, *U.S. – Upland Cotton*, para. 7.855.

[365] U.S. First Written Submission, paras. 7 and 74.

[366] U.S. First Written Submission, paras. 7 and 74.

[367] Exhibit Bra-687 (Cash Basis Accounting Worksheet). In these calculations, the corrected figure of USD 21 million for premiums collected in FY 2005 is used. *See* U.S. Rebuttal Submission, para. 96, footnote 145.

sovereign.[368] As such, foreign obligor risk not only "[c]an … be treated differently than country risk," as noted in the Panel's question, but <u>must</u> be treated as <u>additional</u> to country risk.

280. Commercial banks could not afford to ignore these risks in setting the fee structure for their products. Brazil notes that even ExIm Bank – another arm of the U.S. government – takes the cost of this additional risk factor into account, as reflected in the "transaction risk increment" of its fee calculator.[369] In contrast, any additional risk associated with a below-sovereign rating for a particular foreign obligor does not translate into an additional GSM 102 fee increment. Accordingly, GSM 102 is not structured or designed to account fully for the risks involved in GSM 102-supported transactions or, ultimately, to meet the program's long-term costs and losses.

281. While the United States argues that it can fully account for the riskiness of individual foreign obligors by implementing GSM 102 exposure limits for each foreign obligor[370], it offers no evidence of the way in which it does so. What little it does offer is not encouraging. The United States refers to "**<u>the</u>** non-sovereign rating for [a foreign bank's] country".[371] This reference suggests that in setting exposure limits, the CCC does not account for differing ratings between individual non-sovereign foreign obligors in a country; rather, it applies a single rating ("**<u>the</u>** … rating") for all non-sovereign foreign obligors within that country.

282. In any event, controlling for borrower risk solely through exposure limits, and not also through fees, is not sufficient, even if exposure limits are implemented properly. Prudent fiscal management compels commercial banks to take varying borrower risk into account not only *via* exposure limits, but *also* through fees. In other words, managing risk requires a commercial bank to adopt both strategies; one is not a substitute for the other, as the United States suggests. Commercial lenders must control their exposure to concentrations of risk (in other words, they must diversify) using exposure limits, *and*, at the same time, they must accurately price all applicable risks with respect to the exposure that they do take on.[372] A principal shortcoming of the GSM 102 program is its failure to adjust its guarantee fees to take account of material risks; that failure is not cured by diversifying its portfolio of inaccurately-priced guarantees. CCC's failure to take account of individual foreign obligor risk in setting GSM 102 fees means that its fee schedule is not truly "risk-based," and is not designed to cover the long-term costs and losses of the program, regardless of its exposure-based diversification policies.

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[368] Brazil's First Written Submission, para. 416 and Exhibit Bra-540 (Standard and Poor's Credit Ratings).

[369] *See* <u>http://www.exim.gov/tools/fee_calc.cfm</u>. *See also* <u>http://www.exim.gov/tools/calchelp.cfm</u>, which includes an explanation of the "transaction risk increment" field, noting that transaction risk increment 0 is for "(1) sovereign risk transactions; and (2) any non-sovereign risk (public or private) transactions deemed to be no riskier than the sovereign in a specific country. Transaction risk increments 1 through 5 are for all other non-sovereign (public or private) risk transactions."

[370] U.S. First Written Submission, paras. 78-79.

[371] U.S. First Written Submission, para. 78 (note 120) (emphasis added).

[372] Exhibit Bra-615 (Paul Bennett, "Applying Portfolio Theory to Global Bank Lending," 8 *Journal of Banking and Finance* 153-169, 163-164 (1984)). In the context of modelling how each borrower's role in the portfolio's overall risk could be taken into account, Bennett observes that:

> Based on each credit's original risk rating, a certain standard markup over the cost of funds is specified. This standard markup is intended to compensate for the borrower's own default risk (and accordingly it rises in increasingly large steps as ratings decline). Contributions to portfolio risk should be reflected in *deviations* of actual pricing from these standard markups. For example, if a particular borrower adds a sizable amount of portfolio risk, then he should be charged more than just the standard markup.

105. What considerations must guide the Panel's decision to accept or refuse new evidence or arguments on issues that were addressed by the original Panel? Please discuss in light of the following:

a. The original Panel found that original subsidy estimates, while not reflecting "actual" figures, nevertheless provide a reliable measure of the United States government's own assessment of the profitability of the export credit guarantee programmes. Is the United States asking the Panel to revisit that conclusion (see paras 108 ff. of the United States' First Written Submission).

b. The United States presents evidence which, it argues, demonstrates that the three programmes examined by the original panel were operated at no net cost to the US government. Is there any issue as to whether the Panel can or should accept the United States' evidence in this respect?

283. Parts (a) and (b) of the compliance Panel's question are intimately related, and Brazil therefore answers them together. However, in the final paragraph of this response, Brazil offers an additional response that is specific to part (b) of the Panel's question.

284. Despite the adoption of an amended GSM 102 fee schedule, the CCC predicts that costs and losses for the "cohorts" of GSM 102 ECGs newly issued in FY 2006, FY 2007 and FY 2008 will, over the long term, exceed fees, penalties and recoveries.[373]

285. The original panel relied on this very same evidence for earlier cohorts. Taking a forward-looking or future-oriented approach to its assessment of the CCC ECG programs under item (j) of the Illustrative List, the original panel reviewed U.S. government projections concerning the long-term cohort-specific costs of the programs. Those projections, issued each year for the cohort of ECGs newly issued in that year, employ a statutorily-mandated NPV methodology considered by U.S. law to "measure more accurately the costs of Federal credit programs".[374]

286. During the original proceedings in this dispute, the United States argued throughout its many submissions to the panel and Appellate Body that these projections are not appropriate for assessing the performance of an ECG program under item (j), because they do not reflect actual, cash-basis results of the ECG programs calculated on a retrospective basis[375], and because they do not utilize ECG program-specific parameters.[376]

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[373] Brazil's First Written Submission, paras. 433-437. *See also* Exhibit US-71.

[374] Exhibit Bra-545 (2 U.S.C. § 661(1)).

[375] The United States appealed this specific element of the original panel's analysis. U.S. Appellant's Submission in *U.S. – Upland Cotton*, paras. 407 and 410-413 (and note 419), *available at* http://www.ustr.gov/assets/Trade_Agreements/Monitoring_Enforcement/Dispute_Settlement/WTO/Dispute_Settlement_Listings/asset_upload_file938_5598.pdf. For U.S. arguments before the original panel, *see* U.S. 11 July 2003 First Written Submission, paras. 176-178; U.S. 11 August 2003 Answers to Panel Questions, paras. 157, 159, 170 and 173; U.S. 22 August 2003 Rebuttal Submission, paras. 161-162, 167, 171; U.S. 30 September 2003 Further Submission, para. 151; U.S. 18 November 2003 Further Rebuttal Submission, paras. 196-199; U.S. 22 December 2003 Answers to Panel Questions, paras. 86, 90, 91-95, 96-99, 100-101, 103, 117-121 and U.S. 11 February 2004 Answers to Further Panel Questions, para. 21.

[376] U.S. 30 September 2003 Further Submission, paras. 144 and 147 (emphasizing that estimates are reached under "government-wide accounting rules", "without regard to the actual experience specific to the CCC export credit guarantee programs"); U.S. 18 November 2003 Further Rebuttal Submission, para. 196 ("estimates are compelled by government-wide accounting rules for credit programs ….") and U.S. 3 December 2003 Closing Statement, para. 10 (emphasizing that CCC is subject to "government-wide requirements" for the calculation of estimates and re-estimates).

287. The original panel and the Appellate Body rejected the United States' arguments, accepting a forward-looking approach to the assessment of the ECG programs under item (j).[377] As the original panel noted, although these projections are "initial estimates"[378], "[t]hey are not … mere random guesses as to the amount of possible, but highly unlikely, costs to the government."[379] To the original panel, these initial estimates of long-term losses were probative because they are calculated with a "methodology used and relied upon by the United States government to assess the estimated long-term net cost to the United States government of export credit guarantees."[380]

288. Addressing the United States' argument that the statutorily-imposed NPV methodology was not sensitive enough to adjust for CCC-specific experience with the ECG programs, the original panel found it particularly significant that the estimates were based on CCC's historical experience with country and borrower markets, presumably because that experience underscored the reliability of the estimates as indicators of long-term cost.[381]

289. Concluding its analysis, the original panel noted that the CCC's initial estimates

> indicate to us that the United States government believes, based on its own assessment, that it may not, even over the long term, be able to operate the export credit guarantee programmes without some net cost to the government.[382]

290. These adopted findings concerning the probity of the CCC's initial estimates should, in principle, be followed by subsequent panels and, specifically, by this compliance Panel. In its 26 February answer to question 2, Brazil explained that prior adopted panel and Appellate Body reports create "legitimate expectations" among WTO Members, and should be taken into account by panels when they are relevant to the resolution of a dispute.[383] Further, where the issues before a panel are the same as those previously examined by the Appellate Body, it is "not only appropriate," but to "be expected," that the panel would follow the Appellate Body's earlier conclusions.[384]

291. With respect to compliance proceedings, in particular, the Appellate Body has stated that "Article 21.5 proceedings do not occur in isolation but are part of a '*continuum of events*.'"[385] The Appellate Body observed that "doubts could arise about the *objective nature* of an Article 21.5 panel's assessment if, on a specific issue, that panel were to *deviate* from the reasoning in the original panel report in the absence of any change in the underlying evidence."[386]

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[377] Appellate Body Report, *U.S. – Upland Cotton*, paras. 763-764 and Panel Report, *U.S. – Upland Cotton*, paras. 7.842-7.843. *See also Id.*, para. 7.835 ("[T]he item (j) analysis need not be a purely retrospective one ….").

[378] The use of the term "initial" means cohort-specific estimates of long-term losses on the value of ECGs actually issued in a given fiscal year (rather than the value of ECGs budgeted or projected to be issued). The United States attempts to mislead the compliance Panel by erroneously stating that CCC initial estimates of long-term losses for GSM 102 are nothing more than the result of "an historically overly-optimistic projection of actual use of the program." U.S. First Written Submission, paras. 103 and 104. Brazil demonstrated the erroneous basis for this U.S. assertion in its Rebuttal Submission. *See* Brazil's Rebuttal Submission, paras. 506-511.

[379] Panel Report, *U.S. – Upland Cotton*, para. 7.843.

[380] Panel Report, *U.S. – Upland Cotton*, para. 7.843.

[381] Panel Report, *U.S. – Upland Cotton*, para. 7.843 ("Actual historical experience is a 'primary factor' on which estimates are based.").

[382] Panel Report, *U.S. – Upland Cotton*, para. 7.843.

[383] Appellate Body Report, *U.S. – Softwood Lumber V*, para. 111.

[384] Appellate Body Report, *U.S. – OCTG Sunset Reviews*, para. 188.

[385] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 103 (emphasis added) citing Appellate Body Report, *Mexico – Corn Syrup (21.5)*, para. 121. *See* Brazil's First Written Submission, para. 28.

[386] Appellate Body Report, *U.S. – Softwood Lumber VI (21.5)*, para. 103 (emphasis added).

292. Notwithstanding these principles, in these Article 21.5 proceedings, the United States asks the compliance Panel to ignore the original panel and the Appellate Body's findings on the relevance of the CCC's initial estimates of long-term program losses. The United States asks the compliance Panel to abandon the original panel and Appellate Body's adoption of a forward-looking, future-oriented assessment under a methodology "used and relied upon by the United States government to assess the estimated long-term net cost to the United States government of export credit guarantees,"[387] in favor of a purely retrospective assessment of program performance.

293. The United States' bases its request for the Panel to ignore the original panel and Appellate Body's reliance on initial estimates on two related arguments.

294. *First*, the United States argues that using an NPV methodology to assess costs does not represent "actual losses".[388] Converting the NPV methodology into a retrospective, cash-basis accounting methodology by taking account of re-estimates, the United States argues that the original panel erred in relying on a forward-looking assessment using the NPV methodology that is "used and relied upon"[389] by the U.S. government to estimate the cost of the GSM 102 program.[390]

295. In short, the United States is suggesting that the compliance Panel should discard the initial estimates of long-term losses, because when the "long-term" arrives, those estimates do not always turn out to have been accurate.

296. The original panel considered this U.S. objection and rejected it.[391] The original panel accepted that a forward-looking assessment of the ECG programs under an NPV methodology was a solid basis on which to make findings under item (j), despite that fact that NPV calculations are by definition projections of future results, discounted back to present value terms.

297. U.S. law has not changed in this respect since the original panel visited this question. U.S. law continues to require long-term, forward-looking projections of program performance using a net present value methodology because the results of this methodology "measure more accurately the costs of Federal credit programs" than cash-basis methodologies.[392]

298. The U.S. government is not alone in this approach. The NPV calculation used to arrive at initial projections of losses on ECGs actually issued in a given year is critical, whether or not re-estimates are made over time, and without regard to those re-estimates. Bank regulators all over the world use projections of default probabilities and losses-given-default – the core of net present value methodology – to gauge the adequacy of a bank's capital.[393] Forward-looking assessments of long-term costs are "used and relied upon"[394] by the U.S. government for the same reason they are used and relied upon by the private banking sector – they dictate how a program, or a bank, should structure fees, exposure limits, capital reserves and the like to achieve a return on investment (or in the case of a government program, in the very least to break even).

299. *Second*, the United States argues that even if a forward-looking approach involving estimates is an acceptable basis for an assessment under item (j), the NPV methodology applied by the U.S.

[387] Panel Report, *U.S. – Upland Cotton*, para. 7.843.
[388] U.S. Rebuttal Submission, para. 88.
[389] Panel Report, *U.S. – Upland Cotton*, para. 7.843.
[390] U.S. First Written Submission, paras. 85-94.
[391] Panel Report, *U.S. – Upland Cotton*, para. 7.843.
[392] Exhibit Bra-545 (2 U.S.C. § 661(1)).
[393] *See* "Internal Ratings-Based Approach" of the Basel Committee on Banking Supervision", described at http://www.bis.org/publ/bcbs128.htm.
[394] Panel Report, *U.S. – Upland Cotton*, para. 7.843.

government to assess the long-term costs of GSM 102 ECGs is inappropriate, as it entails assumptions that are not specifically-tailored to the GSM 102 program, making it unreliable.[395]

300. The compliance Panel should reject the U.S. reproach of the original panel and Appellate Body's approach. The process by which the CCC arrives at initial estimates of long-term program performance has not changed since the original proceedings; nor have the criteria used by the CCC to make this assessment.

301. Once again, the United States is asking the Panel to revisit the original panel's findings, despite the fact that the original panel rejected the U.S. argument, and the fact that now, as in the original proceedings, the NPV methodology "used and relied upon"[396] by the U.S. government is sufficiently tailored to generate reliable estimates of the long-term costs of the GSM 102 program.

302. USDA's own "Agriculture Financial Standards Manual" – not an agency far removed from the GSM 102 program, as the United States asserts[397] – states that expected loss rates, or estimated default costs, are based on "loan performance experience".[398] If historical experience truly established that the NPV methodology required by U.S. law overstated the risk of default, the U.S. government would have adjusted it for the purpose of calculating future projections on new GSM 102 commitments. Those adjustments have been made; FAS' self-assessment of the program states that the "credit models used to calculate the subsidy for the guaranteed credits were revised in FY2001 and FY2003 and <u>currently provides reliable estimates</u>", and identifies the model applied specifically as "<u>[t]he USDA model</u>".[399] These "reliable estimates" show, as they have in every year since the inception of net present value accounting by the U.S. government for credit accounts in 1992, that the CCC anticipates losses on the cohort of GSM 102 ECGs issued under the amended fee schedule in FY 2006, FY 2007 and FY 2008.[400]

303. In the face of the evidence described above, the United States has not advanced any new, credible arguments to support its assertion that a forward-looking assessment of the GSM 102 program based on loss estimates calculated under the NPV methodology used and relied upon by the U.S. government is no longer reliable. There is, therefore, no basis for this Panel to accept the United States' arguments that the estimates are unreliable. These arguments were considered, and rejected, in the original proceedings in this dispute. To find now that the estimates are unreliable would involve a significant departure from the findings in the original proceedings, with no valid basis for that change. It would also involve a violation of the principle of *res judicata*, because the reliability of the estimates has been definitively resolved for purposes of this dispute, and indeed verified by USDA's FAS.[401] The United States is not entitled to re-litigate an issue that has been definitively resolved for purposes of this dispute.

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[395] U.S. Rebuttal Submission, paras. 108-125.

[396] Panel Report, *U.S. – Upland Cotton*, para. 7.843.

[397] U.S. Rebuttal Submission, para. 115.

[398] Exhibit Bra-616 (U.S. Department of Agriculture, Office of the Chief Financial Officer, Credit, Travel, and Accounting Division, *Agriculture Financial Standards Manual* (May 2004), p. 121, accessed December 2006 at <u>http://www.ocfo.usda.gov/reports/index.htm</u>) ("In estimating default costs, the following risk factors are considered: (1) loan performance experience ….").

[399] Exhibit Bra-588 (Agricultural Export Credit Guarantee Programs Assessment, ExpectMore.gov, Section 3.CR2, accessed January 2007 at <u>http://www.whitehouse.gov/OMB/expectmore/detail.10002020.2005.html</u>) (emphasis added).

[400] *See* evidence cited in Brazil's Oral Statement, para. 253. *See also* Exhibit US-71.

[401] Exhibit Bra-588 (Agricultural Export Credit Guarantee Programs Assessment, ExpectMore.gov, Section 3.CR2, accessed January 2007 at <u>http://www.whitehouse.gov/OMB/expectmore/detail.10002020.2005.html</u>) (The "credit models used to calculate the subsidy for the guaranteed credits were revised in FY2001 and FY2003 and <u>currently provides reliable estimates</u>.") (emphasis added).

304. Brazil concludes with a final thought on part (b) to the Panel's question. As noted above, the United States is essentially asking the compliance Panel to revisit the original Panel and Appellate Body's conclusion that an NPV measure of long-term costs is appropriate to this dispute, because projected losses might not always materialize for every cohort.[402] In this sense, Brazil believes that parts (a) and (b) of the Panel's question are intimately related; the response offered above demonstrates why the United States request should be rejected.

305. Alternatively, the United States might be asking the compliance Panel, effectively, to reverse the findings and conclusions of the original panel that the original measures – the ECG programs before they were amended on 1 July 2005 – were operated at a loss and, therefore, to conclude that they did not involve export subsidies under item (j). Those findings and conclusions were upheld on appeal, and the DSB's recommendation are based upon them. This Panel may not depart from the findings made in the original dispute on this issue, for two reasons.

306. *First*, as we are reminded by the United States' requests for preliminary rulings, the compliance Panel's terms of reference extend solely to "measures taken to comply". The amended GSM 102 program is a measure taken to comply; the original GSM 102, GSM 103 and SCGP programs are not.

307. *Second*, under the principle of *res judicata*, the United States is not entitled to re-litigate an issue that has been definitively resolved for purposes of this dispute. The United States' request should be rejected.

106. The parties disagree as to whether Brazil should include recoveries for pre- 1992 guarantees in its cash basis accounting formula (Exhibit Bra-613). Is the Panel correct in understanding that Brazil's formula does not includes amounts for (1) claims paid after 1992 under pre-1992 guarantees; (2) fees paid on pre-1992 guarantees? If so, please explain the relevance or non-relevance of including recoveries under pre-1992 guarantees in light of the non-inclusion of costs and other revenues related to the same guarantees.

308. The compliance Panel's understanding that Brazil's cash basis accounting formula does not include costs and revenues associated with pre-1992 guarantees is correct. In Brazil's view, it would not be appropriate to include recoveries under pre-1992 guarantees in the accounting analysis if all costs and other revenues related to the same guarantees are left out. If the United States believes that recoveries for guarantees issued prior to FY 1992 should be included in the formula, then the formula should be extended back to the years before FY 1992 so that claims and other expenses associated with those guarantees are also accounted for (which means including not only claims paid after 1992, as the United States did in its Rebuttal Submission, but also before that date). Otherwise, the results for the post-1991 cohorts demonstrated in Brazil's analysis as shown in Exhibit Bra-613 should be sufficient for a long-term cash basis analysis of the programs.

309. An approximate indication of the results that would be obtained if guarantees issued in fiscal years prior to 1992 were to be included in the analysis can be given on the basis of information provided in the General Accounting Office ("GAO") report previously submitted as Exhibit Bra-584.

310. GAO points to claims of USD 6.5 billion for the period 1980-1994. If one subtracts approximately USD 1.0 billion in claims paid out in connection with post-1991 cohorts (as indicated in Exhibit Bra-613), and adds the claims paid from FY 1995 onwards (USD 692 million, according to

[402] *See* U.S. Rebuttal Submission, paras. 93-94, 98 ("[T]hese financial results showing that the programs charged premium rates *more than* adequate to cover the long-term operating costs and losses of the programs were generated by the export credit guarantee programs as previously configured and examined by the original panel.") (italics in original; underlining supplied).

the liquidating account data shown in footnote 150 of United States' Rebuttal Submission), one is left with approximately USD 6.2 billion in claims for those pre-1992 guarantees.

311. On the recovery side, GAO reports approximately USD 600 million recovered in the period 1980-1994. Subtracting recoveries associated with post-1992 cohorts (USD 470 million) and adding recoveries registered in the liquidating account from FY 1995 onwards (approximately USD 5.06 billion), the result is USD 5.2 billion. Leaving aside interest revenue and expenses and administrative costs[403], a gap of USD 1 billion would have to be covered by the collection of ECG fees.

312. Assuming an "average" fee of 0.6% for the period 1980-1992 (equal to the ratio between fees collected and guarantees issued in the period considered by the original panel during the period FY 1993-2002 – respectively, USD 186.5 million and USD 32.9 billion[404]), noting GAO's statement that USD 51.1 billion in guarantees were issued in the period 1980-1994, and subtracting from that amount the guarantees issued in FY 1993 and 1994 (USD 7.1 billion), the estimated amount of fees would be 0.006 times 44.0, *i.e.*, USD 264 million.

313. This is insufficient to cover the above-mentioned gap of USD 1 billion. Therefore, consideration of pre-1992 cohorts would, if anything, add a loss of approximately USD 750 million to the negative results already shown for the post-1991 cohorts.

Questions to the United States

107. What can explain the discrepancy between the "credit guarantee liability" recorded in the CCC's financial statements (which suggest that the program is provided at a net cost to the US government) and the evidence presented by the US in para. 87 of its First Written Submission?

108. Please explain why the "liability" figure in the CCC's financial statements should not be considered by the panel to provide, if not the amount of actual losses, at least a reliable estimate of the CCC's own perception of the cost to the government of the programmes since their inception. Is the Panel wrong in understanding that a "credit guarantee liability" in this context means that the CCC considers that the programmes will not cover their costs and losses in the long term?

109. Please indicate to the Panel whether there have been occurrences of reschedulings prior to the occurrence of defaults and the payment of claims by the CCC.

110. Is it possible to calculate the "subsidy estimate net of reestimates" for GSM 102 alone (similar to what the US has done for all three programmes in para. 87)? If so, please provide a table recording the results of this exercise.

111. In paragraph 7.853, the original Panel stated that it "disagree(d) with the United States that we should "eliminate" the data for certain, more recent, cohorts in our analysis." Is the United States asking that this Panel eliminate such data for the most recent cohorts (the table at para. 87 of the United States' First Written Submission includes data up to 2005 only). Why should this Panel do what the original refused to do? What would be the result of the United States "re-estimates" exercise if the original subsidy estimate for the 2006 and 2007 cohorts were included?

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[403] Brazil notes that interest revenue and expenses shown in table 3 of the original panel report indicate that, for the 10-year period 1993-2002, interest expenses *exceed* interest revenue by over USD 100 million. Therefore, the assumption in the above analysis is conservative, and if anything is highly likely to be in the United States' favour.

[404] For the amount of guarantees issued, *see* Exhibit US-7.

112. Please explain whether and how the CCC limits risks or control costs of the GSM 102 programme as regards foreign banks' individual credit ratings.

113. Please explain whether and how CCC country risk categories correspond to ICRAS ratings.

Question to Brazil

114. Brazil argues that "(t)hat the United States has, on one view of the data, beaten the odds and met its costs and losses over a series of years does not mean that ECG programs are structured and designed to do so" (para. 503, Brazil's Rebuttal). Is Brazil arguing that evidence regarding the actual operation and "profitability" of the programme (i.e. retrospective evidence) is irrelevant to the Panel's analysis under item (j)?

314. Brazil is not arguing that retrospective evidence regarding cash results of an ECG program is irrelevant to the Panel's analysis under item (j). Brazil has demonstrated that on a review of retrospective evidence regarding the cash results of the ECG programs – either including (*see* Brazil's response to question 106, above) or not including (*see* Exhibit Bra-613) pre-1992 ECGs – the programs are operating at a loss.

315. However, Brazil is mindful of the original panel's finding that "the item (j) analysis need not be a purely retrospective one," but instead "also appropriately takes into account elements of the structure, design and operation of the measure …."[405]

316. Forward-looking evidence regarding the structure, design and operation of the GSM 102 program is particularly relevant in these proceedings. Much as the "long term" qualification in item (j) is meant to smooth out aberrant losses suffered by an otherwise cost-neutral ECG program, breaking even against the odds does not take an ECG program that is not structured or designed to meet long-term costs and losses beyond the reach of item (j).

317. In short, avoiding losses by good fortune is not the same as designing a program to meet its long-term costs and losses. As Brazil has previously noted, the U.S. view of item (j), which deems relevant *only* retrospective evidence of cash results, necessarily means that an ECG program could charge *no fees* whatsoever, and be excluded from item (j) if program administrators were lucky enough not to suffer any defaults in a given period. Leaving administrative costs aside, the U.S. view is that this program would then have "broken even" in that period. In Brazil's view, it could hardly be maintained that this program is *structured and designed* to meet its long-term costs and losses, however. The original panel agreed; it recognized that a purely retrospective approach was overly-simplistic, and would fail to account for serious structural flaws in an ECG program's fiscal management.

318. It is important to note that <u>undertaking a forward-looking assessment of GSM 102 does not mean foregoing a quantitative assessment of program performance</u>. As noted in response to question 105, above, despite the adoption of the amended GSM 102 fee schedule, the CCC offers quantitative assessments of the amount by which costs and losses for the "cohorts" of GSM 102 ECGs newly issued in FY 2006, FY 2007 and FY 2008 will, over the long term, exceed fees, penalties and recoveries.[406] These forward-looking estimates are derived with a statutorily-mandated net present value ("NPV") methodology heralded by U.S. law as "measure[ing] more accurately the costs of Federal credit programs".[407] Using the same NPV methodology, CCC's 2006 financial statements record its conclusion that when ECGs outstanding on 31 September 2006 are closed, the CCC expects

[405] Panel Report, *U.S. – Upland Cotton*, para. 7.835.
[406] Brazil's First Written Submission, paras. 433-437. *See also* Exhibit US-71.
[407] Exhibit Bra-545 (2 U.S.C. § 661(1)).

to suffer a net loss of USD 220 million.[408] The original panel relied on this very same evidence for earlier cohorts.[409]

319. Comparing GSM 102 fees to OECD Arrangement MPRs, as discussed in response to question 100, also facilitates a forward-looking, quantitative assessment of the program. The Panel will recall the OECD's explanation that the Arrangement's benchmark rates, including MPRs, are set "to ensure that Participants to the Arrangement charge premium rates in addition to interest charges that … are not inadequate to cover long-term operating costs and losses associated with the provision of export credits."[410] The Arrangement's MPRs are on average 106 percent greater than GSM 102 fees, meaning that GSM 102 fees are strikingly "inadequate to cover long-term operating costs and losses associated with the provision of export credits".

[408] Exhibit Bra-585 (Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2005 and 2006, Report No. 06401-21-FM, November 2006).

[409] Panel Report, *U.S. – Upland Cotton*, paras. 7.842-7.843, 7.855.

[410] Exhibit Bra-547 (OECD document TD/PG(2004)10/FINAL, 6 July 2004, para. 1, Premium and Related Conditions: Explanation of the Premium Rules of the Arrangement on Officially Supported Export Credits (the Knaepen Package), accessed November 2006 at http://webdomino1.oecd.org/olis/2004doc.nsf/43bb6130e5e86e5fc12569fa005d004c/a2c08162302d3415c1256ec9003919f1/$FILE/JT00167196.PDF).

ANNEX D-13

RESPONSES OF THE UNITED STATES TO THE PANEL'S SECOND SET OF QUESTIONS

(2 April 2007)

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141	7 U.S.C. 5622
142	7 C.F.R. 1493 (Subparts A and B)
143	*The New Shorter Oxford English Dictionary* at 793, Volume 1, (2005 Edition)
144	Economic Research Service, Commodity Costs and Returns available at http://www.ers.usda.gov/data/CostsandReturns/
145	Comparisons of USDA February Projections to Final Estimates
146	Comparison of NCC Planting Intentions Report Data to Final NASS Acreage Data
147	Updated Cotton, Corn, and Soybean Futures Data for 2007 (Year To Date)
148	*The New Shorter Oxford English Dictionary* at 1350, Volume 1, (2002 Edition)
149	*The Handbook of Fixed Income Securities*, 6th ed. (2001), Fabozzi, Frank J. (McGraw-Hill Professional), pp. 588-592
150	Marshall, John F. "Futures Versus Swaps: Some Considerations for the Thrift Industry," *Review of Business*; Winter 1990/1991; 12, 3, pp. 15-23
151	BSC Bond Street Capital; Credit Tenant Lease Loans - Minimum $10,000,000. http://www.bisonfinancial.com/loans/bsc_ctl.html
152	Glennon, Dennis and Nigro, Peter; "Measuring the Default Risk of Small Business Loans: A Survival Analysis Approach," *Journal of Money, Credit, and Banking*, Vol. 37, No. 5 (October 2005), pp. 923-947
153	Notice to GSM-102 Program Participants: USDA Clarifies Method for Computing Interest Coverage Under GSM-102 Program (15 July 2005) http://www.fas.usda.gov/scriptsw/PressRelease/pressrel_dout.asp?PrNum=0105-05
154	Wall St. Journal prime rates from February, 2000 to the present, available at http://www.hsh.com/indices/prime00s.html (accessed 20 March 2007)
155	Comparison of interest rate coverage of CCC GSM-102 export credit guarantees and Ex-Im Bank Letter of Credit Insurance for Banks (1 July 2005 - 1 March 2007)
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157	Remarks by Ben S. Bernanke, Chairman of the United States Federal Reserve Board, "Modern Risk Management and Banking Supervision" (12 June 2006) available at http://www.federalreserve.gov/boardDocs/speeches/2006/200606123/default.htm
158	Overview: US Standard General Ledger available at http://www.fms.treas.gov/ussgl/about.html
159	Standard General Ledger cover; Treasury Financial Manual Transmittal Letter No. S2 06-02 (14 July 2006), which immediately follows the cover, and pages III-146 and III-151 of the Ledger. http://fms.treas.gov/ussgl/tfm_releases/06-02/ussgl_06-02.pdf (Pages 972, 977)
160	Office of Management and Budget Circular A-136 available at https://max.omb.gov/maxportal/pdf/circular_a136_section_6.1.pdf

Exhibit US-	Title
161	2008 U.S. Government Budget Appendix: CCC Export Loans Program Account, pp. 104-106
162	Federal Reserve Board Supervisory Letter SR 94-12 available at http://www.federalreserve.gov/BOARDDOCS/SRLETTERS/1994/SR9412.HTM
163	"Applying the CAMEL Framework", Asian Development Bank available at http://www.adb.org/Documents/Guidelines/Financial part060302.asp
164	Government Accountability Office Report No. GAO-04-531

1. The United States submits below responses to the Panel's questions directed at either both parties or the United States alone. Before turning to those questions, the United States notes that important new data has become available since the meeting with the Panel providing even further support for the U.S. arguments that marketing loan and counter-cyclical payments do not "numb" the planting decisions of the U.S. farmers. As the Panel may recall, in the meeting with the Panel, the United States submitted the recently-issued survey of MY 2007 upland cotton planting intentions, showing that U.S. producers intended to pull back on their upland cotton plantings in MY 2007 by approximately 14 percent in response to such factors as the relatively more attractive prices for corn and the poor performance of U.S. exports since August 2006 (at which time the Step 2 program was eliminated). This evidence clearly contradicted Brazil's claims that U.S. farmers do not respond to market signals and continue to plant upland cotton in situations where – without marketing loan and counter-cyclical payments – they would not do so.

2. Brazil has attempted to dismiss this evidence asserting that "[i]f marketing loan and CCP subsidies did not exist, and if U.S. cotton farmers would have to react to market price signals, far more than 14 percent of cotton acreage predicted by the NCC would switch to substitute crops."[1] Brazil has not substantiated that assertion, nor explained how a projected 14 percent year-over-year decline in planted acreage is consistent with the proposition that U.S. cotton farmers' planting decisions are numbed and do not react to market signals. Moreover, recent data published by USDA show that, in fact, "far more than 14 percent of cotton acreage" is projected to switch to other crops in the upcoming crop year. According to the "Prospective Plantings" report published by the National Agricultural Statistics Service ("NASS") based on surveys conducted by USDA in the first two weeks of March from a sample of more than 86,000 farm operators across the United States, "upland cotton acreage is expected to total 11.9 million, ***down 21 percent from last year and the lowest since 1989***."[2] The magnitude of the acreage shift is even more remarkable when one considers regional responses. According to the NASS report, "due to the increased demand and higher prices of crops used for bio-fuels," acreage is expected to decline dramatically ***in every single area in which upland cotton is grown***. These shifts are so substantial that, in many cases, planted acreage is at historically low levels; levels lower than they were in years well before either the marketing loan or counter-cyclical payments came into effect[3]:

- Upland growers in the Delta States (Arkansas, Louisiana, Mississippi, Missouri, and Tennessee) are expecting the largest decrease in acreage. Producers intend to plant 2.91 million acres, ***a 31 percent decrease from the previous year***.
- Farmers in Mississippi expect to plant 740,000 acres, ***40 percent less than last year and the lowest acreage since 1983***.
- In Louisiana producers intend to plant 380,000 acres, ***the lowest since 1975***.
- In the Southeastern States (Alabama, Florida, Georgia, North Carolina, South Carolina, and Virginia) growers intend to plant 2.55 million acres, ***a decrease of 24 percent from last year***.
- The planted area in North Carolina is expected to decline 570,000 acres, ***34 percent less than 2006***.
- Producers in Texas, Oklahoma, Kansas, and New Mexico intend to plant 6.01 million acres, ***a 13 percent decrease from last year***.

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[1] Oral Statement of Brazil, para. 73.
[2] NASS Prospective Plantings Report, p. 1 (March 30, 2007) (Exhibit US-140).
[3] *See* NASS Prospective Plantings Report, pp. 28-29 (March 30, 2007) (Exhibit US-140).

- Texas producers expect to plant 5.70 million acres, ***down 700,000 acres from last year***.

- Upland planted acreage in California and Arizona is expected to total 390,000 acres, ***down 18 percent from last year***.

- California producers intend to plant 210,000 acres, ***the lowest since USDA began tracking upland cotton acreage intentions in 1941***.

3. In other words, there is no longer any question of "*if* U.S. cotton farmers would have to react to market price signals." The evidence proves definitively that, even under Brazil's arguments, U.S. cotton farmers *do* react to market price signals and other planting and production signals (such as considerations of weather, pests, and good agronomic practices). This is a matter of fact. And no amount of econometric gymnastics performed by Brazil for purposes of this proceeding – which appears, increasingly, to be the main evidentiary basis for its claims – detracts from it.

4. As a large number of the Panel's questions deal with the question of the effect of marketing loan and counter-cyclical payments on plantings, production and exports, the above data are particularly important in reviewing the U.S. and Brazilian responses.

A. SCOPE OF THIS PROCEEDING

Questions to both parties

44. The European Communities argues in respect of the preliminary objection raised by the United States regarding the claims of Brazil relating to export credit guarantees for pig meat and poultry meat under the GSM 102 programme that "the important issue is the nexus or the degree of interrelatedness or interdependence between different elements of the measure." (Oral Statement of the European Communities, para. 6) The European Communities submits in this regard that:

> ***"the Panel should examine the original measure at issue and the 'measures taken to comply,' and, with particular reference to the 'elements of the measure' that the United States argues are outside the Panel's terms of reference, enquire into the extent to which these are interrelated or interdependent with measures or 'elements of measures' that the United States accepts are within the Panel's terms of reference." (Oral Statement of the European Communities, para. 11)***

Do the parties agree with the approach suggested by the European Communities and with the considerations in paragraph 13 of the Oral Statement of the European Communities?

1. The United States does not agree with the approach suggested by the European Communities. Nor does the United States agree that the "factors" listed in paragraphs 13 of the EC Oral Statement support expanding the scope of this proceeding to include GSM 102 export credit guarantees provided for exports of pig meat and poultry meat.

2. The scope of matters that are properly reviewed in an Article 21.5 proceeding are established by Article 21.5 of the DSU. That Article provides that:

> Where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures. . . .

3. Two things about this language indicate the proper approach to determining the measures that are properly within the scope of an Article 21.5 proceeding:

- First, the text provides for dispute settlement procedures for the resolution of disagreements regarding "measures taken to comply *with the recommendations and rulings* [of the DSB]."

- And, second, the text does *not* provide for "measures taken to comply with the recommendations and rulings" of the DSB *and any other "interrelated" or "interdependent" measures*.

4. By the terms of Article 21.5, the touchstone for determining what is a "measure taken to comply" is *the recommendations and rulings* of the DSB. It is these recommendations and rulings that – necessarily and logically – drive what measures are taken to comply and, thus, what measures are properly the subject of a "compliance" proceeding under Article 21.5 of the DSU. Considerations of "interrelatedness" or "interdependence" may be implicated in resolving as a factual matter *what the measure taken to comply is* in a particular dispute. However, the "interrelatedness" or "interdependence" that is relevant in that context is between elements of the *new* measure taken to comply (e.g., *EC – Bed Linen (21.5)*)[4] or multiple *new* measures that may not all be declared by a responding Member as being taken to comply with the DSB's recommendations and rulings but nonetheless are properly deemed measures taken to comply given the particular recommendations and rulings in the original proceeding and the facts of the dispute (e.g., *Softwood Lumber (21.5), Australia Leather II (21.5),* and *Australia – Salmon (21.5)*).[5]

5. Moreover, it is not "interrelatedness" or "interdependence" in the abstract that is important but, rather, such a connection *vis-a-vis the DSB's recommendations and rulings*. Thus, if the DSB's recommendations and rulings distinguish between different elements of a measure or different measures then that distinction is determinative for purposes of the compliance proceeding as well. There is no fresh test of "interrelatedness" or "interdependence" applied under Article 21.5 of the DSU such as the one the European Communities now espouses that would allow *any measure* deemed

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[4] In *EC – Bed Linen (21.5)* a question raised was whether all elements of the new dumping redetermination on imports from India should be considered part of one indivisible measure such that even those elements that had not changed since the original proceeding and had not been subject to any recommendations and rulings therein should be subject to renewed challenge in the Article 21.5 proceeding. The Appellate Body explained that:

> we are of the view that the investigating authorities of the European Communities were not required to change the determination as it related to the "effects of other factors" in this particular dispute. Moreover, we do not see why that part of the redetermination that merely incorporates elements of the original determination on "other factors" would constitute an inseparable element of a measure taken to comply with the DSB rulings in the original dispute. Indeed, the investigating authorities of the European Communities were able to treat this element separately. Therefore, we do not agree with India that the redetermination can only be considered "as a whole new measure."
>
> *EC – Bed Linen (AB),* para. 86.

[5] The *Australia – Salmon (21.5)*, *Australia – Leather (21.5),* and *U.S. – Softwood Lumber IV (21.5)* disputes all dealt with situations in which two new measures were taken close in time – one that was declared to achieve compliance – and another that the complaining party alleged "undid" the compliance achieve by the first. In those disputes, the panels assessed the connectedness of the new measures to determine whether they should both be considered "measures taken to comply" such that compliance is examined by reference to both.

to be "interrelated" or "interdependent" with a measure taken to comply to be swept into the scope of a compliance proceeding.

6. In the present dispute, the DSB's recommendations and rulings clearly distinguish "export credit guarantees under the GSM 102, GSM 103 and SCGP export credit guarantee programmes . . . *in respect of exports of upland cotton and other unscheduled agricultural products supported under the programmes, and in respect of one scheduled product (rice)*"[6] from other export credit guarantees under those programs. This is because the original panel found that Brazil had only made its case under Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement* with respect to export credit guarantees provided in respect of exports of rice and unscheduled products.[7]

7. By contrast, the original panel found that "[i]t has not been established . . . that such actual circumvention has resulted in respect of the twelve other United States scheduled commodities."[8] According to the original panel, "in these circumstances, and as Brazil has also not made a *prima facie* case before this Panel that the programmes do not conform fully to the provisions of Part V of the Agreement on Agriculture, this Panel must treat them as if they are exempt from actions based on Article XVI of the GATT 1994 and Article 3 of the SCM Agreement in this dispute."[9]

8. Whether one understands the original panel's finding to have been made with respect to *guarantees* or the export credit guarantee *programs* that provided for the guarantees, what is indisputable is that the original panel *drew a clear distinction* between some of the measures (or aspects of measures) and others. And as a result of that distinction, neither all export credit guarantees (nor the entirety of the programs) were subject to findings of WTO-inconsistency or to the DSB's recommendations and rulings on their basis. Put another way, the original panel and Appellate Body did not consider export credit guarantees in respect of exports of pig meat, poultry meat, or any of the other twelve scheduled products to be so "interrelated" to, or "interdependent" with, export credit guarantees in respect of unscheduled products and rice that they found themselves unable to make separate findings of WTO-consistency with respect to the two. The original panel and Appellate Body did not consider the two to be so "interrelated" or "interdependent" that the same *implementation obligations* had to be extended to both. Indeed, Brazil does not contest the fact that "there is no adopted finding that the original GSM 102 program is applied in a manner that circumvents the United States' commitments with respect to pig meat and poultry meat."[10] Moreover, Brazil admits that "[d]uring implementation, the United States could have taken steps to amend the GSM 102 program exclusively with respect to the terms and conditions applicable to rice and unscheduled products."[11]

9. In short, the original panel distinguished between the different guarantees, the DSB's recommendations and rulings distinguished between the different guarantees, and the U.S. obligations only applied to – and could have been implemented by – action only with respect to certain of the guarantees. Under these conditions, there is no reason why all guarantees under the GSM 102 program – or the program itself – must be considered one "indivisible" measure for purposes of this compliance proceeding as the European Communities has suggested.

10. Moreover, this is true regardless of the fact that the United States chose to make the same improvements *vis-a-vis* all guarantees under the program. The European Communities' own arguments in *EC – Bed Linen (21.5)* – and the compliance panel's adoption of those arguments and the

[6] *Upland Cotton (Panel),* para. 8.1(d) (emphasis added).
[7] *Upland Cotton (Panel),* para. 8.1(d).
[8] *Upland Cotton (Panel),* para. 7.881.
[9] *Upland Cotton (Panel),* para. 8.1(d)(ii).
[10] Brazil Responses to Panel Section A-C Questions, para. 14 (February 26, 2007).
[11] Brazil Responses to Panel Section A-C Questions, para. 15 (February 26, 2007).

resulting DSB rulings – are instructive on this issue. In that dispute, the original panel made – and the Appellate Body upheld – a finding that the European Communities acted inconsistently with the *AD Agreement* by, *inter alia*, "determining the existence of margins of dumping on the basis of a methodology incorporating the practice of zeroing."[12] The European Communities was asked to bring the measure at issue – a dumping order on imports of bed linens from India – into conformity with its obligations under the *AD Agreement*.[13] Although the only measure subject to the recommendations and rulings was the order as it applied to Indian imports, the European Communities chose to make a redetermination of dumping, without applying any "methodology incorporating the practice of zeroing," with respect to all imports under the order, including imports from Pakistan and Egypt.[14] As a result of this redetermination, the European Communities found that imports from Pakistan and Egypt had not been dumped.[15] That, in turn, necessitated a reassessment of injury to determine whether imports of bed linens from India alone caused injury (and the EC found that they did).

11. In the Article 21.5 proceeding that followed, India challenged not only the redetermination of *dumping* with respect to imports from India but also the redetermination of *dumping* with respect to imports from Pakistan and Egypt as well as the redetermination of *injury* with respect to imports from India alone. India argued that these other redeterminations were so "closely connected to the Panel and Appellate Body reports in the original dispute" that they were properly within the scope of the Article 21.5 proceeding.[16] The European Communities disagreed, arguing that "[n]ot all the measures that are somehow 'connected' to the measure in dispute in the original panel proceedings qualify as measures 'taken to comply.'"[17] According to the European Communities:

> The EC considers that *since there were no rulings by the DSB concerning the anti-dumping measures against imports from Egypt and Pakistan, there was nothing for the EC to "comply" with, and no obligation to undertake any reassessment of the original findings.* Therefore, the EC maintains that Regulation 160/2002 [(redetermination of dumping with respect to imports from Pakistan and Egypt)] *cannot be considered as a measure "taken to comply" within the meaning of Article 21.5.* Similarly, the EC asserts that the injury redetermination in Regulation 696/2002 was *rendered necessary by the decision of the EC authorities to re-examine the findings of dumping for Pakistan and Egypt, which decision was not itself a measure "taken to comply" with the DSB's recommendation.* Thus, the EC asserts this measure was also *independent*, and *not a measure "taken to comply."* In the EC's view, *India's claims against these two measures can only be heard in the context of a new dispute.*[18]

12. The panel agreed with the European Communities. It noted that:

> [N]either the Panel nor the Appellate Body found any violation with respect to the anti-dumping measures concerning imports from Egypt or Pakistan. As a consequence, the DSB's rulings cannot have touched upon these anti-dumping measures. Nor could the DSB have recommended that the EC bring into conformity

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[12] *EC – Bed Linen (Panel)*, para. 7.2(g).

[13] *EC – Bed Linen (Panel)*, para. 7.5; *see also EC – Bed Linen (AB)*, para. 86(1) ("upholds the finding of the Panel in paragraph 6.119 of the Panel Report that the practice of "zeroing" when establishing "the existence of margins of dumping", as applied by the European Communities in the anti-dumping investigation at issue in this dispute, is inconsistent with Article 2.4.2 of the Anti-Dumping Agreement.")

[14] *EC – Bed Linen (Panel)*, para. 6.9-6.10.

[15] *EC – Bed Linen (Panel)*, para. 6.9-6.10.

[16] *EC – Bed Linen (Panel)*, para. 6.12.

[17] *EC – Bed Linen (Panel)*, Annex D-3 (Oral Statement of the European Communities, para. 5 (September 10, 2002)).

[18] *EC – Bed Linen (Panel)*, para. 6.11.

with its obligations measures as to which there was no finding of violation. Thus, the EC was under no legal obligation to do anything with respect to the anti-dumping measures on imports from Egypt and Pakistan.

The EC chose, at its own volition, to open the determinations of dumping with respect to imports from Egypt and Pakistan so as to apply to those determinations the conclusion of the adopted Reports finding the practice of "zeroing" to be inconsistent with the AD Agreement. While this decision on the part of the EC may have been prudent, and is commendable, it was not required by the DSB's recommendation in the original dispute, which was to bring the measure at issue, viz., the antidumping measure on imports of bed linen from India, into conformity with the EC's obligations under the AD Agreement.[19]

13. The Panel found, on this basis, that the redetermination of dumping for imports from Egypt and Pakistan were not properly the subject of the Article 21.5 proceeding. Further, even though the redetermination of injury applied in respect of imports from India, the panel found that it was not within the scope of the proceeding because it was not alleged to "*undo* the compliance effectuated by the [measure asserted to be taken to comply (*i.e.,* the redetermination of dumping with respect to imports from India)]."[20] In this way, the panel distinguished the facts of *EC – Bed Linen (21.5)* as being "fundamentally different"[21] from the facts of *Australia – Leather (21.5)*, in which "the complaining Member . . . argued that Australia had taken two measures, the first of which was purported to implement the DSB's ruling, while the second measure undid the purported compliance."[22] While the *Australia – Leather (21.5)* panel considered that it was appropriate to deem the second new measure a "measure taken to comply" under the circumstances of that dispute, the same reasoning did not apply under the facts of *EC – Bed Linen (21.5)*.

14. The analysis in *EC – Bed Linen (21.5)* confirms that there is no blanket test of "connectedness" or "interrelatedness" that applies in Article 21.5 proceedings. Moreover, the mere fact that improvements have been made to more than just the original measures subject to findings of WTO-inconsistency and DSB recommendations and rulings does not render all changed measures "measures taken to comply." Where the improvements are made to measures that were in existence at the time of the original panel proceeding and that were nonetheless not subject to any DSB recommendations and rulings, the compliance proceeding must respect the fact that the DSB's recommendations and rulings do not apply to the measures.

15. Here, if the United States had not made any changes with respect to guarantees for exports of pig meat and poultry meat, Brazil could not – in the European Communities' words – "have requested an Article 21.5 panel to complain about the absence of implementation measures."[23] The right to make such a complaint does not arise merely because the United States decided not to wall off those guarantees from all other guarantees in applying the positive changes it was making to bring the other guarantees into compliance with the DSB's recommendations and rulings with respect to the latter. That just means that the United States went *beyond* its implementation obligations. Voluntary improvements such as these by Members are "prudent" and, in the view of the *EC – Bed Linen (21.5)*

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[19] *EC – Bed Linen (Panel)*, para. 6.18-6.19 (emphasis added).

[20] *EC – Bed Linen (Panel),* para. 6.21.

[21] *EC – Bed Linen (Panel)*, para. 6.16.

[22] *EC – Bed Linen (Panel),* para. 6.16. The panel similarly distinguished *Australia – Salmon (21.5),* which also involved two measures, one notified to the DSB and another not so notified that might have undermined the measure taken to comply.

[23] *EC – Bed Linen (Panel)*, Annex D-3 (Oral Statement of the European Communities, para. 9 (September 10, 2002)).

panel, "commendable."[24] They do not transform all measures subject to the changes into measures taken to comply with the recommendations and rulings of the DSB.[25]

16. Finally, the United States notes that the European Communities references *U.S. – Softwood Lumber IV (21.5)* in connection with its arguments. However, the facts and reasoning of *U.S. – Softwood Lumber IV (21.5)* are inapposite. Indeed, *U.S. – Softwood Lumber IV (21.5)* simply built on the reasoning in *Australia – Leather II (21.5)* and *Australia – Salmon (21.5)* in clarifying when the scope of a compliance proceeding may be expanded to include a new measure that is issued at approximately the same time as the one declared to be the measure taken to comply and that is alleged to "undo" the compliance achieved by the declared "measure taken to comply."[26] Because *EC – Bed Linen (21.5)* did not involve any such situation, the *EC – Bed Linen (21.5)* panel found the facts before it to be "fundamentally different" from the facts in *Australia – Leather II (21.5)* and *Australia – Salmon (21.5)* and declined to apply the reasoning from those disputes. Precisely the same factual difference exists here between the facts of this dispute and those in *U.S. – Softwood Lumber IV (21.5)*.

45. Could the parties comment on the observations made by the European Communities in paras. 15-24 of its Oral Statement on the issue of whether the marketing loan and counter-cyclical payment programmes are within the scope of the Panel's proceeding?

17. The United States disagrees with a number of the European Communities' observations in paragraph 15-24 of its oral statement.

(1) There is no basis for the European Communities' suggestion that statutory/regulatory provisions authorizing payments and individual payments thereunder can be conflated "for the purposes of a compliance panel" if the statutory/regulatory provisions set out the conditions under which payments are to be made.

18. The United States disagrees with the European Communities' suggestion that where "entitlement to payment is conditional . . . only upon certain essentially factual requirements, essentially in the hands of the recipient" the distinction between the statutory/regulatory provisions authorizing the payments and particular payments thereunder "may be less clear" than in other circumstances, "and there may be a degree of nexus or interrelatedness of interdependence between the (for example, fiscal) programme and payments under it, such as might justify their treatment as indivisible for the purposes of a compliance proceeding."[27] Moreover, the United States considers that the suggestion has no application here.

19. First, the present situation is not one in which "entitlement to payment is conditional . . . only upon certain essentially factual requirements, essentially in the hands of the recipient."[28] Payments under the Step 2, marketing loan, and counter-cyclical payment programs are conditional upon, *inter alia*, certain price conditions prevailing. Whether or not these price conditions prevail is *not* a matter within the hands of any potential recipients. In fact, the recipients cannot even know whether they will, in fact, receive such payments at the time that planting decisions must be made. Thus, the European Communities' suggestion that it is permissible to conflate the statutory and regulatory provisions authorizing payments and the payments themselves where "entitlement to payment is

[24] *EC – Bed Linen (Panel)*, para. 6.18-6.19 (emphasis added).
[25] *EC – Bed Linen (Panel)*, para. 6.18-6.19 (emphasis added).
[26] *See e.g., U.S. – Softwood Lumber IV (21.5)*, para. 74.
[27] Oral Statement of the European Communities, para. 19.
[28] Oral Statement of the European Communities, para. 19.

conditional . . . only upon certain essentially factual requirements, essentially in the hands of the recipient"[29] simply has no application here.

20. Second, even leaving aside the lack of relevance, the premise that a compliance panel may conflate two distinct measures – the statutory and regulatory provisions authorizing payments and the payments themselves – where the former set out particular circumstances in which the payments are to be made is arbitrary and without basis.[30] Not surprisingly, the European Communities does not provide a single citation to support this assertion. It identifies no provision of the WTO agreement that justifies it. Nor does the European Communities articulate any rationale that would support simply disregarding in the asserted circumstances that the statutory and regulatory framework authorizing payments and particular payments made thereunder are distinct measures *as a matter of fact*.

21. The distinction between "a measure of general and prospective application" – the epitome of which is a statutory/regulatory provision – and individual instances of its application is well-established in WTO dispute settlement. Indeed, the European Communities acknowledges that very distinction.[31] The United States is not aware of any basis in the DSU or in WTO dispute settlement practice for the suggestion that statutory/regulatory provisions cease to be measures distinct from individual instances of their application *solely because of what the statutory/regulatory provisions say*.

22. A statutory or regulatory provision does not cease to be "a measure of general and prospective application" if it identifies conditions under which payments are to be made. And the considerations that underpin the distinction between such measures and particular instances of their application are no less applicable in those circumstances.

23. Specifically, where a complaining Member challenges statutory/regulatory provisions and other measures of general and prospective application themselves, they "by definition" assert:

> that a Member's conduct—not only in a particular instance that has occurred, but in future situations as well—*will necessarily be inconsistent with that Member's WTO obligations*. In essence, complaining parties bringing "as such" challenges seek to prevent Members *ex ante* from engaging in certain conduct. The implications of such challenges are obviously more far-reaching than "as applied" claims.[32]

Because of this, the Appellate Body underscored the "seriousness" of as such claims against measures of general and prospective application.[33]

24. The European Communities has provided no reason why challenges to statutory/regulatory provisions should be considered any *less* serious, or any *less* far-reaching than "as applied" claims if the provisions set out particular conditions under which payments are to be made. This is especially true where, as here, the asserted WTO-inconsistency relates to the *effects* of subsidies under specific market conditions. The fact that particular payments may have caused adverse effects under the particular market conditions prevailing in one marketing year, does not necessarily mean that if payments are made "in future situations . . . [they] will necessarily be inconsistent with that Member's

[29] Oral Statement of the European Communities, para. 19.

[30] Oral Statement of the European Communities, para. 19.

[31] Oral Statement of the European Communities, para. 17 ("[t]he European Communities agrees with the United States that there is a distinction between a subsidy programme within the meaning of the *SCM Agreement* (which may be a measure at issue) and instances of a subsidy under such programme (each of which may also be a measure at issue). . . .These measures should not normally be conflated.")

[32] *U.S. – Oil Country Tubular Goods from Argentina (AB)*, para. 172 (emphasis added).

[33] *U.S. – Oil Country Tubular Goods from Argentina (AB)*, para. 172.

WTO obligations."[34] While a Member is certainly free to argue that will be the case, if it does so, the complaining Member bears the burden of proving its claims. This is no different in a situation where a statute sets out the conditions when payments are to be made.

25. Indeed, Brazil's arguments confirmed precisely this point in the original proceeding. There, in the case of its "as such" challenge to the provisions of the 2002 FSRI Act and the 2000 ARP Act providing for Step 2, marketing loan, and counter-cyclical payments, Brazil argued that:

> [T]he Panel needs to evaluate whether the U.S. subsidies will *necessarily threaten to cause serious prejudice* at price levels below the trigger prices of the U.S. subsidies. Second, the Panel needs to consider whether the U.S. subsidies *threaten to cause serious prejudice even at price levels at which only crop insurance subsidies and direct payments are made*."[35]

Moreover, Brazil asked the Panel "to find that the mandatory provisions of the 2002 FSRI Act and the 2000 ARP Act together with their implementing regulations, as listed above, *cannot be applied in a WTO consistent manner*."[36]

26. In addition, the EC has provided no reason why the well-established distinction between the statutory/regulatory provisions providing for payments and particular payments provided thereunder is any less important "for the purposes of a compliance panel." In *U.S. – Countervailing Measures on Certain EC Products*, the panel articulated succinctly the limited purpose of "compliance" proceedings pursuant to Article 21.5 of the DSU: "[t]he purpose of Article 21.5 is to provide an expeditious procedure to establish whether a Member has properly implemented the DSB recommendations and rulings."[37] Moreover, it noted many of the attendant limitations on the applicable procedures:

> [T]here is no provision for a "reasonable period" to implement the ruling in an Article 21.5 dispute. Thus, an Article 21.5 panel ruling . . . may immediately give rise to rights for compensation or suspension of concessions under Article 22 DSU. Moreover, the parties do not have the same opportunity to present evidence and arguments in Article 21.5 proceedings. [I]mportant facts and issues . . . [may] continue[] to surface quite late into the Article 21.5 proceedings, proceedings that are already abbreviated. . . . Finally, the shorter timeline significantly limits both the panel's opportunity to interact with the parties and the panel's time to deliberate. The panel typically has only one opportunity to meet with the parties, unlike the normal proceedings where two substantive meetings take place.[38]

27. It is precisely in these circumstances that *maintaining* the well-established distinction between the statutory/regulatory provisions providing for payments and particular payments provided thereunder would seem all the *more* important, especially given the seriousness of "as such" claims underscored by the Appellate Body in *U.S. – Oil Country Tubular Goods from Argentina*.[39]

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[34] *U.S. – Oil Country Tubular Goods from Argentina (AB)*, para. 172 (emphasis added).

[35] Brazil Further Submission, para. 426 (9 September 2003) (emphasis added).

[36] Brazil Further Submission, para. 435-436 (9 September 2003) (emphasis added). As the Panel declined to address Brazil's claims against the "2002 FSRI Act and the 2000 ARP Act together with their implementing regulations," however, the Panel neither conducted the requested evaluations, nor made any findings along the lines requested by Brazil.

[37] *U.S. – Countervailing Measures on Certain EC Products (Panel)*, para. 7.74. This panel report was not appealed.

[38] *U.S. – Countervailing Measures on Certain EC Products (Panel)*, para. 7.75, n. 294.

[39] *U.S. – Oil Country Tubular Goods from Argentina (AB)*, para. 172.

28. Third, the European Communities' arguments are again based on the untenable premise that there is a blanket test of "interrelatedness" or "interdependence" under Article 21.5 of the DSU such that even measures not found to be WTO-inconsistent in an original proceeding may nonetheless be swept into the scope of an Article 21.5 proceeding if they nonetheless are deemed to be "interrelated" to, or "interdependent" with, the measures found to be WTO-inconsistent. As discussed above, that premise is unfounded. In the European Communities' own words in a dispute in which it was the responding party, "[n]ot all the measures that are somehow 'connected' to the measure in dispute in the original panel proceedings qualify as measures 'taken to comply.'"[40]

29. The EC's new assertion of a blanket "interrelatedness" or "interdependence" test is not only unfounded, it makes little sense, especially in the context of this dispute. The EC has not offered any reason why a measure should be considered "indivisible" from another "for purposes of a compliance panel" where the measures were not "indivisible" for purposes of an original proceeding. Indeed, this was a critical consideration in resolving a second scope question in *EC – Bed Linen (21.5)*. There the Appellate Body rejected an attempt by India to have the scope of an Article 21.5 proceeding expanded to include an element of a measure taken to comply (the "other factors" analysis in an antidumping redetermination) that was identical to an element that had been found to be WTO-consistent in an original measure. India argued that the element was an inseparable part of the measure taken to comply. But the Appellate Body disagreed, explaining that "we do not see why that part of the redetermination that merely incorporates elements of the original determination on 'other factors' would constitute an inseparable element of a measure taken to comply with the DSB ruling in the original dispute. *Indeed, the investigating authorities were able to treat this element separately*."[41] Similarly here, Brazil, the United States, and the original panel all were able to treat the statutory/regulatory provisions providing for payments separately from particular payments thereunder in the original proceeding. There is no reason why those measures should be treated as inseparable in this compliance proceeding.

(2) There is no basis to the EC's argument that "if there is sufficient *nexus* between payments and programme for one programme; and if there is sufficient *nexus* between all payments; this in turn suggests a sufficient *nexus* between all three programs, such that the whole new bundle can and should be treated as indivisible for the purposes of this compliance proceeding."[42]

30. The United States disagrees with EC's argument that "if there is sufficient *nexus* between payments and programme for one programme; and if there is sufficient *nexus* between all payments; this in turn suggests a sufficient *nexus* between all three programs, such that the whole new bundle can and should be treated as indivisible for the purposes of this compliance proceeding."[43]

31. First, the EC argument again assumes incorrectly that original measures never found to be WTO-inconsistent may be within the scope of an Article 21.5 proceeding simply because they are deemed to have some "nexus" either with original measures or measures taken to comply with recommendations and rulings of the DSB. This is patently incorrect, for the reasons discussed above. Indeed, the EC argument would effectively make Article 21.5 proceedings an "open season" for complaining parties to challenge measures "as such" that had either not been challenged or had been challenged unsuccessfully in original proceedings. There will *always* be a "nexus" between statutory and regulatory provisions and individual instances in which they are applied. If the EC argument were credited, a complaining party could simply challenge one instance of the application of a statutory/regulatory provision in an original proceeding and save any claims against the

[40] *EC – Bed Linen (Panel),* Annex D-3 (Oral Statement of the European Communities, para. 5 (September 10, 2002)).
[41] *EC – Bed Linen (AB) (21.5 – India),* para. 86.
[42] Oral Statement of the European Communities, para. 21.
[43] Oral Statement of the European Communities, para. 21.

statutory/regulatory provisions themselves until a compliance proceeding where "there is no provision for a 'reasonable period,'" and "the parties do not have the same opportunity to present evidence and arguments" as in an original proceeding.[44] The negotiators of the DSU never agreed that compliance proceedings could be used (some could argue "abused") in this way.

32. Second, the fact that the original panel cumulated the effects of the Step 2, marketing loan, and counter-cyclical payments made in MY 1999-2002 in assessing whether they caused "present" significant price suppression does not mean that those measures became one "indivisible" measure for purposes of WTO dispute settlement. That argument bears no connection to reality. Payments under the three programs are distinct measures as a matter of fact and as a matter of WTO dispute settlement, regardless of whether their effects can be added together in assessing whether there is sufficient "price suppression" to meet the standard of "significant price suppression" for purposes of Article 6.3(c) of the *SCM Agreement*.

33. Third, the unreasonableness of the approach suggested by the European Communities here is especially apparent when one considers that the European Communities argued – successfully – in *EC – Bed Linen (21.5)* that an analysis of "other factors" did not share a sufficient "nexus" with the other parts of the *same* determination to be deemed one "indivisible" measure. In other words, even though they were all part of a *single* antidumping redetermination that was part of a *single* EC regulation involving imports of bed linens from India and formed an integral and necessary basis for the imposition of a *single* antidumping order, the EC argued (and the panel agreed) the "other factors" analysis should not be considered an "inseparable" part of the redetermination. Yet, here, for some reason, the European Communities suggests that entirely distinct payments made to entirely different recipients under entirely different conditions and under entirely different statutory/regulatory provisions must somehow be considered one indivisible measure for purposes of this compliance proceeding simply because their effects were examined cumulatively in the original dispute. The United States submits that this is an entirely untenable argument.

34. Moreover, the Appellate Body has clarified that the "measure" identified as being subject to WTO claims cannot "vary depending on the substance of the legal provision invoked by a complainant and the interpretation that a panel might give to that provision."[45] The European Communities' suggestion that what is a "measure" depends on how effects were examined for purposes of Articles 5(c) and 6.3(c) of the *SCM Agreement* is not consistent with the Appellate Body's clarification and should be rejected on that basis as well.

(3) The European Communities is mistaken in its suggestion that the United States has argued that "the fact that something has not changed . . . necessarily means that it is outside the scope of a compliance proceeding."[46]

35. The European Communities appears to misunderstand the U.S. arguments. The United States has never suggested that "the fact that something has not changed necessarily means that it is outside the scope of a compliance proceeding."[47] The United States fully agrees that where the "something" that "has not changed" is a measure that was subject to DSB recommendations and rulings, it is possible – although not always – that a compliance proceeding could determine that no measure taken to comply exists.

36. The United States has simply argued that where a measure is *not* one that was subject to DSB recommendations and rulings, and where it is *not* a measure taken to comply (*evidence* of which is the

[44] *U.S. – Countervailing Measures on Certain EC Products (Panel)*, para. 7.75, n. 294.
[45] *EC – Customs (AB)*, para. 132.
[46] Oral Statement of the European Communities, para. 22.
[47] Oral Statement of the European Communities, para. 22.

fact that it has not changed), that measure is not properly within the scope of a compliance proceeding.

(4) The European Communities' argument that "claims of present serious prejudice and *threat* of serious prejudice are closely interrelated, such that a threat claim in an original panel may inevitably give rise to a claim of present serious prejudice in a compliance panel"[48] is illogical.

37. The United States notes a number of flaws in the European Communities' argument that:

> Finally, and *significantly*, the European Communities observes that there is support in the case law for the view that claims of present serious prejudice and *threat* of serious prejudice are closely interrelated, such that a threat claim in an original panel may inevitably give rise to a claim of present serious prejudice in a compliance panel.[49]

38. First, despite the asserted "significance" of the point, the European Communities fails even to identify the alleged "support in the case law."[50] Indeed, there is not a single citation provided by the European Communities; the point is entirely unsupported.

39. Second, this assertion is not logical. The *claims* that a Member makes in an original proceeding do not limit the *claims* that it makes in a compliance proceeding so long as, in the compliance proceeding, the claims apply with respect to a measure taken to comply. In contrast, if there are no measures taken to comply then only one claim is available – that no measures taken to comply exist.

40. Here, the marketing loan program and counter-cyclical payment programs are not original measures subject to any finding of WTO-inconsistency. "As a consequence," in the words of the *EC – Bed Linen (21.5)* panel, "the DSB's rulings cannot have touched upon these [programs]. Nor could the DSB have recommended that the [United States] bring into conformity with its obligations measures as to which there was no finding of violation. Thus, the [United States] was under no legal obligation to do anything with respect to the [marketing loan program and counter-cyclical payment programs]."[51] In these circumstances, there is obviously no basis for Brazil to claim that the United States failed to bring those measures into conformity with any (non-existent) DSB recommendations and rulings.

41. Moreover, the marketing loan program and counter-cyclical payment programs are not measures taken to comply with any recommendations and rulings in respect of *other* measures (*i.e.,* measures that *were* found to be WTO-inconsistent). The Appellate Body has explained before that "[i]n our view, the phrase 'measures taken to comply' refers to measures which have been, or which should be, *adopted by a Member to bring about compliance with the recommendations and rulings of the DSB*."[52] Neither the marketing loan program, nor the counter-cyclical payment program, nor any marketing loan payments or counter-cyclical payments, nor some combination of these measures was "adopted by [the United States] to bring about compliance with the recommendations and rulings of the DSB." In fact, these measures were in existence and were even at issue in the original proceeding. And, as Brazil acknowledges, they have not been changed since that proceeding to implement any DSB recommendations and rulings or for any other reason.[53] Thus,

[48] Oral Statement of the European Communities, para. 23.

[49] Oral Statement of the European Communities, para. 23.

[50] This is aside from the fact that there is no such thing in the WTO as "case law." The WTO is not a common law system.

[51] *EC – Bed Linen (Panel)*, para. 6.18-6.19 (emphasis added).

[52] *Canada – Aircraft (AB) (21.5 – Brazil)*, para. 36.

[53] Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 35.

under the express terms of Article 21.5 of the DSU, those measures cannot be the subject of any claims of inconsistency "with a covered agreement" – whether or "present" serious prejudice, "threat" of serious prejudice or anything else – in this compliance proceeding.

> ***46. In its Oral Statement, the European Communities characterizes Brazil's and the United States' respective approaches as the "measure model" and the "element of the measure model" (Oral Statement of the European Communities, para. 7). Please discuss whether you agree with this characterization and whether, in your view, the application of a measure alleged to be a subsidy to different agricultural products relates to a "measure" (or elements thereof) or if, rather it relates to a "claim". Would it be permissible for a compliance panel to examine a "claim" that relates to subsidies (granted as part of measures taken to comply) provided to agricultural products to which the "initial measure" did not apply?***

42. With respect to the first of the Panel's questions, the United States does not agree with the European Communities regarding the characterization of the parties' views, the appropriateness of framing the question of the scope of Article 21.5 proceedings through an elaborate construct of "models" that is not found anywhere in the text (but instead has been made up by the EC for purposes of this proceeding), or the necessity of any such construct in resolving the question of whether or not GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat are within the scope of this proceeding.

43. The United States recalls that the Members have expressly agreed in Article 3.2 of the DSU that the WTO dispute settlement system "serves to preserve the rights and obligations of Members under the covered agreements, and to *clarify the existing provisions of those agreements* in accordance with customary rules of interpretation of public international law." The United States does not see "element of measure model," "measure model" or any other similar language in Article 21.5 of the DSU. What the United States does find, instead, is the following language, which identifies both the measures that are properly within the scope of Article 21.5 proceedings and the claims that can be made therein:

> Where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures. . . .

44. This language makes clear that only measures "taken to comply" with the recommendations and rulings of the DSB are properly before a compliance panel. Where the DSB's recommendations and rulings are limited to particular things – regardless of whether those things are measures or elements of a measure – it follows that the focus of a compliance proceeding is whether those things have been brought into compliance consistently with the DSB's recommendations and rulings and with the provisions of the WTO Agreement cited by the complaining party. There can be no presumption that the responding Member's measures taken to comply are inconsistent with its WTO obligations; the burden is on the complaining party to prove inconsistency.

45. Applying that logic in the present dispute, the same result obtains whether one understands GSM 102 guarantees as elements of the GSM 102 program or as individual measures themselves; the latter being the correct understanding, in the U.S. view for the reasons explained previously.[54] In either case, the fact is that the original panel found that Brazil had only established its case with respect to export credit guarantees in respect of exports of rice and unscheduled products.[55] Neither the original panel nor the Appellate Body found that Brazil had proven its case with respect to guarantees provided in respect of the twelve other scheduled products (export credit guarantees in

[54] U.S. Comments on Brazil's Answers to First Set of Panel Questions, paras. 9-17.
[55] *Upland Cotton (Panel)*, para. 8.1(d)(i).

respect of exports of wheat, coarse grains, vegetable oils, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, pigmeat, poultry meat, live dairy cattle, or eggs).[56] As the original panel clearly distinguished between these different guarantees, there is no basis for either ignoring the fact that it did so or suggesting that no such distinction can be drawn in this compliance proceeding. Indeed, given the abbreviated and expedited nature of compliance proceedings, discussed above, it is all the more important that Brazil not be permitted to eliminate such distinctions here.

46. Turning to the Panel's second question – whether "the application of a measure alleged to be a subsidy to different agricultural products relates to a 'measure' (or elements thereof) or if, rather it relates to a 'claim'" – the United States considers that the fact that a measure is applied to particular products (or is applied generally to all products) is necessarily relevant to understanding the *nature* and *scope* of the measure. However, it may *also* be relevant in assessing the particular claim being made. In the case of Brazil's claims against the export credit guarantees, it was relevant to both. Consider the following examples:

- Section 1207 of the Farm Security and Rural Insurance Act ("FSRI Act") of 2002 – the Step 2 program – that Brazil challenged, as such, for providing prohibited export and import substitution subsidies in the original proceeding was limited by its terms only to upland cotton.[57] This fact was relevant to understanding the nature and scope of the measure being challenged in the original proceeding. However, the fact that Section 1207 applied with respect to upland cotton was not an important consideration in assessing the prohibited subsidy claims that Brazil made.

- By contrast, Sections 1201-1205 of the 2002 FSRI Act – the marketing loan program – provides for non-recourse loans and loan deficiency payments with respect to a number of different products.[58] Brazil challenged separately (a) the provisions themselves to the extent that they applied to upland cotton and (b) individual instances of their application (payments made in MY 1999-2002 and payments allegedly "mandated" to be made in MY 2003-2007). The particular product to which the measure applied was important, in both cases, in understanding the nature and scope of the measure(s) challenged.

  However, the fact that Section 1201-1205 applied with respect to upland cotton was also relevant to the *claims* made by Brazil under Articles 5 and 6 of the *SCM Agreement* because the claims required the identification of a "subsidized product" and an examination of the effects of payments under the programs on the "subsidized product."[59] Brazil could only prevail on its claims against these measures if it could show the requisite effects with respect to the "subsidized product."

- Similarly, Section 202 of the Agricultural Trade Act of 1978 allows the Commodity Credit Corporation ("CCC") to guarantee the "repayment of credit made available to finance commercial export sales of agricultural commodities."[60] To avoid the application of the mandatory-discretionary principle – which would have been fatal to any "as such" claim given that these provisions clearly do not even mandate the provision of guarantees, let alone the provision of *export subsidies* – Brazil argued

[56] *Upland Cotton (Panel)*, para. 8.1(d)(ii).

[57] *See* 2002 Farm Security and Rural Investment Act (Exhibit BRA-29).

[58] *See* 2002 Farm Security and Rural Investment Act (Exhibit BRA-29). The United States does not include the counter-cyclical payment program in this discussion because it does not provide for payments in respect of any particular product. It simply authorizes payments in respect of historical base acres.

[59] *See* Articles 6.3(c) and 6.3(d) of the *SCM Agreement*.

[60] 7 U.S.C. 5622 (Exhibit US-141). *See also*, implementing regulations in 7 C.F.R. 1493 (Exhibit US-142), which maintain the same product scope.

> that its claims of actual circumvention under the *Agreement on Agriculture* were "akin to . . . 'as applied' claim[s]" with respect to the export credit guarantees.[61] However, Brazil did not initially limit its challenge to the provision of guarantees to any subset of eligible products. The original panel therefore considered whether Brazil had proven its claims of circumvention with respect to *all* guarantees in respect of *all* eligible products.
>
> Nonetheless, Brazil was only *successful* in proving that the provision of export credit guarantees to exports of rice and unscheduled products resulted in actual circumvention under the *Agreement on Agriculture* or in breach of any obligations under the *SCM Agreement*. Therefore, the products to which the guarantees applied were important in defining the scope of measures that were subject to any finding of WTO-inconsistency, DSB recommendations and rulings, or any implementation obligation on the part of the United States. This is no different, for example, than if Brazil had challenged, under Articles 5 and 6 of the *SCM Agreement*, the marketing loan program not only as it applied to upland cotton but all other products eligible for payments thereunder. If, in those circumstances, it had been able to make its case only in respect of upland cotton, that fact would have been important in understanding both the scope of U.S. implementation obligations and the scope of measures taken to comply. The same is true in the case of the export credit guarantees.

47. This brings us to the third question presented by the Panel – whether it would be "permissible for a compliance panel to examine a 'claim' that relates to subsidies (granted as part of measures taken to comply) provided to agricultural products to which the 'initial measure' did not apply." The United States recalls, again, that by the very terms of Article 21.5, the touchstone of any analysis of "measures taken to comply" is the recommendations and rulings of the DSB and the consideration of whether or not a challenged measure is properly understood to have been "taken to comply" with those recommendations and rulings. The Panel's question appears to assume that critical consideration since it asks whether subsidies that are "part of measures taken to comply" may be subject to claims in a compliance proceeding. It is difficult – in the abstract – to conceive of why a Member would comply with DSB recommendations and rulings relating to subsidies provided to one product by providing subsidies in respect of other products.

48. That is, in any event, an entirely different situation than the one before this Panel. Here, Section 202 of the Agricultural Trade Act of 1978[62] and its implementing regulations permit guarantees to be made to the exact same group of agricultural products as before. The question is whether the United States – through the various changes it has made – has brought into conformity with the DSB's recommendations and rulings and with any provisions of covered agreements cited by Brazil those guarantees that were found to have been provided in a WTO-inconsistent manner by the original panel. The guarantees provided in respect of exports of pig meat and poultry meat are not measures taken to comply with any recommendations and rulings of the DSB, nor are they part of any measures taken to comply with any recommendations and rulings of the DSB.[63]

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[61] Brazil's Answers to Additional Questions Following Second Panel Meeting, paras. 11, 37 (20 January 2004).

[62] 7 U.S.C. 5622 (Exhibit US-141).

[63] As discussed above, the mere fact that they were subjected to the same improvements as the guarantees that were subject to the DSB's recommendations and rulings do not render them measures taken to comply or elements of any measures taken to comply.

Questions to the United States

47. The United States has raised a preliminary objection regarding Brazil's claims of (threat of) serious prejudice in respect of the marketing loan and counter-cyclical payment programmes. Is the Panel's understanding correct that, apart from this preliminary objection regarding programmes, the United States also considers that the issue of whether payments made under the marketing loan and counter-cyclical payment programme after 21 September 2005 cause serious prejudice to the interests of Brazil is not properly within the scope of this proceeding?

49. Yes. As depicted in the chart below, the original panel (a) made a finding of "present" serious prejudice only with respect to payments made under the Step 2, marketing loan and counter-cyclical payment program in MY 1999-2002; (b) declined to make any finding of "threat" of serious prejudice with respect to payments allegedly "mandated" to be made in MY 2003-2007; and (c) declined to make any find of "threat" of serious prejudice with respect to the Step 2, marketing loan, and counter-cyclical payment programs themselves (which would have implicated *all* payments under the programs). In these circumstances, the only measures subject to any finding of WTO-inconsistency, and DSB recommendations and rulings based thereon, or any implementation obligations were payments made under the Step 2, marketing loan and counter-cyclical payment program in MY 1999-2002 (*i.e.*, through July 31, 2003). Thus, unless Brazil were to establish that payments made after September 21, 2005 were measures taken to comply with the recommendations and rulings of the DSB – and, for the reasons explained in the U.S. comments on Brazil's response to Question 15 in the first set of questions from the Panel, the United States does not consider that Brazil has presented any basis to make such a finding – those payments are not properly within the scope of this Article 21.5 proceeding.

Measure Challenged	**Claim Made**	**Resolution by Original Panel**	**Paragraph in Panel Report**
"U.S. subsidies provided during MY 1999-2002"	"Present" serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*	**Finding** of WTO-inconsistency against Step 2, marketing loan, and counter-cyclical/market loss assistance programs	7.14168.1(g)(i)
"U.S. subsidies provided during MY 1999-2001"	"Present" serious prejudice under Articles 5(c) and 6.3(d) of the *SCM Agreement*	**Rejected** for failure to make *prima facie* case	7.14658.1(g)(ii)
"U.S. subsidies provided during MY 1999-2002"	"Present" serious prejudice under Articles XVI:1 and XVI:3 of the GATT 1994	**Declined** to address, *inter alia,* because of finding of inconsistency with Articles 5(c) and 6.3(c) of the *SCM Agreement*	7.1476
"U.S. subsidies" allegedly "mandated" to be provided during MY 2003-2007	"Threat" of serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*	**Declined** to address in light of finding of inconsistency with Articles 5(c) and 6.3(c) and 3.1(a) and 3.2 of the *SCM Agreement*	7.1503
"U.S. subsidies" allegedly "mandated" to be provided during MY 2002-2007	"Threat" of serious prejudice under Articles 5(c) and 6.3(d) of the *SCM Agreement*	**Rejected** for failure to make *prima facie* case	7.1504
"U.S. subsidies" allegedly "mandated" to be provided during MY 2003-2007	"Threat" of serious prejudice under Articles XVI:1 and XVI:3 of the GATT 1994	**Declined** to address, *inter alia,* because of finding of inconsistency with Articles 5(c) and 6.3(c) of the *SCM Agreement*	7.1505

Measure Challenged	Claim Made	Resolution by Original Panel	Paragraph in Panel Report
"selected provisions of the FSRI Act of 2002 and the ARP Act of 2000"	"Threat" of serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*	**Declined** to address in light of findings regarding export subsidies, import subsidies, "present" serious prejudice, and "threat" of serious prejudice	7.1511
"selected provisions of the FSRI Act of 2002 and the ARP Act of 2000"	"Threat" of serious prejudice under Articles 5(c) and 6.3(d) of the *SCM Agreement*	Same as above	7.1511
"selected provisions of the FSRI Act of 2002 and the ARP Act of 2000"	"Threat" of serious prejudice under Articles XVI:1 and XVI:3 of the GATT 1994	Same as above	7.1511

48. How does the United States address the argument of Brazil that "[i]f the United States were to prevail on its view that subsequent mandatory and price-contingent marketing loan and CCP payments are not properly before this Panel, the grant of annual recurring subsidies becomes 'a moving target that escape from [the WTO subsidy] disciplines'"? (Closing Statement of Brazil, para. 4)

50. As the United States explained in its comments on Brazil's response to Question 15 in the first set of questions from the Panel, the United States does not consider this to be a valid argument. Under the reasoning of the original panel, nothing prevents Members from challenging present adverse effects of past or current payments, threat of serious prejudice of past, current, or future payments, or present adverse effects or threat of serious prejudice from payment programs as such. Indeed, Brazil availed itself of many of those opportunities in the present dispute. The obligations of a responding Member depend on what the outcome is of those challenges. Where, as here, a complaining Member only *prevails* on one claim – that of "present" serious prejudice with respect to particular payments made in particular years – the Member is bound by that outcome. The complaining Member cannot seek to avoid that outcome either through *post hoc* attempts to rewrite the original panel report, or by complaining that its remedy is more limited that it would have been had the original panel's findings of WTO-inconsistency been made with respect to a different and broader set of measures.

51. Nor is this a situation where Brazil had no remedy under the original panel's findings. Brazil has itself expressly recognized otherwise. Before the Appellate Body, Brazil argued that subsidies provided in MY1999-2002 must be found to be capable of having "present" effects at the time of the appeal (*i.e.,* in late 2004 to 2005) in order for it to have any remedy in the dispute. Brazil argued, specifically, that if the U.S. arguments to the contrary were credited "Brazil will have no remedy under Article 7.8 of the SCM Agreement for its serious prejudice, since it is allegedly legally impossible for the MY 2002 price-contingent recurring subsidies to have any adverse effects after 31 July 2003 (the close of MY 2002)."[64] The Appellate Body agreed, finding that "the effects of a 'recurring' subsidy may continue after the year in which it is paid."[65]

52. Under Brazil's own arguments, then, it would have had "a remedy under Article 7.8 of the SCM Agreement for its serious prejudice" even in years after the MY 1999-2002 subsidies were

[64] *Upland Cotton (AB),* para. 529.
[65] *Upland Cotton (AB),* para. 484.

provided. This not only confirms that the U.S. measures were not, in fact, "a moving target" but that Brazil specifically understood the limited scope of the original panel's findings. Had the findings been with respect to the programs themselves and/or all future payments as Brazil alleges, there would have been no basis for Brazil to allege that "Brazil will have no remedy under Article 7.8 of the SCM Agreement for its serious prejudice" since the findings of serious prejudice found by the original panel would have extended beyond MY 2002 to all times in the future in which Step 2, marketing loan, and counter-cyclical payments were to be made.

53. At the same time, it is clear that claims of serious prejudice under the SCM Agreement have a temporal scope. This is established by the text of the agreement, for example the distinction between present and "threat of" serious prejudice. The fact that the negotiators specifically agreed on obligations that have a temporal scope means that a Member is not free in dispute settlement proceedings to complain that the temporal scope constrains their remedies.

49. Could the United States comment on the argument of the European Communities that the text of Article 21.5 of the DSU does not limit the temporal scope of that provision in the manner suggested by the United States? (para. 29 of the Oral Statement of the European Communities)

54. It is unclear from the oral statement of the European Communities what it means by "limit[ing] the temporal application [of Article 21.5] in the manner advocated by the United States."[66] In any event the European Communities' arguments do not appear to respond to the arguments that the United States has actually made.

55. Specifically, the United States has argued that Brazil has not identified any textual basis that requires the Panel to make findings regarding compliance as of the end of the six-month period set out in Article 7.9 of the *SCM Agreement* rather than as of the date of panel establishment pursuant to Article 21.5 of the DSU. Contrary to Brazil's suggestions, neither Article 21.5 of the DSU nor Article 7.9 of the *SCM Agreement* require this. Moreover, prior panels in *EC – Bed Linen (21.5)* and *U.S. – Shrimp (21.5)* have properly assessed compliance as of the date of establishment of the panel.

56. The European Communities' assertion that there is no temporal limitation in Article 21.5 of the DSU is, thus, fully consistent with the U.S. argument. Indeed, in *EC – Bed Linen (21.5)*, the European Communities made precisely this point, noting that the absence of a temporal limitation applicable to compliance proceeding *supported* its argument that "the relevant date for assessing the consistency of the measures 'taken to comply' with the covered agreements is the date of establishment of the panel, and not that of the end of the 'reasonable period of time.'"[67] Specifically, the European Communities argued there that:

> As noted by the panel in US – Shrimps (Article 21.5), "the DSU is silent as to the date on which the existence or consistency of the implementing measure must be assessed". The same panel went on to find that:
>
> > … it should take into account all the relevant facts occurring until the date the matter was referred to it. By applying this approach, an Article 21.5 panel can reach a decision that favours a prompt settlement of the dispute. Indeed, it avoids situations where implementing measures allowing for compliance with the DSB recommendations and rulings would be disregarded simply because they occur after the end of the reasonable period of time. The Panel,

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[66] Oral Statement of the European Communities, para. 29.

[67] *EC – Bed Linen (21.5)*, Annex A-2, First Written Submission of the European Communities, para. 35.

> while mindful of the obligation of the United States to bring its legislation into conformity by the end of the reasonable period of time, considers that it is consistent with the spirit of Article 3.3 of the DSU to take into account any relevant facts until the date on which the matter was referred to the Panel.

. . . .[T]he EC submits that the relevant date for assessing the consistency of the measures "taken to comply" with the covered agreements is the date of establishment of the panel, and not that of the end of the "reasonable period of time".

Of course, the EC is not suggesting that the implementing Member is under no obligation to implement the DSB's rulings and recommendations within the "reasonable period of time". That obligation, however, does not flow from Article 21.5, but instead from Article 21.3 of the DSU, which states in pertinent part that

> If it is impracticable to comply immediately with the recommendations and rulings, the Member concerned shall have a reasonable period to comply.

It is obvious, nevertheless, that a finding that a Member has violated Article 21.3 of the DSU by implementing late the DSB's recommendations and rulings would be necessarily declaratory, since there is nothing that such Member could do in order to correct that violation. In any event, as discussed below, in the present case India did not state in its panel request any claims based on Article 21.3 of the DSU.[68]

57. When India clarified in *EC – Bed Linen (21.5)* that it was looking for two findings – one regarding compliance as of the end of the reasonable period of time and one as of the date of establishment of the panel, the European Communities again forcefully argued that the former was not within the compliance panel's terms of reference:

> The EC has requested the Panel to make a ruling to the effect that the relevant date for assessing the consistency of the measures "taken to comply" with the covered agreements is the date of establishment of the Panel.
>
> India agrees with that request. Nevertheless, it argues that, in addition, the Panel should assess the consistency of the measures "taken to comply" also as of the date of expiry of the "reasonable period of time".
>
> India's request is not within the Panel's terms of reference. The obligation to comply within the "reasonable period of time" does not arise from Article 21.5, but from Article 21.3 of the DSU. Yet, India has not cited Article 21.3 in its panel request.
>
> In any event, the ruling requested by India would serve no useful purpose and would complicate unnecessarily the Panel's task. If the Panel found that the EC did not comply as of end of the 'reasonable period of time', but did so as of the date of establishment of the panel, there would be nothing else that the EC could do in order to remedy that temporary lack of compliance.
>
> . . . . While it may be true that no Member has ever invoked a violation of Article 21.3 in Article 21.5 proceedings, this does not prove that it is unnecessary to

[68] *EC – Bed Linen (21.5)*, Annex A-2, First Written Submission of the European Communities, paras. 34-37.

> state that claim separately. Rather, it seems more likely that no Member has ever bothered to invoke a violation of Article 21.3 because a ruling that the implementing Member has complied late would be declaratory and devoid of practical consequences.[69]

58. In response to questions, the European Communities clarified its view that "the position expressed in paragraph 35 of the EC's First Written Submission" – *i.e.*, that "the relevant date for assessing the consistency of the measures 'taken to comply' with the covered agreements is the date of establishment of the panel, and not that of the end of the 'reasonable period of time'" – did not depend on the particular terms of reference of a panel but, rather, "is valid with respect to all Article 21.5 disputes."[70]

59. There is no basis for the European Communities to argue that the analysis should somehow be different here. In particular, the United States notes the European Communities' argument now that "whether or not Brazil's request would ever be capable of having any practical utility is a different matter that this Panel does not need to address, being essentially a matter for Brazil, exercising its judgement in good faith."[71] This would appear diametrically opposite to its argument that the panel in *EC – Bed Linen (21.5)* should review compliance as of the date of establishment because "the ruling requested by India would serve no useful purpose and would complicate unnecessarily the Panel's task. If the Panel found that the EC did not comply as of end of the 'reasonable period of time', but did so as of the date of establishment of the panel, there would be nothing else that the EC could do in order to remedy that temporary lack of compliance."[72]

60. While the European Communities' position may differ depending on whether or not its own measures are at issue, the fact remains that the panel in *EC – Bed Linen (21.5)* considered the reasoning identified by the European Communities in *EC – Bed Linen (21.5)* to be persuasive and proper and applied it to dismiss India's request. The panel explained:

> It appears India considers that we must make two decisions on the existence or consistency of measures taken to comply – one as of the end of the reasonable period of time, and one as of the date of establishment of the Panel. We do not consider that it would be either necessary or appropriate, as a matter of judicial economy, to first examine whether compliance had occurred as of the end of the reasonable period of time, and second consider compliance as of the later date.[73]

61. This mirrored the reasoning of the *U.S. – Shrimp (21.5)* panel invoked by the European Communities and set out above. The United States recalls – and agrees with – the European Communities' argument that the reasoning underpinning this result "is valid with respect to all Article 21.5 disputes."[74] The same result is certainly valid here.

Question to Brazil

50. Does Brazil maintain its claims with respect to the three unscheduled products (lyocell, lysine, wood products) identified by the United States as falling outside the

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[69] *EC – Bed Linen (21.5)*, Annex D-3, Rebuttal Submission of the European Communities, paras. 12-19.

[70] *EC – Bed Linen (21.5)*, Annex E-3, Answers of the European Communities to Questions from India, para. 3.

[71] Oral Statement of the European Communities', para. 29.

[72] *EC – Bed Linen (21.5)*, Annex D-3, Rebuttal Submission of the European Communities, paras. 18.

[73] *EC – Bed Linen (Panel) (21.5 – India)*, para. 6.28.

[74] *EC – Bed Linen (21.5)*, Annex E-3, Answers of the European Communities to Questions from India, para. 3.

scope of the Agreement on Agriculture? (see paragraph 83 of the United States' Rebuttal)

B. CLAIMS OF BRAZIL REGARDING PRESENT SERIOUS PREJUDICE

1. Significant price suppression - Article 6.3(c) of the *SCM Agreement*

Questions to both parties

51. The parties disagree on whether or not the marketing loan and counter-cyclical payments have more than minimal effects on production of upland cotton. Could each party explain how its approach to the analysis of the impact of these payments on production of upland cotton is supported by the provisions of Articles 5 and 6 of the SCM Agreement and by any other relevant WTO provisions?

62. Brazil makes two claims of "present" serious prejudice under Article 5(c) of the *SCM Agreement*, one alleging significant price suppression under Article 6.3(c) and the other alleging a comparative increase in world market share within the meaning of Article 6.3(d) of the *SCM Agreement*. In either case, the key consideration is what "the effect of the subsidy *is*" at present (*i.e.*, for purposes of this dispute, MY 2006).[75] The use of the present tense -- "is" – is important not only because it helps to identify the proper period for examination of the effects but also confirms that the effects that are important are those that *exist* in *fact* – not any potential or speculated effects that may or may not arise under different market circumstances. "Is" means, *inter alia*, "that which exists, that which is; the fact or quality of existence."[76] "Is" comes from the verb "to be," which itself means, *inter alia*, "have place in the realm of fact, exist, live" "be the case or the fact; obtain."[77]

63. That the concern of Articles 6.3(c) and 6.3(d) is with "effects that exist in fact" is further confirmed by the ordinary meaning of "effect" which is, *inter alia*, "something accomplished, caused or produced; a result, a consequence" and "reality, fact as opp[osed] to appearance."[78] Thus, to prove its claims under Articles 5(c) and 6.3(c) or 6.3(d), Brazil's must show that the effects that exist in fact of marketing loan and counter-cyclical payments are either significant price suppression or an increase in world market share as, respectively, contemplated under those provisions.

64. Brazil has argued that effects of marketing loan and counter-cyclical payments on production of upland cotton are a key element of the alleged causal link between the payments and significant price suppression/increase in world market share. According to Brazil, marketing loan and counter-cyclical payments induce U.S. farmers to plant upland cotton in circumstances where, without (or "but for") the marketing loan and counter-cyclical payments they would not have done so. Brazil asserts that this allegedly subsidy-induced level of planting leads to overproduction, which leads to increased exports (under Brazil's theory pre-Panel meeting) – or unsold stocks (under Brazil's theory as of the Panel meeting) – and, ultimately, to the adverse effects with respect to price/market share claimed by Brazil.

65. To examine whether marketing loan and counter-cyclical payments have these alleged effects on the production of upland cotton, it is necessary to look at the particular decision matrix of U.S. producers and the factors that they *actually* consider as they decide whether and what to plant. Moreover, it is important to look at the way that the marketing loan and counter-cyclical payment programs *actually* operate and interact with production decisions. These considerations underpin the

[75] This was the marketing year in effect at the time this Panel was established on September 28, 2006. *See* Minutes of Meeting, para. 49 WT/DSB/M/220 (circulated November 2, 2006).

[76] *The New Shorter Oxford English Dictionary* at 1421, Volume 1, (1993 Edition) (Exhibit US-129).

[77] *The New Shorter Oxford English Dictionary* at 195, Volume 1, (1993 Edition) (Exhibit US-130).

[78] *The New Shorter Oxford English Dictionary* at 793, Volume 1, (2005 Edition) (Exhibit US-143).

U.S. approach to examining the effects of marketing loan and counter-cyclical payments on production in this proceeding.

66. By the same token, the United States submits that for Brazil's arguments regarding planting decisions – to be given any weight – must be consistent with, at the very minimum, the basic facts of upland cotton production and with how the marketing loan and counter-cyclical payment programs operate. This means, for example, that the arguments cannot be inconsistent with the fact that in each year when a farmer sits down to decide whether to plant cotton, he does not *know*:

- whether the weather will cooperate and how much cotton will ultimately be produced, what the demand and consumption situation will look like at the time of harvest, and what price cotton will ultimately fetch on the market at harvest,

- what the supply, demand, and price situation will be for other competing crops,

- whether the adjusted world price (or "AWP") will be below 52 cents so that he might receive a marketing loan payment with respect to upland cotton that he decides to grow (or whether he might receive a marketing loan payment for a competing crop),

- what his variable costs will ultimately be if he decides to grow upland cotton (versus some other crop or versus putting his land to some other use), and

- (while it does not depend on whether he plants upland cotton or not) if the season-average farm price for the marketing year to come will ultimately be below the threshold at which he might receive a counter-cyclical payment with respect to any upland cotton or other crop *base acres* that he holds.

67. The farmer's planting decision *must* be made on the basis of *expectations* about, *inter alia*, weather, supply, demand, prices, government payments, and variable costs both with respect to upland cotton and competing crops. Whether or not his expectations ultimately turn out to be correct or incorrect is not a relevant factor in his planting decision; he cannot rewind time and make different production decisions based on how things *actually* turn out. Brazil has conceded this both in this proceeding[79], and in the original proceeding.[80] Moreover, this is the general approach underlying Brazil's modeling efforts both in this and the original proceeding.[81]

68. The United States has shown that much of the evidence and arguments presented by Brazil fails to withstand scrutiny when examined in the light of these basic facts of upland cotton production. For example:

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[79] *See* Brazil First Written Submission, Annex I, para. 36 ("U.S. cotton producers respond to the *expected* prices and *expected* rates of subsidy that apply at the time planting and other key decisions are made in the production cycle") (emphasis added) and Brazil First Written Submission, Annex I, para. 58 ("[t]he magnitude of the impact on incentives to produce cotton is equal to the *expected* difference between the loan rate, which is known at planting time, and the grower's *expectations* at the time of planting about the AWP for cotton that will apply when the grower makes that marketing loan transaction.") (emphasis added). Brazil Further Submission, Annex I, para. 17-18.

[80] *US – Upland Cotton (AB)*, para. 440 ("Brazil counters that farmers decide what to plant based on expected market prices as well as expected payments under the challenged subsidy programs, such that planted acreage responds to both these factors.")

[81] Brazil First Written Submission, Annex I, para. 4 ("U.S. producers respond to revenue they expect to receive from market prices and expected government subsidies, where relevant expectations are those that are held around the time that planting and other key production decisions are made. U.S. producers do not know with certainty what actual prices and subsidies will turn out to be as they unfold during the marketing year. Therefore, as in reality, the model assumes that actual prices or subsidies in a marketing year do not affect cotton growers' behavior in that marketing year.")

- Brazil has repeatedly attempted to show effects on upland cotton production in MY 2006 (or MY 2005, under Brazil's preferred approach) based on the actual prices received and/or actual payments received in those years, effectively assuming that production decisions were made on the basis of facts that do not even materialize until many months after planting decisions are made[82];

- Brazil has repeatedly ignored the fact that U.S. farmers consider net revenue, planting conditions and other relevant factors for competing crops vis-a-vis upland cotton – and not just such factors as they relate to upland cotton in isolation – in determining what to plant[83];

- Brazil has repeatedly attempted to establish production effects with reference to actual levels of production in a particular year, which are affected substantially by factors entirely out of the farmer's control (such factors as pests, weather, and technological changes), rather than with respect to effects on planting (*i.e.*, the actual production decision within the hands of the farmer)[84];

- Brazil denies in the face of fact that the use of genetically-improved varieties in the United States and elsewhere have resulted in a dramatic increase in yields that has changed substantially the cost structure of upland cotton farmers in the United States and other countries (for example, India)[85];

- Brazil repeatedly attempts to frame production decisions by reference to costs other than the variable (or operating) costs actually considered by U.S. farmers in their decision matrix[86]; and

- Brazil fails to take into account or distinguish in its analysis the effects on price that are the result of factors on the demand side of the economic balance, including, importantly, the influence of China's upland cotton trade on world market prices. These are effects confirmed by the very evidence Brazil submits, including a report by the International Cotton Advisory Committee ("ICAC") showing the strong correlation between Chinese supply and demand and the A-Index[87], the fact that the A-Index itself has been changed to reflect the influence of Chinese trade on the upland cotton market, as well as market reports observing the role of China's trade in "prevent[ing] a significant price increase in 2005/2006."[88]

69. Brazil's theories about the allegedly significant effects that marketing loan and counter-cyclical payments are having on production, exports (or, under the latest theory, unsold stocks), and ultimately world market prices are divorced from reality and are, instead, heavily dependent on the modeling exercise it has commissioned precisely for the purposes of showing significant price effects. As the United States has shown, that modeling exercise is flawed in its structure and operation as well

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[82] *See e.g.*, Brazil First Written Submission, paras. 127, 144-145; Brazil Rebuttal Submission, para. 191; Oral Statement of Brazil, para. 31.

[83] *See e.g.*, Brazil First Written Submission, para. 142, Brazil Rebuttal Submission, paras. 221-224.

[84] *See e.g.*, Brazil First Written Submission, paras. 93, 96, 124.

[85] *See e.g.*, Brazil Comments on U.S. Oral Statement, para. 32.

[86] *See e.g.*, Brazil First Written Submission, paras. 159-164, Brazil Rebuttal Submission, paras. 245-253, Oral Statement of Brazil, paras. 63-78.

[87] *See* ICAC "Review of the World Market Situation" for May-June 2006 at p. 8 (Exhibit BRA-485).

[88] U.S. First Written Submission, para. 315-316 (citing, for example, "Cotton: Review of the World Situation", International Cotton Advisory Committee at 7 (May-June 2006) (BRA-485)).

as in the parameters and assumptions upon which it rests.[89] Indeed, to get the most exaggerated results possible, Brazil has attempted to discredit its own earlier modeling as "unnecessarily complicated and cumbersome" and "not directly appropriate to the issue at hand."[90] Brazil has submitted in its stead a model that its own creator (Brazil's economist in this dispute) described as a "simple model" that "does not represent the depth of analysis that would be appropriate to support a trade remedy proceeding or a serious prejudice claim before a WTO panel."[91] Not only this but Brazil has systematically adjusted virtually each and every parameter in order to produce even greater impacts on production and prices than would have obtained had it used even the elasticities employed in its original modeling exercise (which were themselves often overstated).[92]

70. In short, the United States submits that although Brazil bears the burden of proof of proving its claims under Articles 5(c)/6.3(c) and 5(c)/6.3(d) of the *SCM Agreement*, it has failed to show that marketing loan and counter-cyclical payments are having the kind and degree of effects on planting and production that it has alleged. Under Brazil's own theory that is a critical first step in establishing a causal link between the payments and the adverse effects alleged to exist.

71. What the data do show – instead – is that for the entire period MY 2002-2007, U.S. cotton farmers expected to meet or exceed their variable costs of planting cotton. Moreover, compared to key competing crops, upland cotton was the most attractive option from the standpoint of costs and revenue in at least three of the years (MY 2003, MY 2004, and MY 2006). In two of the other three years (MY 2002 and 2007), where cotton was not the most attractive option, upland cotton plantings declined *substantially* consistent with the signals from the market. And in the single year (MY 2005) in which acreage shifts did not line up with the different relative attractiveness of cotton and competing crops, other factors were clearly responsible (most importantly, a shift away from soybean acreage due to concerns about an outbreak of Asian soybean rust at the end of MY 2004).[93] Thus, U.S. upland cotton farmers' planting decisions are entirely consistent with the decisions that they would have made had there been no marketing loan and counter-cyclical payments, and are fully consistent with both market signals and other planting and production considerations.

72. The fact that U.S. upland cotton production in these years was both economically rational and consistent with market and planting/production considerations is further confirmed by the fact that U.S. production has been generally stable as a percentage of world production throughout the entire period that U.S. marketing loan and counter-cyclical payments have been made and for a great many years before that as well. This evidence shows that – contrary to Brazil's assertions – marketing loan and counter-cyclical payments have not been inducing U.S. farmers to plant, produce, and export where market signals would cause their foreign counterparts to pull back. The stable share of U.S. production and exports over this period indicates that whatever signals the "world market" is sending, U.S. producers are receiving it clearly and responding to it in much the same way as their foreign counterparts.

73. The independent studies that the United States has submitted – which, unlike Brazil's modeling exercise, were not commissioned for the purposes of this proceeding – lends further support for the argument that the challenged payments are *not* having effects on production that are likely to lead to "significant" price suppression. These studies show, in particular, that counter-cyclical payments likely have minimal effects on acreage and hence production and that a substantial part of

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[89] U.S. First Written Submission, Annex I; U.S. Rebuttal Submission, Annex I, U.S. Oral Statement, Statement of Dr. Glauber.

[90] Brazil Rebuttal Submission, Annex I, para. 4.

[91] Daniel A. Sumner. "Boxed In: Conflicts Between U.S. Farm Policies and WTO Obligations." Center for Trade Policy Studies, The Cato Institute, December 2005. (Exhibit US-108)

[92] Of course, many of the elasticities in the model used for purposes of the original proceeding were already overstated.

[93] *See* U.S. Comments on Brazil's "Oral" Presentation, paras. 70-72.

counter-cyclical payments paid are capitalized into higher land rents and land values. Moreover, data regarding the planted acreage and base acreage show that U.S. farmers do, in fact, use the planting flexibility afforded by the direct and counter-cyclical payment programs (indeed, even before the dramatic decline in expected cotton planted acres for the upcoming marketing year, the data show that U.S. cotton farmers holding cotton base acres are planting approximately *40 percent less* upland cotton than they planted at the time base acres were set). In addition, a significant – and growing percentage – of cotton is grown on farms that do not hold *any* upland cotton base acreage or on planted acreage that is in excess of the upland cotton base acreage held by a farm. That is, for these cotton farmers, there can be no link – even alleged – between cotton base counter-cyclical payments and upland cotton production because these farmers are growing cotton on acreage *beyond* any cotton base acreage.[94]

74. This data reinforces other evidence submitted by the United States; for example, data regarding cost of production shows that for most U.S. production (at least 92 percent) market revenue not only covers variable costs of production but also *all* costs of production. As discussed further below in response to Question 59, this is highly significant because the "total" costs of production reported by USDA include imputed economic opportunity costs. These are not even actual cash costs for many – if not most – upland cotton farmers and, thus, may not ever need to paid out. The data show, therefore, that the vast majority of U.S. farmers are not only able to meet their variable costs of producing upland cotton – the costs that are important from a short-run perspective – they are able to meet their total *cash* costs of producing upland cotton *and* they are able to meet economic opportunity costs that are, for the most part, not even real expenditures that need to be made in order for the farm to stay in business. When one considers this together with the fact that whole-farm decisions about whether or not to close down operations are made on the basis of whole-farm costs and revenue – not just the costs and revenue relating to individual crops – it is clear that U.S. upland cotton farming in the United States is an entirely economically rational business and one that does not depend on marketing loan and counter-cyclical payments for its continued financial viability.

75. Finally, consistent with the evidence before the Panel showing that marketing loan and counter-cyclical payments do not have the kind of "major" production enhancing effects that Brazil's claims assume, Brazil's own modeling exercise reflects minuscule price effects when the modeling parameters are re-adjusted to more realistic levels (that is, *even without* adjusting the model itself for the many fundamental flaws in its structure and operation). Any possible price suppression would only be in the range of 1 to 1.5 percent in the re-calibrated run of the Sumner II model for MY 2006-2008. Even though this result is overstated, it translates into a *less than one cent per pound* impact on world market prices at present A-Index levels.[95] Brazil has provided no evidence to establish that such an impact – exaggerated as it is – nonetheless constitutes "significant" price suppression of the world market price for upland cotton. Indeed, Brazil's approach would effectively equate *any* effect on prices with *significant* price suppression and, thereby, write "significant" out of Article 6.3 of the *SCM Agreement* altogether. Neither that approach – nor the specific arguments made by Brazil as to production effects – is supported by the text of Articles 5 and 6 of the *SCM Agreement*.

52. In its Third Party Submission New Zealand observes:

> ***"Marketing loan payments are amber box measures, the category in which are included the non-prohibited measures with the most trade distorting effect on production and trade." (para. 5.19)***
>
> ***Do the parties consider that the fact that under the Agreement on Agriculture a subsidy is included in the 'amber box' is relevant to***

[94] *See* U.S. First Written Submission, paras. 220-225; U.S. Rebuttal Submission, 263-266.
[95] The average A-Index for January 2007 was 60.44 cents/lb.

the analysis of the subsidy's consistency with Articles 5 and 6 of the SCM Agreement?

76. No. The fact that a measure is notified as an amber box measure does not indicate that it is causing adverse effects within the meaning of Article 5(c) of the *SCM Agreement*. The "amber box" is simply a catch-all category that refers to "domestic support measures in favour of agricultural producers" that do not fit within the so-called "green"[96] (measures that Members agree are non- or minimally-trade distorting) or "blue" (direct payments under production limiting programs) boxes.[97] While "amber box" measures may not meet all the requirements necessary to be deemed non- or minimally-trade distorting for purposes of the "boxes" set out in the *Agreement on Agriculture*, this does not mean that they are causing any of the adverse effects identified in Article 5 of the *SCM Agreement*.

77. To the contrary, the different effects discussed above simply serve to illustrate that there is a spectrum of effects that support measures may have, with no or minimal effects on one end of the spectrum and adverse effects on the other. Articles 5 and 6 of the *SCM Agreement* are only concerned with measures that are at the latter end of the spectrum. Those provisions are not concerned with the non- or minimally-trade distortive measures within the "green box," or with any "amber box" measures that – while they might have somewhat greater effects on trade than green box measures – are not causing any adverse effects within the meaning of Articles 5 and 6.

78. This spectrum of effects is a relevant consideration in assessing Brazil's claims that effectively *any* degree of price suppression must be considered to be "significant" price suppression for the purposes of the present dispute. Brazil's arguments ignore the fact that some amount of trade distortion is expected and tolerated for domestic support measures and that it is only when the trade distortion is found to rise to the level of *significant* price suppression, or one of the other adverse effects identified in Articles 5 and 6 the *SCM Agreement* that the obligation to either withdraw the measure or eliminate the adverse effects thereof arises under Article 7.8 of that agreement.

<u>Questions to the United States</u>

53. The United States argues that Brazil has not provided evidence of 'actual production inducing' effects of marketing loan and counter-cyclical payments and that Brazil 'purports to demonstrate indirect production effects through its claim that the US planting, production, and exports are not responsive to prices.' (Opening Statement of the United States at the meeting of the Panel with the parties, paras. 62 and 69, emphasis in original)

(a) Could the United States explain further the distinction between what it terms "actual production inducing effects "and "indirect production effects"? Could the United States also elaborate on how this distinction is legally relevant in the context of Articles 5 and 6 of the SCM Agreement?

79. The United States does not intend to draw a distinction between "actual production effects" and "indirect production effects." In the paragraphs of the U.S. Oral Statement listed above, the United States argues two different things.

80. First, the United States argues that Brazil's own theory of causation under Articles 5(c) and 6.3(c) – and the ordinary meaning of the treaty terms therein – require an examination of the

96 *See* Article 6.1 and Annex 2 of the *Agreement on Agriculture*.

97 Article 6.5 of the *Agreement on Agriculture*. Certain reduction commitments apply to "amber box" measures unless they are covered by the *de minimis* or agricultural and rural development provisions of the *Agreement on Agriculture*. *See* Article 6.4 and 6.2 of the *Agreement on Agriculture*, respectively.

actual effects that marketing loans and counter-cyclical payments are having on U.S. farmers' planting decisions.[98] In the U.S. view, this requires that any evidence be consistent with the fundamental facts of how planting/production decisions are made by upland cotton farmers. These facts are discussed above in response to Question 51. As discussed therein, much of the data that Brazil submits is *not* consistent with these facts and, thus, says little about the effects of marketing loan and counter-cyclical payments on U.S. farmers' planting decisions.

81. Second, the United States addresses Brazil's arguments that a link between payments under the marketing loan and allegedly artificially high U.S. planted acreage, production, and exports can be gleaned *indirectly* by what it has asserted is the *absence* of a "link" between "prices, on the one hand, and [U.S.] planted acreage, production, and exports, on the other hand. . . ."[99] According to Brazil's argument, if it can show that there is no link between prices for upland cotton and U.S. planting, production, and exports, this means that marketing loans and counter-cyclical payments must have somehow "insulated" U.S. producers' planting, production and exports from market signals. The United States submits that this reasoning is flawed at its inception because U.S. planting, production, and exports react to factors other than just the price of upland cotton (and, in terms of prices, respond to expected not actual prices). For example, as discussed above, the decision to plant upland cotton results from considerations including of expected net revenue for upland cotton *and competing crops*, expected planting and production conditions, and other such factors. It is, therefore, unrealistic to suggest that there should be a one-to-one link between upland cotton planting, production, and exports and upland cotton prices.

82. Moreover, the comparisons that Brazil has attempted to make to demonstrate the absence of a "link" are inconsistent with the very facts of upland cotton production discussed by the United States above. For example, recall that Brazil has argued that there is no link between U.S. upland cotton production in each year and U.S. farm prices. As the United States has explained this ignores the fact that (a) planting decisions cannot be explained through an examination of cotton prices alone, (b) U.S. farmers base planting decisions on expected not actual prices and (c) "producers do not decide on production, but on plantings. Ultimate production is affected by weather and other factors affecting yields."[100]

83. Indeed, the same alleged "absence" of a "link" between absolute production levels and prices is apparent when one compares foreign production to movements in the A-Index.[101] So, either all producers are cut off from market signals – applying Brazil's reasoning – or, in fact, the evidence submitted by Brazil does not in fact support its assertions of market insulation. The United States submits that the latter is the more logical conclusion.

[98] *See Upland Cotton (AB)*, para. 97 ("Brazil explains that United States upland cotton farmers base planting decisions on expected net returns, meaning expected market prices together with expected government support."); Brazil First Written Submission, Annex I, para. 36 ("U.S. cotton producers respond to the *expected* prices and *expected* rates of subsidy that apply at the time planting and other key decisions are made in the production cycle") (emphasis added) and Brazil First Written Submission, Annex I, para. 58 ("[t]he magnitude of the impact on incentives to produce cotton is equal to the *expected* difference between the loan rate, which is known at planting time, and the grower's *expectations* at the time of planting about the AWP for cotton that will apply when the grower makes that marketing loan transaction.") (emphasis added). Brazil Further Submission, Annex I, para. 17-18.

[99] Brazil First Written Submission, para. 145.

[100] Brazil Appellee Brief, para. 706, n. 995.

[101] The United States uses the A-Index because the U.S. farm price is not the price for foreign-grown cotton. However, given that Brazil considers that there are "broad similarities" between the U.S. farm price and the A-Index, it presumably considers the comparison of U.S. and foreign production to the A-Index to be analogous to the comparison Brazil makes above between U.S. production and farm prices. Brazil First Written Submission, para. 97.

84. Similarly, Brazil has also attempted to compare annual U.S. upland cotton export levels and the average farm price for the marketing year to show the alleged absence of a link between exports and prices. However, there again, Brazil's evidence ignores the reality – readily recognized by its own cotton industry outside this dispute – that U.S. exports have reacted to a dramatic decline in U.S. mill use and the contemporaneous increase in foreign consumption.[102] It is those market conditions, rather than marketing loan and counter-cyclical payments that explain U.S. export behavior in the years prior to the FSRI Act coming into effect. Since the Act came into effect, U.S. export behavior has been entirely consistent with that of foreign counterparts.

85. Brazil has also presented a third set of comparisons purporting to show that planting decisions in a marketing year do not correlate to the prices for upland cotton that prevail many months later[103] or to the futures prices of upland cotton *alone*.[104] Here, too, Brazil's analysis fails to account for the actual bases on which planting decisions are made; in particular, the fact that planting decisions are made on the basis of *expectations* about net revenues not only for cotton but *for competing crops* (as, revealingly, reflected in Brazil's own economic model in this dispute). Moreover, the analysis that Brazil presents in this regard – flawed as it is – actually *undermines* Brazil's claims. For example, Brazil's analysis of shifts in U.S. versus foreign harvested acreage compared to futures prices for upland cotton shows U.S. harvested acreage shifting consistently with harvested acreage in the rest of the world in most years. However, where the two diverge, it is because U.S. harvested acreage reacts more *conservatively* than foreign acreage to increasing futures prices for upland cotton (as in MY 2003 and 2006).[105] Indeed, the *only* year since the FSRI Act came into effect in which U.S. harvested acreage shifts were *less* conservative was MY 2005, and that difference is easily explained when one takes into account such factors as (a) the shift in acreage from soybeans to upland cotton in the Delta and Southeast regions of the United States due to fears of another soybean rust outbreak; and (b) exceptionally good growing conditions resulting in low abandonment.

86. In short, the United States submits that Brazil has not substantiated its argument that U.S. planted acreage does not react to market, planting and production signals. The data show, instead, that U.S. production and exports shift consistently with production and exports elsewhere in the world. This – and an examination of changes in U.S. planted acreage in light of expected revenues and other factors *both* for upland cotton and competing crops – confirms that U.S. producers receive and react to market signals in an economically rational manner that is entirely consistent with the behavior of their foreign counterparts.

(b) What is the response of the United States to the argument that the fact that "U.S. upland cotton producers know that their overall revenue will always be protected by marketing loans and counter-cyclical payments ... plays a major role in their planting decisions"? (Rebuttal of Brazil, para. 185; see also Third Party Submission of New Zealand, paras 5.20-5.21)

87. The United States submits that any eligible recipient of income support knows that he or she will receive some income protection due to payments under the income support program. That is the very nature and intent of income support programs – to ensure that producers receive some income that they would not otherwise get on the market. This is true for payments under the direct payment program, payments under the counter-cyclical payment program, payments under the marketing loan program, and for any other income support program of any Member (for example, those supporting elderly or low-income recipients) . This is precisely the point that Brazil illustrates in the graph it submits purporting to show that not only marketing loan and counter-cyclical payments but also direct

[102] *See e.g.,* U.S. First Written Submission, para. 249.
[103] *See e.g.,* Brazil First Written Submission, paras. 144-145.
[104] *See e.g.,* Brazil First Written Submission, paras. 142-143 and Brazil Rebuttal Submission. paras. 221-224.
[105] *See* U.S. Rebuttal Submission, para. 306.

payments, crop insurance payments, and cottonseed payments provide revenue support to U.S. producers.[106]

88. The mere fact that income support programs provide income support to agricultural producers does *not*, however, mean that the payments have "major" effects on planting or cause any of the adverse effects listed in Articles 5 and 6 of the *SCM Agreement*. If that were true, income support *could not* be listed as one of the types of so-called "green box" measures listed in Annex 2 of the *Agreement on Agriculture*, which by definition only have "no, or at most minimal, trade-distorting effects or effects on production."

89. Whether or not marketing loans and counter-cyclical payments are *in fact* having "major" effects on planting and causing U.S. producers to plant upland cotton where they would not otherwise do so is a question of fact and one that Brazil must prove in the affirmative through evidence of how upland cotton farmers actually make their production decisions and how the programs actually operate. Moreover, the question is not merely proving *any* effect on production. As the United States has noted before, most economists agree that any type of payment to a producer of agricultural products will have some effect on risk and wealth and that this may, in turn, have some effect on production. In fact, the *Agreement on Agriculture* contemplates that even "green box" payments – measures that Members considered may be freely provided without limitation by domestic support reduction commitments – may have *minimal* effects on production. The question is whether Brazil has shown that the risk, wealth, or production effects rise to the level that they cause – under existing market conditions – the *significant* price suppression that Brazil has alleged to exist in the present proceeding. The United States submits that for the reasons above and explained in the prior U.S. submissions, Brazil has not so shown.

(c) In its Opening Statement at the meeting of the Panel with the Parties, Brazil observed:

> ***"...we have demonstrated that these subsidies stabilized cotton producers' revenue despite wildly fluctuating market prices, thereby insulating and numbing acreage response to market price signals. These subsidies also cover the huge long-term gaps between market returns and total costs of production. Both effects are closely interrelated." (para.55)***

Is the United States only arguing that Brazil has not empirically substantiated that these two "effects" have actually occurred or is it also the position of the United States that these effects are in any event legally irrelevant to an analysis of whether a subsidy causes significant price suppression within the meaning of Article 6.3 (c) of the SCM Agreement?

90. The United States is arguing two things in respect of this assertion. First, the very purpose of income support programs is to add to the income of recipients. Therefore, Brazil's assertion that it has "demonstrated" that payments under the marketing loan and counter-cyclical payment programs "stabilize" the income of eligible producers is not remarkable. There is no need for an elaborate graph to "demonstrate" this – it is clear from the very formula for payment under the marketing loan and counter-cyclical payment programs that payments are made when prices fall below certain thresholds.

91. The fact that upland cotton farmers may end up receiving marketing loan and counter-cyclical payments in a year in which prices are below the applicable thresholds does not mean, however, that the payments have had the effect of "insulating and numbing acreage response to market price

[106] *See* Brazil First Written Submission, para.133, Figure 8 and Brazil Rebuttal Submission, para. 189, Figure 6.

signals," as Brazil asserts.[107] For one, planting decisions are made in light of *expectations* about revenue and other factors at the time of planting, not the actual revenue ultimately received or other factors that actually come about much later on when the marketing year actually starts. Moreover, the question of whether expectations of income support under the marketing loan and counter-cyclical payments actually cause U.S. producers to plant more upland cotton than they otherwise would based on market, planting, and production signals alone is a question of fact. And the evidence does not support Brazil's assertion of such substantial planting/production effects.

92. Again, it is indisputable that decisions on whether to plant upland cotton are made many months before a single penny is paid out under the marketing loan and counter-cyclical payment programs. In making these decisions, an upland cotton farmer eligible for payments is likely take into account the fact that he will receive a payment under the marketing loan and counter-cyclical payment programs if market prices fall below the level at which such payments are made. The key question is whether this fact will cause him to plant upland cotton where he otherwise would not have done so based solely on market signals and whether this will result in such substantial excess planting and production that there will be significant suppression of world market prices within the meaning of Article 5(c) and 6.3(c) of the *SCM Agreement*. The answer depends on a comparison of what he would do based on market signals *vis-a-vis* what he does when one adds in the possibility of receiving payments under the marketing loan and counter-cyclical payment programs.

93. In the case of the counter-cyclical payment programs, there is no reason for the farmer to plant upland cotton to receive any payments. He will receive that payment regardless of whether he chooses to plant upland cotton, a competing crop (such as soybeans or corn), or decides to let the land sit idle. Thus, the rational farmer would plant the crop that he is best able to plant (based on expectations about weather, pests, his own expertise etc.) and that he expects will obtain the highest revenue for him on the market. While the expectation that he may receive payments under the counter-cyclical program may have indirect effects on production by making him less risk averse, the research suggests that such effects are likely to be minimal and not crop-specific.[108] So, it is highly unlikely that – *even if* the farmer expects to receive payments under the counter-cyclical payment program – these expectations will induce him to plant upland cotton to any substantially greater extent than if he was simply responding to signals from the market. And consistent with this economic analysis, independent studies and empirical data show that counter-cyclical payments likely have had minimal effects on acreage and hence production.[109]

94. In the case of marketing loan payments, the analysis is somewhat different because there the farmer does have to decide to plant upland cotton in order to get payments under the program. The question is whether he will do so where he otherwise would not have based on market signals (and other planting/production signals) alone. The data show, however, that in every single marketing year since the FSRI Act came into effect, it would have been economically rational for upland cotton farmers to plant upland cotton rather than allowing their land to sit idle because the farmers expected that, even without any payment from the government, market revenue for upland cotton was more than sufficient to cover variable costs. In some of these years, however, it would have been more economically rational (using average U.S. price expectations and costs) to plant a competing crop (for example, corn in MY 2002 and MY 2007). Consistent with that analysis, in those years, the acreage data show a corresponding drop in U.S. upland cotton plantings. Indeed, the only year there was not such a corresponding shift in acreage was MY 2005, and the data also show precisely why that was

[107] Brazil Opening Statement, para. 55.

[108] *See e.g.,* Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 203 (Exhibit US-35), Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter- cyclical Payments' Production Impacts,*" Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86,* (Spring 2007), p. 81 (Exhibit US-85).

[109] *See e.g.,* U.S. First Written Submission, paras. 203-276; U.S. Rebuttal Submission, paras. 226-267, 282-295.

the case – namely, shifts in acreage away from soybeans to cotton in the Southeast and Delta regions due to fears of another outbreak of Asian soybean rust and other planting/production-related considerations.

95. In other words, in each of the years under FSRI Act, shifts in U.S. planted acreage were consistent with what one would expect if there were no marketing loan payments or counter-cyclical payments and U.S. farmers were basing their planting decisions solely on market price signals and other considerations relevant to planting and production. This is true regardless of whether the particular year was one in which expected prices were at levels at which farmers believed both marketing loan payments and counter-cyclical payments were likely (such as MY 2002 and 2005) or one in which expected prices were higher and the expectations were that marketing loan payments were unlikely (such as MY 2003, MY, 2005, and MY 2006).

96. This brings us to the third U.S. argument relating to Brazil's assertion that marketing loan and counter-cyclical payments allegedly "cover the huge long-term gaps between market returns and total costs of production." As discussed in response to Questions 51 and 59, Brazil's assertion of "huge long-term gaps" and their alleged significance make improper use of the "total cost" figures published by USDA. To illustrate the fallacy in the "total cost" approach that Brazil advances, recall that, in its "oral" presentation to the Panel, Brazil submitted charts comparing total costs of producing cotton, corn, and soybeans to total gross revenue earned in respect of the crop.[110] Brazil claimed that this proved the "economically irrational business of growing cotton in the United States without marketing loan and CCP subsidies."[111] What it showed, however, was the unreasonableness of Brazil's analysis.

97. According to Brazil, U.S. farmers would have lost money *across the board* producing *any* of these crops (or would have expected to do so) in any of the years in examined. In fact, if one were to apply Brazil's flawed reasoning more broadly, one would obtain similar results for virtually *all* major field crops in the United States. Thus, for example, according to Brazil's theory, producers of every single major field crop except for soybeans would have lost money in MY 2005 and, even for soybeans, U.S. farmers would have eked out no more than $1/acre.

Total Gross Value of Production/Acre v. Total Costs/Acre
for Major Field Crops (MY 2005)

	Cotton (USD)	Corn (USD)	Wheat (USD)	Rice (USD)	Sorghum (USD)	Barley (USD)	Oats (USD)	Sugarbeet (USD)	Peanut (USD)	Soybean (USD)
Total gross value of production	483	285	121	469	118	148	142	880	564	265
Total Costs	544	402	203	703	282	255	154	965	665	264
Total Value - Total Costs	**-87**	**-117**	**-82**	**-235**	**-164**	**-107**	**-25**	**-85**	**-101**	**1**

98. In other words, Brazil's analysis of "rational" farming behavior would require the Panel accept that *none* of the 434 million acres of cropland in the United States should have been planted to any major field crop in MY 2005. Under Brazil's approach no upland cotton, corn, wheat, rice, sorghum, barley, oats, sugarbeet, or peanuts should have been grown. And any evidence that they were in fact grown must be accepted as evidence of the production effects of the marketing loan and counter-cyclical payments.[112]

[110] Brazil Oral Statement, para. 57 and paras. 57-91.
[111] Brazil Oral Statement, para. 57 and paras. 57-91.
[112] Notably, no payments were made in respect of wheat or soybeans in MY 2005 (and have never been made in respect of those crops).

99. The absurdity of these results confirms that Brazil's "total cost" approach is a fundamentally erroneous approach to assessing the planting decisions of U.S. farmers. Rather, any proper assessment of the "economic rationality" of upland cotton farming must look to, *inter alia*, the variable costs of production. Indeed, the fact that variable costs are the relevant consideration in planting decisions is well-accepted in agricultural economics[113], and has been recognized by the Appellate Body.[114] It is also evidenced by the fact that there is *no economic model* of which the United States is aware that uses total costs in its supply response equations (that is, to examine the planting decision).

100. The "total costs" that Brazil uses to assert the existence of "long-term gaps between market returns and total costs of production" can neither be used to examine planting decisions, nor do they permit a proper assessment of the long-term viability of U.S. upland cotton farmers. As discussed in response to Question 59, Brazil's argument on the basis of these alleged "gaps" that U.S. farmers would close down their operations if marketing loan and counter-cyclical payments were not available is simply wrong.

54. Could the United States explain whether, and, if so, why, it is of the view that this Panel should not rely on the findings and analysis by the original Panel regarding the effects of marketing loan and counter-cyclical payments on production and exports? Please comment in particular on paras. 7.1291, 7.1295, 7.1302, 7.1349, 7.1353 of the Panel Report.

101. The question decided by the original panel was what effect the marketing loan, counter-cyclical payment, and Step 2 payments made in MY 1999-2002 were having in that period (and whether that effect amounted to "significant" price suppression with the meaning of Article 5(c) and 6.3(c) of the *SCM Agreement*). The question Brazil presses before this Panel is a different one; it is whether the marketing loan and counter-cyclical payments are causing "present" serious prejudice (*i.e.,* under the marketing conditions prevailing in the current marketing year in the absence of the Step 2 program).

102. Under Article 11 of the DSU, the Panel is tasked with, *inter alia*, making "an objective assessment of the matter before it, including an objective assessment of the facts of the case." The Appellate Body has explained before that the task of a compliance panel is to examine the evidence and arguments presented to it in the compliance proceeding, even in situations where the factual situation is precisely the same one that had examined in the original proceeding (e.g. the assessment by an administering authority of the effects of the same exports in the same period on the same industry).[115] The obligation is, clearly, all the more important where the factual situation presented is a different one (*i.e.*, where the measures, the time period, and the market conditions are all different from those examined in the original proceeding). This – and the fact that Brazil is obligated to prove

[113] *See e.g.*, U.S. Further Rebuttal Submission in the Original Proceeding, paras. 117-122 (18 November 2003); Cecil Davison and Brad Crowder, "Northeast Soybean Acreage Response Using Expected Net Returns" *Northeastern Journal of Agriculture and Resource Economics*, April 1991, pp. 33-41 (Exhibit US-137) and Duncan M. Chembezi and Abner W. Womack, "Regional Acreage Response for U.S. Corn and Wheat: The Effects of Government Programs", *Southern Journal of Agricultural Economics*, July 1992, pp 187-198 (Exhibit US-138).

[114] *US – Upland Cotton (AB)*, para. 453 ("We agree with the general proposition of the United States that *variable costs may play a role in farmers' decision-making as to whether to plant upland cotton or some alternative crop, and how much of each crop to plant*. From a short-term perspective, variable costs may be *particularly important*.") (emphasis added).

[115] *U.S. – Softwood Lumber (21.5)*, para. 101 (Noting that Canada's arguments "seem to assume that a panel is *required* to evaluate the facts in an Article 21.5 proceeding in exactly the same way as it evaluated those facts in the original panel proceedings, and to hold an investigating authority making a redetermination to the inferences that it drew from the same evidence in the original determination. . . . [W]e do not see why the Panel would be bound by the findings of the original panel.") (emphasis in original).

its claims in this proceeding – means that there is no basis to automatically adopt for purposes of this proceeding the same factual conclusions drawn by the original panel about the effects of the marketing loan, counter-cyclical payment, and Step 2 payments in a different period. Those conclusions are appropriate here only if Brazil proves that the same reasoning is valid and supported by the arguments and evidence before this Panel. For the reasons set out in the U.S. submissions and presentations to date, the United States submits that Brazil has not so proven.

103. With this in mind, the United States addresses the particular conclusions in the paragraphs identified by the Panel above:

104. ***Paragraphs 7.1291 and 7.1295:*** Paragraphs 7.1291 and 7.1295 of the original panel report speak about marketing loan payments. The original panel states in both these paragraphs that it considers that payments under the marketing loan program "stimulate production and exports and result in lower world market prices than would prevail in their absence." However, the discussion of the reasoning underpinning the panel's conclusion to this effect is very limited.

105. The original panel states, in support of its conclusion, that "[w]e concur with Brazil, who cited certain USDA economists in support, that the structure, design and operation of the marketing loan programme has enhanced production and trade-distorting effects."[116] The USDA economists cited by the original panel, however, simply acknowledge that payments under the marketing loan program may have effects on production based on farmers' expectations about revenues from the market and the market loan program.[117] Moreover, the footnote to this statement by the original panel notes that "[t]he fact that the United States notifies the marketing loan programme as 'amber box' support under the Agreement on Agriculture may not necessarily be determinative for the purpose of our 'adverse effects' analysis under Part III of the SCM Agreement."[118] Read together, the United States understands the original panel to be noting that the particular design and operation of the marketing loan program is such that it may have more than non- or minimally-trade distorting effects given the particular market conditions that prevail. The United States does not disagree.

106. Whether – under the particular market conditions in any particular year – payments under the marketing loan program do in fact have such effects and whether the effects give rise to such a degree of overproduction and export of excess production that "significant" price suppression result is a question of fact. That question requires an examination of the expectations of the upland cotton farmer about prices, payments, variable costs, yields, weather and other such factors. The evidence and arguments before this Panel that examine these expectations and the reactions of U.S. farmers to those expectations do not support a finding that marketing loan payments are having substantial effects on production, exports, and prices under the prevailing market conditions. Rather, the evidence shows that shifts in U.S. planted acreage are consistent with the shifts one would expect if U.S. farmers were basing their planting decisions solely on market price signals and other considerations relevant to planting and production.

107. ***Paragraphs 7.1302:*** Paragraphs 7.1302 of the original panel report address counter-cyclical payments. The original panel makes two main observations here. The first is that "[w]e agree with the view of USDA economists that, due to their market-price contingency, CCPs may influence production decisions indirectly by reducing total and per unit revenue risk associated with price variability in some situations" and the second is that there is an allegedly "strong positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production." The United States does not disagree with the former observation. However, the very USDA economists whose views the original panel has noted have conducted further analysis and

[116] *Upland Cotton (Panel)*, para. 7.1295.

[117] *See e.g.*, "Analysis of the U.S. Commodity Loan Program with Marketing Loan Provisions," USDA, AER 801 (BRA-222).

[118] *Upland Cotton (Panel)*, para. 7.1295, n. 1401.

explained that the degree of any such production effects is likely to be minimal and mitigated by a number of factors. For example, Westcott notes in this regard that:

(a) where prices are expected to be above maximum threshold – counter-cyclical payments behave just like the fixed direct payments[119];

(b) "cross-commodity effect[s] suggest[] that CCPs may provide a general reduction in revenue risks rather than a crop-specific effect. Net returns among alternative crops would remain the primary consideration underlying production choices;"[120]

(c) "while a number of studies indicate that farmers are risk averse (Chavas and Holt, 1990, 1996, for example), other risk reduction instruments already exist to manage risks. Thus, with revenue risk reduction now provided by CCPs as part of farm programs, farmers may adjust their use of these other farm and nonfarm risk management strategies;"[121] and

(d) "a large portion of output in the U.S. agricultural sector is produced by a small share of large producers. . . . Evidence that risk aversion decreases as income rises (Chavas and Holt, 1990, 1996) suggests that risk aversion may also tend to decline as the size of farms increases. Thus, with larger farms that account for most production being less averse to facing risk, this lowers potential production effects of CCPs due to risk reduction. And while smaller farms may be more risk averse in their farm enterprise, off-farm income may reduce the overall level of household income risk."[122]

108. On the basis of these and other factors, Westcott concludes that "there are several mitigating factors which suggest that overall production effects of CCPs through revenue risk reduction are likely to be limited."[123] The United States agrees with that assessment. Other studies submitted by the United States – for example, a 2007 study by Lin & Dismukes in which the authors found that "[t]he effect of CCPs on producers' planting decisions . . . appears to be *very negligible* – an increase in the acreage of major field crops of less than 1% . . . ."[124] – confirm that the effects of the counter-cyclical payments are, in fact, likely to very limited. These studies are important because – as discussed below – the counter-cyclical payment program had just come into effect at the time of the original panel proceeding. Accordingly, the studies available to the original panel were necessarily forward-looking and did not have much or any actual experience with the operation of program itself. The more recent studies incorporate deeper experience with, and understanding of, how the program operates in practice.

109. Regarding the second observation, as the United States has explained in response to Question 29 of the first set of questions from the Panel[125], the United States does not disagree that

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[119] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 203 (Exhibit US-35).

[120] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 204 (Exhibit US-35).

[121] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 204 (Exhibit US-35).

[122] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 204 (Exhibit US-35).

[123] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 205 (Exhibit US-35).

[124] Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter-cyclical Payments' Production Impacts," *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 83 (Exhibit US-85) (emphasis added).

[125] U.S. Answers to Parts D-E of First Set of Panel Questions, paras. 14-23.

many holders of upland cotton base acres produce some amount of upland cotton. However, the United States submits that this does *not* support the conclusion that payments under the counter-cyclical payment program *cause* U.S. farmers to produce upland cotton. To the contrary, the data show that:

- On farms that have upland cotton base acres (and thus may receive cotton counter-cyclical payments), the ratio of cotton *planted* acres to total upland cotton *base* acres was only 60 percent in MY 2002-2005. In other words, U.S. upland cotton farmers were planting only approximately 60 percent of the cotton acres that they planted in the historical period used to calculate base acres.

- Second, a significant portion of U.S. upland cotton planted acreage (over MY 2002-2005, an average of about 17 percent) is on farms with cotton planted acreage that exceeds cotton base acres, or, indeed, on farms with no cotton base acres at all.

110. In the view of the United States, these facts confirm that U.S. farmers do, in fact, use the planting flexibility afforded by the direct and counter-cyclical payment programs. This is consistent with the fact that U.S. farmers base their production decisions on market signals and are not somehow induced to plant upland cotton simply because they hold upland cotton base acreage. Moreover, the data above show that a significant – and growing percentage – of cotton is grown on farms that do not hold *any* upland cotton base acreage or on planted acreage that is in excess of the upland cotton base acreage held by a farm. That is, for these cotton farmers, there can be no link – even alleged – between cotton base counter-cyclical payments and current production because these farmers are growing cotton on acreage *beyond* their cotton base acreage, if any. These are the facts that the United States considers to be the most relevant because they focus on the level of upland cotton *planting* and *production* and the relationship that these bear – if any – to payments. Brazil's claim focuses on *precisely* this same relationship.

111. By contrast, the fact that many holders of upland cotton base acres produce some amount of upland cotton is hardly remarkable. This just shows that upland cotton is often still produced on land that was historically planted to upland cotton (*i.e.*, at the time base acres were established). Upland cotton is grown in a limited number of areas in the United States, primarily in a few southern and western states, where the weather and other conditions are ideal for upland cotton production. Upland cotton was grown in these areas well before the counter-cyclical payment program came into effect and continues to be grown there now. Continued planting of upland cotton on this farmland is not the effect of any government payment; it is a function of the fact that upland cotton can be grown easily in these areas but cannot be grown in others. As the United States has shown, cotton is grown in the same states and – in large part – the same counties in 2005 as it was in 1992, well before the counter-cyclical payments came into effect. The same would be true if one were to go back even decades earlier in time. Many of the same farms produce *some* upland cotton today for the same reasons that they did so at the time that base acres were enrolled and even in years before that – for example, farmers may have experience and expertise growing upland cotton in those areas and know they can grow upland cotton with good results given the particular growing conditions in the region. The continuity noted by the original panel does not support any finding that counter-cyclical payments are *inducing* U.S. farmers to plant upland cotton to any significant degree.

112. ***Paragraphs 7.1349 and 7.1353:*** These two paragraphs deal with the collective effects of the Step 2, marketing loan, and counter-cyclical payments made in MY 1999-2002. As that question is not before this Panel, the analysis therein is not directly applicable here. Nonetheless, the United States addresses the general reasoning in those paragraphs. In paragraph 7.1349, the original panel explains that "[w]e agree with the United States that 'the question is one of the nature of the subsidy examined and the degree of any predicted effect, which could range from significant to negligible.' These price-contingent subsidies were, in our view, sufficient to cause the significant price suppression that we have found to exist in the same world market." By contrast, here, Brazil has not

even provided empirical substantiation that there is presently any significant price suppression let alone that marketing loan and counter-cyclical payments are the cause thereof. Moreover, the evidence discussed above regarding how the marketing loan and counter-cyclical payments are actually operating at present and under the prevailing market conditions indicates that, contrary to Brazil's assertions, these payments are not having substantial effects on production, exports, or significant price suppressive effects on prices.

113. In paragraph 7.1353, the original panel explains that it considers "the divergence between United States producers' total costs of production and revenue from sales of upland cotton" to be a relevant consideration as to whether there are effects on production in the medium- to long-term." The original panel explains that "*[f]ixed and variable costs* are the total amount which the producer incurs in order to produce the product and the total amount it must recoup, in the long-term, to avoid making losses. To the extent that the producer charges prices that do not recoup the total cost of production, over time, it sustains a loss which must be financed from some other source, or else the producer simply has to close down his business."[126]

114. The United States does not disagree that total costs of production are a relevant consideration and that over the long-term, farmers must recoup both fixed and variable costs. As discussed below, in response to Question 59, however, the data indicate that the vast majority of U.S. upland cotton production is economically viable in both the short- and the long-term without the marketing loan and counter-cyclical payments programs. The vast majority of U.S. farmers met or exceeded their total fixed plus variable cash costs in almost *each year* since the FSRI Act came into effect. Moreover, cumulatively, over the long term, the U.S. farmers generated a cash surplus, not a deficit.[127] The cumulative returns over the period 2000-2005 were a *positive* return of $161 per acre. Moreover, for MY 2000-2006, the cumulative net returns are an (estimated) *positive* $133 per acre.[128] These farmers were not, therefore, "sustain[ing] a loss" that they would have had to finance using marketing loan and counter-cyclical payments or other sources of income "or else . . . close down [their] business[es]."[129]

115. Indeed, while Brazil again asserts the kind of "divergence" that the original panel noted, the fact is that this "divergence" has been *created by Brazil* by using the "total cost" data published by USDA. As discussed below in response to Question 59, these "total" costs were never intended to be used as an indicator of the long-term viability of upland cotton producers. The data simply provide a stylized snapshot of one crop on a hypothetical farm to which USDA attributes not only average actual operating/variable costs of production but also an allocated value for fixed cash costs and – even beyond that – an allocated value for economic opportunity costs that, for the large part, do not ever have to be paid out. Therefore, it is simply inaccurate to suggest that a farmer would – in the absence of marketing loan and counter-cyclical payments – be forced to "close down [their] business[es]"[130] if they were not able to meet the "total" costs reflected in the USDA data. This is not only because of the nature of the data but because of the fact that whether or not farmers will "close down [their] business[es]"[131] depends on the overall cost-revenue balance of the farm, not one enterprise of that farm.

116. Nonetheless, even despite the conceptual flaws in conducting an single-crop-specific assessment of "total costs"for purposes of assessing the financial viability of an entire farm – let alone an entire sector of the agricultural economy (*i.e.* upland cotton farmers) – the data indicate that the vast majority of U.S. upland cotton farmers are meeting not only their variable costs of producing

[126] *Upland Cotton (Panel)*, para. 7.1353, n.1465.
[127] This analysis considers those items in the published USDA figures that are true cash costs (*i.e.* fixed and variable).
[128] *See* U.S. Comments on Brazil's "Oral" Statement, para. 77.
[129] *Upland Cotton (Panel)*, para. 7.1353.
[130] *Upland Cotton (Panel)*, para. 7.1353.
[131] *Upland Cotton (Panel)*, para. 7.1353.

upland cotton, but they are generating enough additional market revenue to cover *both* fixed cash costs and enough excess that they could – if they had to do so (*quad non*) – cover the kind of imputed economic costs that Brazil has attempted to include in its calculations. These issues are addressed in further detail below in response to Question 59.

55. Can the United States confirm that the figures "$868 million" and "$838 million" Brazil cited in para. 40 of its Opening Statement are correct figures if one uses the "Brazil's methodology" and the "Cotton-to-Cotton methodology"? (Please note that the Panel is not asking whether the US agrees with these methodologies.)

117. These figures appear consistent with the so-called "Brazil methodology" and the "Cotton-to-Cotton" methodology, respectively.

56. The United States has cited new empirical research on the production effects of counter-cyclical payments. How does the United States address Brazil's criticism that none of this research has dealt specifically with the effects of countercyclical payments under the FSRI Act of 2002 on upland cotton? (Rebuttal Submission of Brazil, para. 120)

118. The United States believes the recent research regarding counter-cyclical payments is highly relevant to an assessment of the economic effects of such payments. Recall that when the panel made its original findings, the counter-cyclical payment program had just come into effect. Thus, few studies were available based on empirical analysis or practical experience with the program to help the original panel in assessing the effects of payments therenunder.

119. Since that time, there have been a number of studies conducted regarding the effects of the program. Much of research has, not surprisingly, been focused on those crops that account for most of the U.S. planted area – corn, soybeans, and wheat. But there is no reason to believe that the payments under the counter-cyclical program in respect of upland cotton base acres would affect planting incentives in any materially differently way than would counter-cyclical payments in respect of other base acres. To the contrary, studies such as the 2005 Westcott analysis – which Brazil asserts "largely reaffirms his earlier qualitative findings" that the original panel considered relevant – agree that any possible effect is likely to be "indirect" and only through "reducing revenue risk associated with price variability in some situations."[132] Westcott has explained that "cross-commodity effect[s] suggest[] that CCPs may provide a general reduction in revenue risks rather than a crop-specific effect."[133] This indicates that counter-cyclical payments may have general revenue risk effects regardless of the base acres in respect of which the payments are made and regardless of the crop that is ultimately selected for planting. Notably, while Brazil has criticized other aspects of the Westcott analysis – despite citing his earlier analysis itself in its first written submission[134] – it has not challenged this aspect of the Westcott reasoning.[135] Nor has Brazil submitted any other evidence or studies to show that the counter-cyclical payments in respect of upland cotton base acreage would necessarily have different effects with respect to upland cotton production than counter-cyclical payments in respect of base acreage for any other crop.

120. In any event, the United States has submitted this research to provide a more robust basis – deriving from tested and reviewed economic methods – for understanding the operation of the counter-cyclical payment program and what the economic effects on planting/production might be as a result of payments thereunder. Especially in the absence of any specific analysis on counter-cyclical

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[132] Brazil Rebuttal Submission, para. 129.

[133] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 204 (Exhibit US-35).

[134] Brazil First Written Submission, para. 128 (citing *Upland Cotton (Panel)*, para. 7.1302.)

[135] Brazil Rebuttal Submission, paras. 128-133.

payments made with respect to upland cotton base acres and upland cotton production, this research is important in providing context and guidance for assessing the effects of counter-cyclical payments. As Brazil has provided no upland cotton-specific studies itself, it has no basis to criticize the United States in this regard. The research that has become available since the original panel, whatever its limits, fills an important gap in the understanding and assessment of the counter-cyclical payment program and supports a conclusion that the effects on cotton production of counter-cyclical payments are likely to be minimal.

57. The United States has offered the Lin and Dismukes (Exhibit US-34) and Westcott (US-35) studies as examples of new empirical research on the production effects of counter-cyclical payments.

(a) Is it not more accurate to characterize the Lin and Dismukes study as a simulation of the possible effect of countercyclical payments on production rather than a study on the actual impact of the payments since it does not statistically estimate the effect of the actual payments (which began only in 2002) on crop production? (Please refer to pages 9-12 of the paper which describe the data, covering the period 1991-2001, used for the study).

121. The United States agrees that the Lin and Dismukes study aims to estimate the likely effects of the counter-cyclical payments. As the United States recognized in its rebuttal submission, "Lin & Dismukes (2007) addressed the possible production impacts of counter-cyclical payments for the 2005 crop."[136]

122. With respect to the data used by the Lin and Dismukes study, however, the United States submits one clarification. Specifically, while the Lin and Dismukes study uses "state-level data for the North Central during 1991-2001 . . . cover[ing] major field crops in this region" – corn, soybeans, and wheat – to estimate the "acreage response equations,"[137] the authors note that they "accurately reflect major characteristics of CCPs in analyzing the payments' potential production impact in the simulation analysis."[138] Thus, the study takes into account the actual operation of the counter-cyclical payment program in assessing effects. For example, the authors use 2003 base acres and program yields for Illinois corn, soybeans, and wheat to determine a possible per-acre or per-unit counter-cyclical payment (based on actual data). Moreover, the study takes into account recent market conditions (for example, "new crop futures prices in mid February 2005 after adjusting for basis to arrive at the farm price equivalents") in assessing production effects.[139]

123. Indeed, the authors state that their "[a]nalysis . . . seeks to answer the following question: 'Given the market price scenario for major field crops perceived by producers at planting decision times, how would CCPs have affected the plantings of 2005 major field crops in the North Central region?"[140] They submit that the use of input data from 1991-2001 – rather than more recent years –

[136] U.S. Rebuttal Submission, para. 232.

[137] Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter-cyclical Payments' Production Impacts," *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 68 (Exhibit US-85).

[138] Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter-cyclical Payments' Production Impacts," *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 68 (Exhibit US-85) (emphasis added).

[139] Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter-cyclical Payments' Production Impacts," *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 83 (Exhibit US-85).

[140] Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter-cyclical Payments' Production Impacts," *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 81 (Exhibit US-85).

is reasonable because, *inter alia*, more recent input data to estimate the acreage response equations would likely not have "yield[ed] different results from those in the simulation analysis for the 2005 crop."[141]

(b) How does the United States deal with Brazil's characterization of the Westcott study as offering no new empirical evidence, and instead, being a qualitative discussion, much like that presented to the original panel (see para 128 of Brazil's rebuttal)?

124. The United States agrees that the Westcott study does not present a quantitative assessment. It may be said to examine from a qualitative standpoint how counter-cyclical payments operate and what effects they might have at different expected price levels. While that study is similar to the Westcott analysis presented to the original panel, it benefits from having had experience with the actual operation of the counter-cyclical payment program.

125. The United States recalls that the first Westcott study, which provided only a hypothetical assessment of the effects of the counter-cyclical payments, in the absence of any studies reflecting experience with the program itself, was the only evidence about the economic effects of counter-cyclical payments presented by Brazil before the original panel.[142] The United States has now submitted a range of studies and reviews, quantitative as well as qualitative, to assist the Panel in assessing the effects of payments under the program. As these studies and reviews show, the consensus view that is forming about the effects of counter-cyclical payments is that the payments have no effects on crop-specific production decisions and minimal effects on overall production. The United States submits that this is a highly relevant consideration in assessing the present effects of the counter-cyclical payments on upland cotton production.

58. The Unites States stated that the key consideration in assessing a farmer's decision to grow upland cotton is whether the farmer has been covering his variable costs of production. In this connection, it presented upland cotton costs and returns estimates for marketing years 1999-2005 (Exhibit US-47). Brazil has disputed the absence of certain items – land, labour and capital recovery costs - in the US calculations of variable costs. In response, the United States has referred to the Commodity Costs and Returns Estimation Handbook (Exhibit US-88) prepared by a Task Force of the American Agricultural Economics Association as the basis for leaving out these items in its calculations. However, the Task Force which authored the Handbook does not use the categories "fixed" or "variable" costs and in fact recommends that the microeconomic concepts of fixed and variable costs not be used in preparing and reporting cost and return estimates. Page 2-67 of the Handbook states:

> ***The Task Force therefore recommends that costs should be categorized only as to whether they are associated with expendable factors or the services of capital assets. The division of costs into categories such as fixed and variable should generally be avoided in preparing CAR estimates. For the purpose of preparing CAR estimates for specific enterprises, the Task Force recommends that all the costs of all expendables be allocated to the generic group OPERATING COSTS and that all other costs be allocated to the group ALLOCATED OVERHEAD.***

[141] Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter-cyclical Payments' Production Impacts," *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 69 (Exhibit US-85).

[142] *See e.g., Upland Cotton (Panel)*, para. 7.1302

Would the United States clarify whether the categories "operating costs" and "allocated overhead" correspond to the economic concepts of fixed and variable costs? In particular, are "operating costs" variable costs or not? Would the United States please indicate whether, and if so, where, the Handbook makes these clarifications or distinctions.

126. In presenting their analyses of costs, both the United States and Brazil have used the cost of production data published by the U.S. Department of Agriculture's Economic Research Service ("ERS"). As ERS states on its website, "[t]he costs and returns estimation program uses surveys conducted about every 4-8 years for each commodity as part of the annual Agricultural Resource Management Survey (ARMS), and methods that conform to standards recommended by the American Agricultural Economics Association (AAEA)."[143]

(A) "Operating Costs" or "Variable Costs"

127. ERS uses the term "operating costs" to describe those costs that are "expendable."

> **"Expendable factors of production** are raw materials, or produced factors that are completely used up or consumed during a single production period. Common examples of these factors that lose their identity with a single use are seed, fuel, lubrication, some pesticides and fertilizer, feed, and feeder animals."[144]

128. The United States has used the ERS operating cost data, but has at times referred to this data interchangeably as "variable cost" data, another commonly-used term. To be clear the United States has not used this term to denote "variable costs," as that terms is defined by the AAEA Handbook. Rather, it has used the term to simply refer to the operating cost data published by ERS.

129. As explained in the U.S. rebuttal submission, however, there are two items with respect to which the U.S. categorization of "operating" (or "variable") costs has differed from that used by ERS.[145] First, the United States has included hired labor as an operating cost. This item raises several conceptual issues and even the ERS data have not treated the item consistently over the years. Therefore, to be conservative, the United States included hired labor as an operating cost, not as an item of allocated overhead. And, second, to isolate the costs and revenues for the "subsidized product" that is the subject of Brazil's claims under Articles 5 and 6 (*i.e.*, upland cotton lint), the United States has adjusted both ginning costs and cottonseed revenue. As the latter are ordinarily simply covered by proceeds gained by the gin from sales of cottonseed, the United States adjusted ginning costs to account for costs not covered by the revenue from cottonseed.[146]

130. Despite having relied on the ERS data and categorization throughout this dispute, Brazil attempts in its rebuttal submission to bring in a new definition of "variable cost" that differs from the one used by ERS (and therefore also differs from "operating costs" within the terminology used in the AAEA handbook).[147] Specifically, Brazil has attempted to include as "variable" or "operating" costs, costs that are not in fact "expendable in a single defined period" including land, unpaid labor, and capital recovery costs. There is no support in the ERS approach to cost of production data nor in the AAEA Handbook nor in the agricultural economics literature for Brazil's argument that these are

[143] Economic Research Service, Commodity Costs and Returns available at http://www.ers.usda.gov/data/CostsandReturns/ (Exhibit US-144).

[144] *Commodity Costs and Returns Estimation Handbook*, updated 09/30/2005, A Report of the AAEA Task Force on Commodity Costs and Returns, pp. 2-7 (Exhibit US-88).

[145] *See* U.S. Rebuttal Submission, paras. 326-343.

[146] *See* U.S. Rebuttal Submission, paras. 338-343

[147] Brazil Rebuttal Submission, paras. 254-283.

"variable" or "operating" costs. Nor is there any support for Brazil's suggestion that farmers actually consider those costs in making year-to-year planting decisions regarding whether and what to plant.

(B) "Fixed Costs" and "Allocated Overhead"

131. The concept of "allocated overhead" is more complicated than the concept of operating costs. As a review of the AAEA Handbook makes clear, it is much broader than the concept of fixed costs. Allocated overhead includes both allocated (fixed) cash costs and imputed costs. The latter are not actually expenditures that must be made but rather are costs imputed based on the concept of economic opportunity cost. It is this data regarding "allocated overhead" (plus "operating"/"variable" costs) that Brazil has referred to as "total costs" and that Brazil has used to attempt to show an alleged gap between U.S. farmers costs and revenue.[148]

132. Neither "fixed costs" nor "allocated overhead" affect farmers' decisions regarding what to plant in each year. As Brazil has acknowledged, if a "farmer would not be able to cover even variable costs, he or she would not plant anything at all to minimize losses."[149] Conversely, where the farmer *is* covering his variable costs, it is economically rational for him to plant *something*. The question is then *what* to plant. And that decision is made taking into account which crop will get the highest return after netting out variable/operating costs.

59. In discussing the impact of long-term costs of production (and hence long-term profitability) of upland cotton production on farmers' decisions to exit cotton farming, the United States argues that income from other crops and off-farm income must be into account. Why does the United States consider these issues relevant given the original Panel's decision that "off farm income" is not a legally relevant consideration. (Panel Report, para. 7.1354, footnote 1470) Please respond to Brazil's arguments on this matter in paragraphs 249-253 of its Rebuttal Submission.

133. The United States considers that the question of "off-farm income" is important because it goes to Brazil's ability to prove one of the key facts that it asserts in this proceeding; namely, that without marketing loan and counter-cyclical payments, U.S. producers would exit the business of upland cotton farming altogether or, in the original panel's words, be forced to "close down [their] business[es]."[150]

134. The United States recalls that it is a "generally and consistently accepted and applied . . . rule that the party who asserts a fact . . . is responsible for providing proof thereof."[151] To "prove" that U.S. upland cotton farmers would be forced to "close down [their] business[es]"[152] in the absence of marketing loan and counter-cyclical payments, Brazil has presented a simple comparison of "total costs of production" for upland cotton – which comprise all operating costs, fixed cash costs, and imputed economic opportunity costs for capital, labor and land – to market revenue. Brazil asserts that there is a gap between these two figures which, allegedly, proves the "economic irrationality" of producing upland cotton in the United States without marketing loan and counter-cyclical payments. Citing to the original panel report, Brazil asserts that this shows that "upland cotton producers would have lost money over the longer term if they were involved in upland cotton production alone."[153]

[148] Brazil Rebuttal Submission, para. 249.
[149] Brazil Oral Statement, para. 67.
[150] *Upland Cotton (Panel)*, para. 7.1353.
[151] *U.S. – Shirts and Blouses (AB)*, p. 14.
[152] *Upland Cotton (Panel)*, para. 7.1353.
[153] Brazil Rebuttal Submission, para. 251 (citing *Upland Cotton (Panel)*, para. 7.1354, n. 1470).

135. This evidence does not, however, prove the points asserted. The flaw is both in the nature, type, and amount of the costs that Brazil includes in its total cost analysis but also in Brazil's analysis on the basis of those costs; in particular, its flawed assumptions about how farmers make decisions about whether to stay in or go out of business. The issue of off-farm income and income from other commodities is relevant to the latter.

136. The United States will discuss the factual and conceptual problems in Brazil's arguments momentarily. As a threshold matter however – and in response to the question from the Panel – the United States notes that whether or not a party proves the facts it asserts is always a "legally relevant" consideration. It is no less true here. Moreover, as discussed above in response to Question 51, Brazil's claim in this case is under, *inter alia*, Article 6.3(c) of the *SCM Agreement* which, by it terms, requires an examination of the *actual* effects that the challenged subsidies have on the world market price of the allegedly subsidized product. Since Brazil has alleged that the challenged measures cause significant world market price suppression by, *inter alia*, keeping U.S. upland cotton farmers in business who otherwise would have closed down their operations, it is imperative for Brazil to show that U.S. upland cotton farmers would actually have done so absent marketing loan and counter-cyclical payments. The fact that U.S. upland cotton farmers actually make their decisions about whether or not to close their operations based on the total costs and revenues *for the farm* as a whole – including revenue from *all* crops as well as from off-farm sources – is necessarily a relevant and important consideration.

137. The original panel's suggestion to the contrary – and Brazil reiteration of that suggestion in this proceeding – appears to be based on the mistaken premise that there is some inconsistency between (a) the reference to "subsidized product" and "like product" in Article 6.3(c) of the *SCM Agreement* and (b) and examination of the total cost/revenue balance for a farm in assessing whether farmers would in fact cease their operations if they did not receive marketing loan and counter-cyclical payments. There is no such inconsistency. The fact is that the effect that Brazil is attempting to attribute to marketing loan and counter-cyclical payments – permitting the farmer to avoid exit or bankruptcy – is itself a farm-wide, not an crop-specific, effect.

138. To the extent that marketing loan and counter-cyclical payments *do* have this kind of effect of keeping the farm in business, there is a consequent effect on the "subsidized product" only because upland cotton farming is *one of the enterprises on the farm* that continues on. Any such effect with respect to the "subsidized product" – if proven – may be a valid consideration for purposes of the analysis under Article 6.3(c) of the *SCM Agreement*. However, by using a proper analysis that focuses on whole farm revenue versus costs, the analysis tracks the *actual* decision matrix of farmers, rather than assuming incorrectly that all upland cotton farms are single-crop farms that are devoted full-time to upland cotton production.

139. This brings us to the flaws in Brazil's approach. Brazil attempts to paint a striking picture in which U.S. upland cotton farmers would have suffered billions of dollars in losses – and widespread bankruptcies – if it had not been for marketing loan and counter-cyclical payments under the FSRI Act. To make this dramatic point Brazil, however, ignores fundamental facts about cotton farming in the United States and puts "total" cost data published by USDA to a use for which it was never intended and is inappropriate. As discussed above, Brazil's flawed approach based on "total costs" would show that U.S. farmers of most – if not all – fields crops were losing money year and after year. Brazil's reasoning would have the Panel accept that almost 500 million acres of U.S. cropland – over 10 percent of the entire U.S. land mass – is being kept in production solely by marketing loan and counter-cyclical payments (even where a number of the crops do not even receive those payments). The United States submits that these are absurd conclusions and ones that underscore perfectly the conceptual weakness in Brazil's approach – using the "total" costs published by USDA are simply not an appropriate means of assessing the financial viability of farms let alone of an entire agricultural sector.

140. For one, the "total" cost data is an average across all U.S. farms, ranging from very small retirement and residential farms to large non-family owed farms with sales in the millions of dollars. By presenting a single average for all such farms, the data obscures the fact that the vast majority of *U.S. production* occurs on farms that are highly profitable. As the United States has explained, the USDA survey data show that, in MY 2003, fully *92 percent* of U.S. production was on farms on which total revenue *exceeded* not only all variable costs actually reported in response to the survey but also the cash costs allocated to upland cotton by USDA and – indeed – even the items of economic opportunity cost included in "total" costs published by USDA. The latter are, for the most part, not even actual expenditures that must be paid out.[154]

141. Not surprisingly, Brazil asks the Panel to simply ignore this data on the basis that it reflects costs/revenue for a marketing year – MY 2003 – in which U.S. upland cotton prices were high. While it is true that prices in MY 2003 were high, however, that does nothing to undermine either the validity or the usefulness of this data. Importantly, there is a substantial spread between the total cost figures and the market revenue figures for the low- and mid-cost producers that made up the 92 percent figure. In the case of the former, U.S. producers' market revenue was almost *double* (or 29 cents/lb more than) the "total" costs reflected in the USDA data. For the mid-cost producers, the difference is almost 10 cents/lb. While prices did fall in MY 2004 and MY 2005 this would simply have had the effect of lowering or eliminating the *excess* above the "total" costs reflected in the USDA data. It does not mean that substantially less production would be shown to be meeting all possible costs. Moreover, Brazil fails to take into account that with yields increasing in later years, costs also were likely to have fallen for these producers in those years. Thus, there is no basis to assume that the results would have been substantially different in later years.

Costs of Production for Cotton, by Cost Group, 2003

Item	Low-cost	Mid-cost
Operating costs 1/ ($/acre)	197.07	256.23
Total costs ($/acre)	356.29	446.24
Operating costs ($/lb.)	0.20	0.33
Total costs ($/lb.)	**0.35**	**0.57**
Harvest month price ($/lb.)	**0.64**	**0.67**
Actual yield (lb per acre)	1,009	781
Share of production (%)	39	53

1/ Includes hired labor. Data on cottonseed value are not available. Using the average 2003 cottonseed revenue as a share of total value (13 percent), cottonseed value is assumed to account for 13 percent of total value of production. Ginning costs are then adjusted as described below.

Source: USDA[155]

142. What this means is that, even if Brazil's arguments about "total cost" were true, they would only relate to a small fraction of U.S. production. Nonetheless, Brazil's arguments – even about this small percentage of U.S. production – are actually not conceptually sound.

143. First, by using the crop-specific cost data published by USDA to reach conclusions about the financial viability of upland cotton farmers generally, Brazil's analysis assumes in effect that all U.S. upland cotton farmers produce nothing but upland cotton. The fact is, however, that for agronomic and risk management reasons farmers in the United States would rarely, if ever, rely solely on the production of one crop, year after year. A farmer manages his farm in a manner to maximize net

[154] *See* U.S. Oral Statement, paras. 72-74.
[155] Exhibit US-93 (WTO-CONFIDENTIAL).

revenue from the entire operation, which could include producing various crops and livestock, and providing other agricultural services (such as custom harvesting) to other producers. A producer manages his or her farm in a manner to maximize net revenue from the entire operation, which could include producing various crops and livestock, and providing other agricultural services (such as custom harvesting) to other producers.[156] The USDA cost of production data – and other similar cost data – do not purport to show the financial viability of a farm growing upland cotton that also relies on many other sources of income and incurs other costs. Rather, it provides a stylized, abstract view of one single crop or livestock enterprise that an individual producer of upland cotton can look at as a kind of general benchmark to compare against his own costs and revenues. The use of this data to extrapolate about the financial viability of upland cotton farmers generally or the entire U.S. upland cotton sector is simply not appropriate.

144. For example, the "total" cost figures used by Brazil include all the items under "allocated overhead," which are either not specific to upland cotton (in which case they are allocated expenses over all the crops and enterprises on a farm) or are not actual cash outlays (in which case they are economic costs arrived at through imputed values).[157] The AAEA Handbook explains at length the difficulties in concepts and methods of measuring allocated costs such as general farm overhead. For example:

> The third category [general farm overhead] is usually referred to as general farm or business overhead and typically includes items *for which it is difficult or impossible to determine the impact of the input on either output or cost for a specific enterprise*. For example, it is difficult to determine the impact of buying a new set of Allen wrenches on the average corn yield per acre or the impact of attending pesticide applicator training on cucumber gross returns.[158]

145. And further:

> "General overhead costs associated with operating a business are usually incurred at the total farm level, across all enterprises, although in some instances these costs can be assigned to groups of products. Examples include liability insurance, subscriptions and dues, accounting and legal fees, shop tools, equipment storage, road maintenance, and so forth. *Allocation of these shared costs to individual enterprises is often difficult or impossible in anything but an arbitrary manner*."[159]

146. While the USDA makes such allocations for purposes of presenting the published costs and returns data, there is no "allocation" of actual costs on farms. These costs are simply incurred and aggregated; and they and must be paid in the long-term using whatever net aggregate revenue remains after variable/operating costs are paid. The assumption that U.S. farmers would "close down [their] businesses" based on a narrow crop-by-crop or enterprise-by-enterprise assessment of allocated overhead is unrealistic.[160]

147. The conceptual flaw in using the total cost data published by USDA to assess financial viability of farms and – more generally an entire sector – are magnified by the fact that they include imputed opportunity costs. For the most part, these are costs that have been calculated by USDA to

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[156] *See e.g.*, U.S. Answers to Parts A-C of First Set of Panel Questions, para. 12 showing that only on average 47% of total farm revenue on upland cotton farms was from cotton.

[157] *See* U.S. First Written Submission, paras. 293-295 (December 15, 2006).

[158] *Commodity Costs and Returns Estimation Handbook*, updated 09/30/2005, A Report of the AAEA Task Force on Commodity Costs and Returns, p. 9-1 (Exhibit US-88).

[159] *Commodity Costs and Returns Estimation Handbook*, updated 09/30/2005, A Report of the AAEA Task Force on Commodity Costs and Returns, p. 9-1 (Exhibit US-88).

[160] *Upland Cotton (Panel)*, para. 7.1353.

attribute some value to unpaid labor and owned land. For example, if a farmer-operator has the skill to serve as a manager in a bank, the prevailing wage for that job might be attributed as the "opportunity cost" of working on the farm. Similarly, if a farmer owns his own land, the "opportunity cost" of using the land may be the value of renting it to some other operator. There are inherent difficulties in valuing such items for which there is no market transaction or cash outlay.[161]

148. More importantly, however, these are not necessarily costs that must be paid off in order for farmers to avoid having to "close down [their] business[es]."[162] A farmer who owns his land does not have to pay anybody an imputed economic cost to account for that fact. According to available data from USDA's Agricultural Resource Management Survey, an estimated 66 percent of all farmland operated in 2003 was on owned land.[163] This means that – for this percentage of farmland – the attribution of an imputed economic cost (and the treatment thereof as a kind of cash cost that must be paid on pains of closing down one's business) is simply not accurate.

149. Nor is it reasonable to suggest that farmers are behaving in an economically irrational way if they do not choose to close down their businesses simply because the total revenues – while sufficient to meet all the operating/variable and fixed cash costs – do not meet these hypothetical imputed economic costs. This ignores important factors, including that farm owners may reasonably anticipate that their equity investment will gain in value and provide long-term returns. That equity investment, therefore, has a value in addition to the annual returns of the commodities planted on the farm. Moreover, 98 percent of all farms in the United States are family farms and, in many cases, the farm is also home to the operators.[164] Given all of these realities, there is simply no reason to believe that a farmer will "close down [his] business" if he were meeting his variable costs and even his total cash costs over the long-run but nonetheless could – theoretically – make more money by renting or selling his land and taking some other job (e.g., as a teller in a nearby town).[165] Nor is reasonable to extrapolate such reasoning out to suggest that an entire agricultural sector is not economically viable without marketing loan and counter-cyclical payments.

150. In sum, the use of the "total cost" data to extrapolate about the financial viability of an upland cotton farms generally or the entire U.S. upland cotton sector does not itself withstand scrutiny. Nor does the reasoning underpinning that analysis; in particular, the assumption that farmers make decisions about their farm based on narrow crop-by-crop or enterprise-by-enterprise analyses of the "total" costs published by USDA (variable costs plus some allocation of fixed cash costs plus some hypothetical imputed economic costs).

151. The flaw in Brazil's reasoning is not only in its use of the crop-specific "total costs" as reflected in the USDA data in assessing the financial viability of upland cotton farmers but in its disregard of off-farm income – and income from other crops – that are an important part of his revenue. For example, the United States has provided data showing that in MY 2002-2005, on average, only 47% of total farm revenue on upland cotton farms was from cotton. That is, the majority of farm revenue (not even taking off-farm revenue into account) was coming from other production. Off-farm revenue adds substantially to that. As the United States explained in its

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[161] For example, the AAEA Handbook notes that "[w]hen a market transaction is not available to value a given expendable factor or capital service, methods that will approximate the opportunity cost of the service are used. *These methods are not as reliable as direct market valuation*." *Commodity Costs and Returns Estimation Handbook*, updated 09/30/2005, A Report of the AAEA Task Force on Commodity Costs and Returns, p. 2-11 (Exhibit US-88).

[162] *Upland Cotton (Panel)*, para. 7.1353.

[163] Hoppe, Robert and David Banker. "Structure and Finances of US Farms: 2005 Family Farm Report." Economic Research Service Economic Information Bulletin No.12, May 2006. (Exhibit US-67)

[164] Hoppe, Robert and David Banker. "Structure and Finances of US Farms: 2005 Family Farm Report." Economic Research Service Economic Information Bulletin No.12, May 2006. (Exhibit US-67)

[165] *Upland Cotton (Panel)*, para. 7.1353.

first written submission[166], in a study of changes in U.S. farm structure over the 20th century, Dmitry *et. al.* (2005) noted that:

> [A]bout a third of farm operators worked off the farm for at least 100 days in 1930. . . By 1970, more than half of farms had off-farm income, and by 2000, 93 percent of farms earned off-farm income. Off-farm work has played a key role in increased farm household income; while farm household income was once below the national average, in 2002 it exceeded the national average by nearly $8,000.[167]

152. Examining specifically the role of off-farm income in farm exits, Hoppe & Korb (2006) explained that:

> Off-farm work has become important to farm operators. About one-third of farmers have worked off the farm *at least 200 days per year*—essentially full-time—since 1978. Off-farm work could hypothetically affect exits in two ways. First, off-farm work may be the first step in an exit from farming, which would be reflected in higher exits for farms the operators of which work off-farm. Second, *off-farm work might lower the probability of exit by providing farm operator households with another source of income*.[168]

153. To date, Brazil has not submitted any literature, study, report, or empirical evidence to contradicts the evidence submitted by the United States regarding the consideration of whole-farm costs and revenues. Nor has Brazil provided any evidence taking into account whole-farm costs and revenues that show that, absent the marketing loan and counter-cyclical payment program, U.S. upland cotton producers would have exited upland cotton farming.

154. When use of USDA's published "total" costs is matched with disregard of an important source of income for the farm[169], the picture that emerges of the financial viability of U.S. farmers is completely and thoroughly distorted. It results in the attribution to marketing loan and counter-cyclical payment "effects" that they are not in fact having. Such improper attribution is inconsistent with Article 6.3(c) of the *SCM Agreement* and cannot support a finding under that provision.

60. In its Rebuttal Submission, the United States argues that Prof. Sumner's description of the model that appeared in a recent CATO publication is not "appropriate" for use in a WTO dispute involving claims of serious prejudice. Professor Sumner has since introduced "more empirical and institutional detail" to the model used in this dispute. These changes are described in paragraphs 111-117 of Brazil's Opening Statement. Does the United States view these changes as being sufficient to make the model appropriate for use in a WTO dispute involving claims of serious prejudice? If not, what modifications does the United States think should have been made to the model?

[166] U.S. First Written Submission, paras. 295-297.

[167] Dimitri, Carolyn et. al., The 20th Century Transformation of U.S. Agriculture and Farm Policy. Economic Information Bulletin Number 3. June 2005, pg. 2-3 (Exhibit US-45).

[168] Hoppe, Robert A. and Korb, Penni. Understanding U.S. Farm Exits. Economic Research Report 21. June 2006, p. 20 (Exhibit US-46).

[169] Dimitri, Carolyn et. al., The 20th Century Transformation of U.S. Agriculture and Farm Policy. Economic Information Bulletin Number 3. June 2005, pg. 2-3 (Exhibit US-45) ("[A]bout a third of farm operators worked off the farm for at least 100 days in 1930. . . . By 1970, more than half of farms had off-farm income, and by 2000, 93 percent of farms earned off-farm income. Off-farm work has played a key role in increased farm household income; while farm household income was once below the national average, in 2002 it exceeded the national average by nearly $8,000").

155. The United States clarifies that it is Dr. Sumner who has argued in his CATO publication that his model presented therein – which is virtually identical to the one Brazil presents here – "abstract[s] from many complexities that would be important to get more precise estimates" and that "[t]he simple model laid out here does not represent the depth of analysis that would be appropriate to support a trade remedy proceeding or a serious prejudice claim before a WTO panel."[170] The United States has simply agreed with Dr. Sumner.

156. Although Brazil now alleges that Dr. Sumner has made substantive improvements to the original CATO model, the model itself continues to "abstract from the many complexities" that exaggerate substantially the estimates obtained. These are factors that Brazil considered sufficiently important to include and tout in the FAPRI-based model used in the original proceeding. For example, Dr. Sumner's model does not explicitly address the acreage decision with appropriate modeling of the incentives to plant cotton relative to competing crops. While the model analyzes a range of years, it does not incorporate any year-to-year market dynamics in its reported impacts. The United States has addressed these and other fundamental problems with the model in its prior submissions as well as in its oral presentation to the Panel, including that the model:

- lacks cross-commodity impacts and cross-price elasticities, potentially leading to biased price effects;

- is static with no explicit relationships for changes in cotton stock levels and no stocks equation;

- contains foreign supply elasticities that are different from FAPRI that underestimate the response of foreign producers to changes in world prices;

- treats production flexibility payments and direct payments differently even though they operate in the same way;

- incorporates Step 2 payments directly into the producer revenue function as fully coupled payment; and

- appears to ignore statutory parameters, for example by including counter-cyclical payment rates in each of the various price expectations that sometimes exceed the statutory maximum.

157. These structural and operational flaws are further compounded by the flawed econometric parameters used by the Sumner II model, resulting in even greater exaggeration of any possible effects on prices. As the United States demonstrated, between the original panel proceeding and this Article 21.5 panel proceeding, Brazil's economist *changed every single elasticity estimate in the modeling exercise*, *except one* (U.S. mill demand elasticity) to substituted an elasticity that would produce even greater impacts on production and prices than would even the elasticities used for purposes of the original modeling exercise.[171]

[170] Daniel A. Sumner. "Boxed In: Conflicts Between U.S. Farm Policies and WTO Obligations." Center for Trade Policy Studies, The Cato Institute, December 2005. (Exhibit US-108)

[171] Of course, many of the elasticities in the model used for purposes of the original proceeding were already overstated.

Supply and Demand Elasticities Used in Sumner I and II

Parameter	Effects of change to Sumner II elasticity (impact on world price due to removal of marketing loans and counter-cyclical payments)	Sumner I (FAPRI)	Sumner II(CATO)
U.S. cotton supply elasticity	**INCREASED IMPACT**	0.361 - 0.466	0.80
ROW cotton supply elasticity	**INCREASED IMPACT**	0.30	0.20
US mill demand elasticity	no change	-0.20	-0.20
US stocks demand elasticity	**INCREASED IMPACT**	-1.40*	no
ROW mill demand elasticity	**INCREASED IMPACT**	-0.25	-0.20
ROW stocks demand elasticity	**INCREASED IMPACT**	-0.463*	no

*Parameter estimate not presented in original Sumner model; estimates drawn from FAPRI model documentation discussed in Annex I to the US Rebuttal Submission, paras 23-25. (Exhibit US-56, Exhibit US-109, Exhibit US-65)

158. United States has also explained that Brazil applies a long-run elasticity for U.S. supply response while imposing very conservative short-run elasticities for international supply and demand response. If the analysis is to be performed in the long run – and the United States considers that it must for the reasons explained at the meeting with the Panel and in response to the panel's questions – then long-run elasticities must be assumed throughout the model. There is no basis for the kind of mix-and-match approach that Brazil has adopted in an effort to exaggerate any possible effects of the marketing loan and counter-cyclical payments.

159. Another key source of bias in Dr. Sumner's analysis is the fact that it does not incorporate, either explicitly or implicitly, any stock behavior.[172] Yet, stock adjustments may have important effects on overall price movements in the short-run. As future prices increase relative to current prices, warehouses will tend to carry more inventory, choosing to sell their cotton in future periods when prices are higher. Likewise, if current prices are high relative to futures prices, sellers find it more attractive to market their cotton rather than holding it for sale in the future. In this way, stocks act to buffer prices. If prices fall, potential sellers will sell less and hold more in stock, thus potentially bolstering prices. If prices rise, inventory holders will sell stocks, thus potentially dampening the increase. Ignoring stockholding behavior in the kind of predominantly short-run assessment that Brazil attempts to conduct exacerbates any possible effects of removal of marketing loans and counter-cyclical payments on world price.

160. In sum, the evidence and arguments before the Panel show that the Sumner II model lacks the rigor or detail to address the complexities of the global fiber market. Brazil's claims that Dr. Sumner has introduced "more empirical and institutional detail" to the model used in this dispute does not alter the fact that it continues to "abstract from many complexities that would be important to get more precise estimates" and "does not represent the depth of analysis that would be appropriate to support a trade remedy proceeding or a serious prejudice claim before a WTO panel."[173]

[172] The absence of such an analysis is especially remarkable given Brazil's new theory that it is stocks – not exports – that are suppressing world market prices.

[173] Daniel A. Sumner. "Boxed In: Conflicts Between U.S. Farm Policies and WTO Obligations." Center for Trade Policy Studies, The Cato Institute, December 2005. (Exhibit US-108)

61. With respect to marketing year 2006, the United States has provided some data on upland cotton exports (Exhibit US-113), planted and harvested area and cotton production (Exhibit US-114), as well as a copy of the National Cotton Council's survey of planting intensions (Exhibit US-115). The data, all of which have been collected through the first half of marketing year 2006, are variously qualified as "estimates" or "projections" or "projected."

(a) Please clarify, as completely as possible, what these various terms mean as they apply to US upland cotton exports, acreage and production.

161. The data presented in Exhibit US-113, the Weekly Export Sales Reporting Data constitute neither a forecast nor a projection. They are best described as monitoring data. Specifically, U.S. exporters are required to provide information to USDA's Foreign Agricultural Service ("FAS") on the quantity of their sales transactions, the type and class of commodity, the marketing year of the shipment and the ultimate destination. They also report any changes in previously reported information, such as cancellations or changes in destinations. FAS compiles the data and publishes a weekly report. These reports provide a snapshot, on a continuing basis, of the level of U.S. export sales and commitments and allow interested parties to assess export performance, compared to USDA or other export projections.

162. The data provided in Exhibit US-114 is from the USDA's World Agricultural Supply and Demand Estimates (WASDE) report, which provides USDA's comprehensive forecasts of supply and demand for major U.S. and global crops and U.S. livestock. The report gathers information from a number of statistical reports published by USDA and other government agencies, and provides a framework for additional USDA reports. Data for U.S. area and production are provided by USDA's National Agricultural Statistical Service, and are based on periodic surveys. The WASDE typically provides data for 3 marketing years, including production and exports.

163. The terms "projections and projected" – both of which mean the same thing – reflect a lower degree of certainty inasmuch as most numbers in the balance sheet are not yet "estimates.' In May of each year, when the WASDE switches to the new marketing year, the term "estimate" is then applied to the previous year's projections even though these numbers, for most crops, are not yet "final." This is because the previous marketing year is not yet over. For example, in May the wheat marketing year is nearly over while the marketing years for cotton and other spring planted crops have three to five months remaining. For simplicity, and to avoid a crop by crop explanation, the numbers in the balance sheet are referred to as "estimates."

164. The term "estimate" reflects a higher degree of certainty. However, "estimates" and even "final estimates" are subject to change pending better or more complete information. Some estimates may be changed many years after the initial "final estimate" is published.

165. Data for the current marketing year (MY 2006) are labeled as projections because final data for most variables covered are not yet available. Data for the previous marketing year (MY 2005) are mostly final (for example, beginning stocks, acreage, and production) but some data may not be complete (for example, exports and ending stocks). Therefore, these data are still labeled estimates. Data for the prior year (MY 2004) are not labeled estimates or projections and are considered final, but they could still be revised. Because the data in the WASDE come from a variety of sources and could a multitude of products and variables, they are always subject to change and revision. In May of this year (MY 2006), the figures for MY 2005 will become "final," the figures for MY 2006 will become "estimates," and new figures for MY 2007 will be "projected" (or deemed "projections").

166. The National Cotton Council's (NCC) planting intentions is a projection for the upcoming season based on a survey sent to approximately 40 percent of U.S. cotton farmers. In mid-December

through early January, farmers are surveyed regarding their acreage for cotton and primary competing crops in the previous year and their intended plantings in the upcoming year.

(b) Would the United States be able to provide the Panel with some information, based on the average of the past six marketing years or so, of how final marketing year data on these variables, would differ from preliminary estimates, projections and the like, taken at the end of February of the relevant marketing year?

167. The requested data, showing the February projections for the current marketing year compared to the final numbers, are provided in Exhibit US-145.

168. The United States notes that each monthly version of the WASDE provides a reliability assessment of projections for that month compared to the final estimate, based on 25 years of data. For example, for U.S. cotton exports for February 2007, the difference between the February projection and the final estimate has averaged 500,000 bales, or 7.1 percent. The February projection has been below the final estimate 13 times and above the final 11 times.[174]

169. For the NCC survey, percent differences from the final acreage numbered have ranged between a low of 1.1 percent and a high of 8.5 percent. The average error over the past six years in 1.7 percent.[175]

(c) Finally, would the United States be able to update that part of Exhibit US-83 dealing with futures prices so as to provide the panel with as complete as possible average January to March 2007 New York futures prices for upland cotton?

170. A spreadsheet containing the most recent futures data for the December 2007 upland cotton contract is provided in Exhibit US-147. Corn and soybean futures data are also provided in this exhibit.

<u>Questions to Brazil</u>

62. How does Brazil rebut the argument of the United States that the fact that marketing loan and counter-cyclical payment programmes provide income support when prices are low is not the key question before this Panel and that while, like any other payments to producers, marketing loan and counter-cyclical payments could affect production, Brazil has not provided any evidence of actual production-inducing effects? (Rebuttal Submission of the United States, paras. 222, 287-291; Opening Statement of the United States at the meeting of the Panel with the parties, paras. 62-75; Comments of the United States on Brazil's 'Oral' Presentation in the meeting with the Panel, paras. 42-57)

63. Could Brazil explain whether or not it considers that whether marketing loan and counter-cyclical payments increase acreage is not relevant to the inquiry of whether these payments cause significant price suppression within the meaning of Article 6.3 (c) of the SCM Agreement? (para. 56 of the Opening Statement of Brazil) Could Brazil comment on the points made by the United States in footnote 72 of the Comments of the United States on Brazil's "Oral" Presentation in the meeting with the Panel?

64. Given that Brazil has criticized the new empirical research cited by the United States because it does not deal specifically with the effects of countercyclical

[174] *See* February 9, 2007 WASDE (Exhibit US-114)
[175] *See* Exhibit US-146.

payments on upland cotton production, why does Brazil consider that the McIntosh, Shogren & Dohlam study (Rebuttal Submission of Brazil, para. 140) is particularly relevant to this case? Could Brazil comment on the arguments of the United States in paragraphs 248-249 of the Rebuttal Submission of the United States?

65. The United States has cited new empirical research on the production effects of counter-cyclical payments. Could Brazil explain why the fact that these studies do not deal specifically with upland cotton should preclude the Panel from considering the studies as being highly probative?

66. Can Brazil explain the differences between the figures for the amount of counter-cyclical payments allocated to upland cotton provided by Brazil at the meeting of the Panel with the parties (Opening Statement of Brazil, para. 40 and Exhibit Bra 625) and the figures in Table 5 of Brazil's Rebuttal Submission?

67. Please confirm whether or not the Panel's understanding is correct:

"Table 6" in Brazil's First Written Submission was produced using the so-called "Brazil's method" using USDA data.

"Table 5" in Brazil's Rebuttal Submission was produced using the so-called "cotton-to-cotton" methodology using USDA data.

The figures cited in para. 40 of Brazil's opening statement (i.e. "$868 million and $838 million) are produced with the "Brazil's method" as well as the "cotton-to-cotton" methodology, using the data provided by the United States in exhibit US-64.

68. Please comment on the following statement by the US:

> *"The United States understands that Brazil intends the counter-cyclical payment figures shown in 'Table 5' of Brazil's rebuttal submission to supersede the counter-cyclical payment figures shown in 'Table 6' of its first written submission." (US response to question 4 at para. 15)*

69. How does Brazil address the argument of the United States that "the only evidence that Brazil has submitted purporting to examine the price effects of marketing loan and counter-cyclical payments specifically are the results of the modelling exercise that it has conducted for purposes of this proceeding"? (Opening Statement of the United States, para. 76)

70. How does Brazil respond to the United States' rebuttal that Brazil has not even established a temporal correlation between payment of subsidies and significantly suppressed prices during the life of the FSRI, that is from marketing year 2002 to 2005? More specifically, please address the United States' claim of the stability of US plantings, US share of world production, US share of world exports and the world price of cotton during this period.

71. In the original case, the Panel concluded that the analysis covering "the six-year period from 1997-2002 ... lends itself to an assessment of the medium- to longer-term examination of developments in the United States upland cotton industry" (see para. 7.1354 of the original panel report). Thus, total costs of production were

the costs considered appropriate by the Panel. Would total costs of production continue to be relevant should the compliance Panel decide to use only marketing year 2005 as the reference period for analysis? Or would variable costs of upland cotton farming in marketing year 2005 now be the relevant information to consider?

72. ***Brazil has argued that the adjustment in cotton stocks should not be included in the simulation of a large and permanent reduction in subsidies to cotton. Please respond to the following argument:***

> ***If the simulation were a comparative static analysis in which a baseline is compared to a counterfactual outcome in some long-run state, modelling such adjustments would be unnecessary. But such adjustments should be taken into account given that the model is used to simulate the average impact on the world price of cotton (among other variables) on specific periods of time (MY 2002-05 or MY 2006-08) and not in the long run.***

73. ***How does Brazil respond to the argument made by the United States in paragraph 79 of its Opening Statement that:***

> ***"to the extent a counterfactual assessment is undertaken, it is only to assess what the price equilibrium would be at present if marketing loan and counter-cyclical payments had been lower, different or did not exist. Article 6.3(c) does not ask what prices will look like in the short-run adjustment period if the marketing loan and counter-cyclical payments are suddenly eliminated... Brazil's argument that it is necessary to look at the short-run effects of total elimination of the programs cannot be accurate as a textual matter."***

More specifically:

(a) ***Why did Brazil not consider it appropriate to include simulations that involve reductions rather than elimination of the subsidy programmes?***

(b) ***If simulations of such scenarios are performed, would the current values of the elasticities chosen (particularly the supply elasticities) to simulate the elimination of marketing loan and counter-cyclical programmes continue to be appropriate? Please kindly provide an explanation for the chosen answer.***

74. ***Brazil's view is that the data that the Panel must consider for its claim of present serious prejudice should be that covering the latest marketing year for which complete information is available, MY 2005, and where credible, evidence after 31 July 2006. Since in MY 2005, payments under Step 2 continued to be made by the United States (payments which the original Panel found to have contributed to adverse effects) how shall the Panel ascertain that any adverse effects observed in marketing year 2005 are due solely to the two subsidy measures which are the subject of the present serious prejudice claim – marketing loan and counter-cyclical payments?***

2. Increase in world market share - Article 6.3(d) of the *SCM Agreement*

Questions to the United States

75. Could the United States explain further the textual basis of its argument that "Article 6.3(d) is not concerned with absolute market share and whether or not in any given year a member's market share would have been lower if subsidies were removed"? (Rebuttal Submission of the United States, para. 401)

171. As the United States noted in its paragraph 401 of its rebuttal submission, the question under Article 6.3(d) is whether "the effect of the subsidy is an *increase* in the world market share of the subsidizing Member . . . as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted." The first part of Article 6.3(d) requires a showing of an *increase* – *i.e.*, "the action, process, or fact of making or becoming greater."[176] This makes clear that what it at issue is movement, not something static like the absolute level of market share in a particular year. The concern of Article 6.3(d) is the movement from one thing – specifically, "the average share [the allegedly subsidizing Member] had during the previous period of three years" – to another, the level in the year that is the subject of the claim. If upward movement – *i.e.*, "increase" or "growth" – is involved in getting from the former to the latter, and the upward movement is itself proven to be "the effect" of a challenged subsidy – the first element of Article 6.3(d) is satisfied. The question then is whether such an "increase" – again, that is shown to be caused by the subsidy – "follows a consistent trend over a period when subsidies have been granted."

172. By its terms, Article 6.3(d) does *not* address situations where a Members' market share is merely alleged be higher than it would be "but for" subsidies, as Brazil assumes in some of its arguments.[177] That is not "the effect" with which Article 6.3(d) is concerned.

Questions to Brazil

76. What is the view of Brazil on the argument of the United States that an inquiry under Article 6.3(d) of the SCM Agreement requires two distinct elements: first, a demonstration of an increase in the world market share of a Member as compared to the average share it had during the previous period of three years, and, second, a demonstration that this increase in world market share compared to the average share the Member had during the previous period of three years is part of a consistent trend over a period when subsidies have been granted? (Rebuttal Submission of the United States, para. 399)

77. In this connection, could Brazil respond to the argument of the United States that Brazil has not shown that either of these elements are met with respect to the marketing loan and counter-cyclical payment programs"? (Rebuttal Submission of the United States, paras. 399-403)

[176] *The New Shorter Oxford English Dictionary* at 1350, Volume 1, (2002 Edition) (Exhibit US-148).

[177] *See* U.S. Rebuttal Submission, para. 401 (responding to Brazil's argument that, according to its model, *removal of the marketing loan and counter-cyclical payment programs* would have resulted in lower U.S. market share in MY 2005).

C. CLAIM OF BRAZIL REGARDING THREAT OF SERIOUS PREJUDICE

Questions to both parties

78. Could both parties comment on the statements of Canada that "(a)t issue is whether these programmes....threaten to cause serious prejudice simply by virtue of their existence" and that "(c)ertain subsidy programs, by their very nature, give rise to a constant likelihood of support that results in a permanent threat of serious prejudice"? (Third Party Submission of Canada, paras. 9-10)

173. The United States does not consider Canada's assertion of "the issue" to be accurate. Brazil has asserted that "the appropriate standard of threat in Part III [of the *SCM Agreement*] is one in which there is a significant likelihood, based on the nature of subsidies *and particular conditions of competition*, that serious prejudice will occur in the future."[178] While the United States disagrees that the "significant likelihood" is the appropriate standard for assessing "threat" for the reasons set out in the U.S. rebuttal submission[179], the United States has understood Brazil to be arguing that the question of threat must be determined on the basis of whether there is a significant likelihood of actual serious prejudice coming about given the particular market conditions and other factors in the future. The United States has not understood Brazil to be arguing that marketing loan and counter-cyclical payment programs "by their very nature, give rise to a constant likelihood of support that results in a permanent threat of serious prejudice," as Canada now argues.

174. To the extent that Brazil now asserts that such a question is "at issue," however, the United States notes the remarkable nature of the claim. In effect, Brazil would be asserting that certain programs are "by their very nature" inconsistent with Article 6.3(c) of the *SCM Agreement*. The United States notes that the *SCM Agreement* does not establish any such a category of measures. If drafters had agreed that there were such measures, they could certainly provided for them, in much the same way that they did in Article 3.1(a) (measures that are contingent upon export performance) and Article 3.1(b) (measures that are contingent on use of domestic over imported goods). The fact that they did not do so in the case of measures that allegedly "by their very nature" give rise to threat of significant price suppression indicates that they did not consider – and did not agree – that such measures exist.

175. In any event, the question is one of fact. If a Member considers that another Member's measures "by their very nature" give rise to threat of significant price suppression, the burden is on the complaining Member to prove it. And – given the remarkable nature of the assertion (*i.e.*, that certain measures are "by their very nature" WTO-inconsistent – the bar is high. The complaining Member must prove that, even if no subsidies are likely to be provided under the program and regardless of the amount if any that are provided – and regardless of what the market conditions are likely to be like in the future – the responding Member's program necessarily "give[s] rise to a constant likelihood of support that results in a permanent threat of" significant price suppression. Even if Brazil were to have made such an claim, it has offered no empirical basis for such an extraordinary finding here.

79. Could the parties state their views on the analysis of the ordinary meaning of the term "threat" in paras. 15-28 of the Third Party Submission of Canada?

176. Before responding to the Panel's question, the United States notes that Canada's arguments are in support of the assertion that "'threat' may be analyzed both as a temporal concept as in Article 15.7, *and* as a probability of occurrence."[180] However, it appears from a plain reading of Article 15.7 of the *SCM Agreement* that the meaning of "threat" therein incorporates not only a temporal concept

[178] Brazil First Submission, para. 253 (emphasis added).
[179] U.S. Rebuttal Submission, paras. 406-413.
[180] Third Party Submission of Canada, para. 10.

("imminent") but *also* a concept of the probability of occurrence ("clearly foreseen"). Indeed, the United States has submitted that this simply reflects the ordinary meaning of "threat," which includes "an indication of the *approach* of something unwelcome or undesireable"[181] and "a person or thing regarded as a *likely* cause of harm."[182] The meaning of "approach," in turn, is, *inter alia*, "a drawing near in time or circumstances" "be nearly equal to""[b]e so situated or arranged that the parts lie successively nearer to"[183] and, as such, reflects a similar notion of close proximity as the term "imminent." The United States has, therefore, argued that the both concepts are important in assessing "threat of serious prejudice" under Article 5 of the *SCM Agreement*.

177. Canada appears to argue that in the case of "threat of serious prejudice" under Article 6.3(c), one must ignore the temporal aspect of "threat" altogether and – instead – consider some concept of probability alone. Yet Canada offers no explanation for why this key aspect of the term must ignored. Indeed, even its own articulation of the ordinary meaning of "threat" – "an indication of *something coming*" – includes the same notion of "drawing near in time or circumstances"and "be[ing] nearly equal to""[b]e[ing] so situated or arranged that the parts lie successively nearer to"[184] that is reflected in the use of the term "imminent" in Articles 15.7 of the *SCM Agreement*, Article 3.7 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade ("*AD Agreement*"), and Article 4.1(b) of the *Agreement on Safeguards* in describing the meaning of the term "threat."

178. To support its argument that there is no temporal aspect to the term "threat of serious prejudice" in Article 6.3(c), Canada asserts that such a concept would be inconsistent with the "opening phrase of Article XVI:1 of the GATT 1994."[185] According to Canada, that article "makes clear, it is not only the actual grant of a subsidy that allows for serious prejudice to be found. Merely *maintaining a program* that mandates payments deemed to be a subsidy causing adverse effects may therefore cause serious prejudice . . . ."[186] Canada appears to be confusing two distinct issues. The first issue is whether a program itself (*i.e.*, the legislation/regulations providing for payments) may be deemed to constitute a *subsidy* for purposes of the *SCM Agreement* such that the "grant" or "maintenance" of it may be found to cause or threaten serious prejudice. The second issue is whether or not the definition of "threat" of serious prejudice in Article 5(c)/footnote 13 requires a showing that the serious prejudice being "threatened" is not only likely but also is soon to come. The latter is the question that is at issue here in the interpretation of the legal standard in Articles 5 and 6 of the *SCM Agreement*.

179. Canada also argues that "standard for threat of serious prejudice should [not] be imported from Article 15.7" of the *SCM Agreement* because "[w]here a standard from another article or other agreement is to be used, the *SCM Agreement* identifies that standard." Canada incorrectly assumes that the United States has asked the Panel to "import" the standard from Article 15.7 of the *SCM Agreement*. The United States has not done so and, in fact, has expressly clarified this in its rebuttal submission.[187] Rather, the United States has argued that the ordinary meaning of "threat" of certain injurious effects – as reflected in Article 15.7 of the *SCM Agreement*, Article 3.7 of the *AD Agreement*, and Article 4.1(b) of the *Agreement on Safeguards* – provides important contextual

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[181] *The New Shorter Oxford English Dictionary* at 3290, Volume 2, (1993 Edition) (Exhibit US-104). Brazil appears to agree that this is ordinary meaning of "threat." Brazil First Submission, para. 247 ("The term 'threat' can refer to 'an indication of the approach of something unwelcome or undesireable' . . . .").

[182] *The New Shorter Oxford English Dictionary* at 3291, Volume 2, (1993 Edition) (Exhibit US-105) (emphasis added).

[183] *The New Shorter Oxford English Dictionary* at 102, Volume 1, (1993 Edition) (Exhibit US-106).

[184] *The New Shorter Oxford English Dictionary* at 102, Volume 1, (1993 Edition) (Exhibit US-106).

[185] Third Party Submission of Canada, para. 18.

[186] Third Party Submission of Canada, para. 18.

[187] U.S. Rebuttal Submission, para. 411.

guidance in interpreting "threat" of serious prejudice in Article 5(c)/footnote 13 of the *SCM Agreement*.

180. As the United States has explained, interpreting the meaning of "threat" in this way is not only the proper approach under customary rules of treaty interpretation[188], but it makes sense given that all three provisions serve a similar function – they identify the same narrow circumstance in which it may be appropriate to discipline a Member's measures *notwithstanding* that the measures are not prohibited *per se* and are not necessarily *causing* any injurious effects or prejudice. Under all of these provisions, the Member's measure can be subjected to discipline only if there nonetheless a proper showing of "threat" of injurious effects or serious prejudice sufficient to justify the application of a remedy (whether it is multilateral, in the case of a WTO claim based on Article 5(c)/footnote 13, or unilateral, in the case of an antidumping or countervailing duty or safeguard investigation). The elaboration of "threat" in the latter three contexts – specifically, underscoring the sense of probability and proximity in time, consistent with its ordinary meaning – is undoubtedly important in understanding the use of the same term in the former context.

181. Canada has not explained why – in the context of this proceeding – the customary rules of treaty interpretation should not apply. Nor has Canada explained why a panel must wait for an express cross-reference in order to consult, as context, the meaning of the same term as it is reflected in other provisions of the *same* agreement as well as in provisions of other agreements, all of which deal with analogous questions involving the "threat of material injury" and "threat of serious injury." To the contrary, what Canada's own arguments make clear is that a cross-reference is used in the *SCM Agreement* where a term is given a special meaning in one place – for example, "injury to the domestic industry" in Part V of the *SCM Agreement*, "nullification or impairment" in the GATT 1994, and "serious prejudice to the interests of another Member" in Article XVI:1 of that GATT 1994 – such that it is necessary to clarify when the term is used "in the same sense" elsewhere.

182. By contrast, a panel may consider the ordinary meaning of a term as reflected in one provision to interpret the same term in another provision (especially of the same agreement) without the need for an express cross-reference. Indeed, if a panel could not do so, this Panel would err (as the original panel also would have done) by considering the definition and requirements for an "export subsidy" finding in the *SCM Agreement* as contextual guidance in interpreting the term "export subsidy" in the *Agreement on Agriculture*. There is certainly no "cross-reference" in either agreement that expressly authorizes a panel to consider the former as contextual guidance for the latter, yet no Member has argued that this prevents the Panel from doing so.

183. Indeed, it is curious that while Canada asserts that "one must look to the specific language and context of an agreement to determine the standard to be applied to a given analysis," it asserts that the appropriate analog for "threat" in Article 5(c)/footnote 13 is in Article 10.1 of the *Agreement on Agriculture*, a provision that deals with circumvention of bound export subsidy commitments, not any sort of injurious or adverse effect.[189] Unlike the circumvention provisions in Article 10.1 of the *Agreement on Agriculture*, all four of the provisions mentioned above – threat of serious prejudice in Article 5/footnote 13 of the *SCM Agreement*, threat of material injury in Article 15.7 of the *SCM Agreement*, threat of material injury in Article 3.7 of the *AD Agreement*, and threat of serious

[188] For example, that treaty terms are to be interpreted "in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." *See United States – Gasoline (AB)*, p. 17 (noting that "[this] general rule of interpretation [codified in Article 31 of the *Vienna Convention on the Law of Treaties*] has attained the status of a rule of customary or general international law. As such, it forms part of the 'customary rules of interpretation of public international law' which the Appellate Body has been directed, by Article 3(2) of the DSU, to apply in seeking to clarify the provisions of the General Agreement and the other 'covered agreements' of the Marrakesh Agreement Establishing the World Trade Organization. . . .)

[189] Third Party Submission of Canada, para. 23.

injury Article 4.1(b) of the *Agreement on Safeguards* – deal with threat of adverse or injurious effects. Given Canada's own assertion that it is important to consider the language and context of the provision in ascertaining the meaning, it is not clear why the analysis of "threat of circumvention" under the *Agreement on Agriculture* should be more important contextual guidance than these closely analogous provisions of *the SCM Agreement itself*, the *AD Agreement*, and the *Agreement on Safeguards*.[190]

184. Finally, the United States notes Canada's assertion that two GATT reports from 1979 and 1980 support the finding that the "meaning of threat is flexible" such that a "permanent source of uncertainty in world sugar markets . . . gave rise to a threat of serious prejudice in the sense of Article XVI:1."[191] The United States does not agree. There is no discussion whatsoever of the legal standard for "threat" of serious prejudice in either of the two GATT reports cited by Canada (*EC – Sugar (Australia)* and *EC – Sugar (Brazil)*)[192], let alone any assessment of whether there is a temporal aspect of that term (as clearly indicated by its ordinary meaning). Nor – obviously[193] – is there any assessment of the meaning of the term given the particular context (*i.e.*, looking to the use of that term in Article 5/footnote 13 of the *SCM Agreement* in the light of the term threat of material injury in Article 15.7 of the *SCM Agreement*, threat of material injury in Article 3.7 of the *AD Agreement*, and threat of serious injury in Article 4.1(b) of the *Agreement on Safeguards*). Indeed, the analysis in those reports appears to depend on certain assumptions about Members' obligations to *prevent* the sanctioned thing from occurring[194], obligations that the Appellate Body has since clarified are not an intrinsic part of "threat."[195] The analysis in those reports – what little of it there is – provides little to no guidance in assessing the questions of threat implicated by Brazil's claims in this proceeding.

[190] Canada's further assertion that "very object and purpose" of the *SCM Agreement* "demonstrates that the standard for threat of serious prejudice may be distinct from that of threat in the case of material injury" does not appear logical. Third Party Submission of Canada, para. 25. The United States is not arguing, of course, that "the standard for threat of serious prejudice" is the same as "that of threat in the case of material injury." Nonetheless, even leaving that aside, one would assume that the same "object and purpose" of the *SCM Agreement* applies to all of its parts. Therefore, if – as Canada asserts – "the object and purpose of the *SCM Agreement* is the establishment of multilateral disciplines 'on the premise that some forms of government intervention distort international trade, [or] have the *potential* to distort [international trade]," one would expect that this would apply to *both* Part III and Part V of the *SCM Agreement*. It is, therefore, unclear how the *same* object and purpose establishes a *different* "standard" for threat in the two contexts.

[191] Third Party Submission of Canada, para. 24.

[192] Third Party Submission of Canada, para. 24 (citing to *EC – Sugar (Australia)*, BISD 26S/290, para. (h) of conclusion and *EC – Sugar (Brazil)*, BISD 27S/69, at para. (g) of conclusion.

[193] Those reports predate these agreements.

[194] For example, emphasizing the absence of "pre-established effective limitations on in respect of either production, price, or the amounts of export refunds," the panel in *EC – Sugar (Brazil)* found that "[n]either the system not its application would *prevent* the European Communities from having more than an equitable share of world export trade in sugar. The Panel, *therefore*, concluded that the Community system and its application constituted a permanent source of uncertainty in world sugar markets and *therefore* constituted a threat of serious prejudice in terms of Article XVI:1." *EC – Sugar (Brazil)*, BISD 27S/69, at para. (g) of conclusion (emphasis added).

[195] Rejecting Brazil's arguments that a program that allegedly provided "unlimited" subsidies necessarily posed a "threat" within Article 10.1 of the *Agreement on Agriculture*, the Appellate Body explained that

> [W]e are [not] prepared to accept Brazil's suggestion that the concept of 'threat' in Article 10.1 should be read in a manner that requires WTO Members to take 'anticipatory or precautionary' action. The obligation not to apply exports subsidies in a manner that 'threatens to lead to' circumvention of their export subsidy commitments does not extend that far. There is no basis in Article 10.1 for requiring WTO Members to take affirmative, precautionary steps to ensure that circumvention of their export subsidy reduction commitments does not occur"
> *Upland Cotton (AB)*, para. 707.

Questions to the United States

80. How does the United States address the argument of Japan that in view of the different purposes of Parts III and V of the SCM Agreement the standard for determining threat of material injury in Article 15.7 of the SCM Agreement is an inappropriate standard for determining the existence of a threat of serious prejudice under Part III of the SCM Agreement? (Third Party Submission of Japan, paras. 8-12.)

185. The United States understands Japan's argument to be that there are allegedly different objects and purposes of Parts III and V of the *SCM Agreement* and that these preclude the Panel from considering the ordinary meaning of "threat" of certain injurious effects, as reflected in Article 15.7 of the *SCM Agreement*, Article 3.7 of the *AD Agreement*, and Article 4.1(b) of the *Agreement on Safeguards* as important contextual guidance in interpreting "threat" of serious prejudice in Article 5(c)/footnote 13 of the *SCM Agreement*. The United States does not agree.

186. First, the obligation to interpret treaty terms "in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose" as codified in Article 31(1) of the Vienna Convention "forms part of the 'customary rules of interpretation of public international law' which the Appellate Body [and panels] ha[ve] been directed, by Article 3(2) of the DSU, to apply in seeking to clarify the provisions of the General Agreement and the other 'covered agreements' of the Marrakesh Agreement Establishing the World Trade Organization. . . ."[196] The Appellate Body has explained that:

> [i]t is well accepted that the use of the singular word 'its' preceding the term 'object and purpose' in Article 31(1) of the Vienna Convention indicates that the term refers to the treaty as a whole; had the term 'object and purpose' been preceded by the word 'their', the use of the plural would have indicated a reference to particular 'treaty terms'. Thus, the term 'its object and purpose' makes it clear that the starting point for ascertaining 'object and purpose' is the treaty itself, in its entirety."[197]

187. Japan's analysis does not attempt to interpret "threat" in Article 5/footnote 13 of the *SCM Agreement* "in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of [the] object and purpose" *of the treat itself, in its entirety*. Rather, Japan appears to ascribe a different "object and purpose" to different parts of the treaty. In this case, it asserts that the object and purpose of Part V, in general – and Article 15, in particular – is to "limit the discretion of national authorities and guarantee against misuse." Japan does not specify what the object and purpose of Part III is, but indicates that it is different from that of Part V. According to Japan, "Part III issues are completely devoid of concerns relating to limiting the discretion of national authorities to prevent misuse thereof in the conduct of domestic CVD investigations [as] no national authority is involved." Japan asserts that this alleged difference in the object and purpose of these *parts* of the treaty requires the Panel to *disregard* the "ordinary meaning" of the term threat as reflected in Article 15.7 of the *SCM Agreement*, Article 3.7 of the *AD Agreement*, and Article 4.1(b) of the *Agreement on Safeguards* and the contextual guidance provided by those provisions in interpreting "threat" of serious prejudice in Article 5(c)/footnote 13 of the *SCM Agreement*. The

[196] *United States – Gasoline (AB)*, p. 17.

[197] *EC – Chicken Classification (AB)*, para. 238. The Appellate Body has explained that it may be possible to consider the "the object and purpose of particular treaty terms" but only "if doing so assists the interpreter in determining the treaty's object and purpose on the whole" and the focus is on "ascertaining the common intentions of the parties." *EC – Chicken Classification (AB)*, para. 238-239. As noted above, Japan does not even discuss "the treaty's object and purpose of the whole," let alone how the different purposes it ascribes to the parts of the *SCM Agreement* relate to that "object and purpose of the whole" or how the interpretation of "threat" in Articles 5(c)/footnote 13 and 15.7 of the *SCM Agreement* follow from there.

United States submits that this constitutes a serious misapplication of the customary rules of treaty interpretation.

188. Second, Japan has provided no basis for its assertion that the object and purpose of Article 15.7 is to "limit the discretion of national authorities and guarantee against misuse" and that, as a result, the meaning of "threat" in that context is necessarily different from the meaning of "theat" in Article 6.3(c). The United States sees nothing in Article 15.7 that suggests that Members assumed that national authorities would necessarily "misuse" their discretion and that they therefore infused the language in Article 15.7 with special meaning that is not relevant elsewhere. To the contrary, both Article 5/footnote 13 and Article 15.7 of the *SCM Agreement* appear, to the United States, to be consistent with the Appellate Body's explanation of the "object and purpose of the SCM Agreement, which is to strengthen and improve GATT disciplines relating to the use of both subsidies and countervailing measures, while, recognizing at the same time, the right of Members to impose such measures under certain conditions."[198] This recognizes the fact that *SCM Agreement* strikes a balance between the right to maintain subsidies in some circumstances and the right to discipline them in others. Article 5/footnote 13 and Article 15.7 of the *SCM Agreement* both function to establish such a balance. There is no basis for understanding the same terms in the two provisions to have different meanings based on an assumption that national authorities are necessarily prone to "misusing" their discretion whereas WTO panels are not.

189. Third, Japan asserts in support of its argument that "[t]he original Panel in this proceeding properly recognized that ASCM Part V, for a variety of reasons, may not be proper context for interpreting and applying Part III."[199] However, the paragraph of the original panel report to which Japan cites provides exactly the opposite. It states expressly that "[o]n the basis of the text of Part III, and for the reasons that follow, we are of the view that, while *they may provide contextual – and general conceptual – guidance*, the more precise quantitative concepts and methodologies found in Part V of the *SCM Agreement* are not *directly* applicable in our examination of Brazil's actionable subsidy claims under Part III of the *SCM Agreement*."[200] This is precisely what the United States has argued – that the ordinary meaning of the term "threat" as reflected in Article 15.7 of the *SCM Agreement*, Article 3.7 of the *AD Agreement*, and Article 4.1(b) of the *Agreement on Safeguards* is important contextual guidance in interpreting "threat" of serious prejudice in Article 5(c)/footnote 13 of the *SCM Agreement*.

190. The fact that it is appropriate to consult that ordinary meaning has not only been confirmed by the original panel but even by Japan itself. Indeed, shortly following the paragraph noted above in Japan's third party submission, Japan argues that Brazil's preferred "significant likelihood" standard – found nowhere in the text of the *SCM Agreement* – "is incomplete as it does not include an explicit evidentiary requirement. An explicit evidentiary requirement such as that set forth in the first sentence of ASCM Article 15.7 is a crucial component of any 'threat' standard."[201] It is unclear why – if Article 15.7 cannot provide contextual guidance in interpreting "threat" under Article 5/footnote 13 – Japan would note the fact that there is an "explicit evidentiary requirement" included in that provision. Japan's reasoning appears to recognize that an evidentiary requirement is an important aspect of *any* claim of threat, and that the requirements set out in Article 15.7 provide important contextual guidance in determining the evidentiary requirements that must apply in the case of "threat" claims under Article 5/footnote 13. The approach is virtually the same for understanding the ordinary *meaning* of "threat" in those provisions.

[198] *U.S. – Lumber CVDs Final (AB)*, para. 95.
[199] Third Party Submission of Japan, para. 10 and n. 12(citing *Upland Cotton (Panel)*, para. 7.1167).
[200] *Upland Cotton (Panel)*, para. 7.1167 (emphasis added).
[201] Third Party Submission of Japan, para. 13.

81. How does the United States respond to the argument of Australia that "it is beside the point for the United States to argue that the programmes under consideration are due to expire in late 2007"? (Third Participant Oral Statement of Australia, para. 13)

191. The United States strongly disagrees with Australia's argument that, in assessing threat of serious prejudice, "it is beside the point for the United States to argue that the programmes under consideration are due to expire in late 2007. The programmes have not expired. There is no guarantee that they will not be rolled over or maintained in another form with adverse effect."[202]

192. First, Australia's observation that "the programmes have not expired" misses the point. If they had already expired, Brazil would simply have *no* basis for any claim with respect to those measures in the present compliance proceeding; those programs would already been withdrawn.

193. Second, the Panel's mandate is to address the "matter" before it – namely, to address Brazil's claims with respect to any measures that are measures taken to comply and properly identified in Brazil's request for panel establishment. To the extent that the marketing loan and counter-cyclical payments can be deemed "measures taken to comply" with the recommendations and rulings of the DSB[203], the question for the Panel is whether Brazil has proved its claims of "threat of serious prejudice" with respect to the measures as identified in Brazil's request for panel establishment. The Panel's mandate does not extend to speculating about whether there may or may not be new measures in place after the marketing loan program and counter-cyclical payment programs in the FSRI Act expire, what the form of those new measures may or may not be, or whether any such other measures may or may not cause adverse effects under market conditions that may or may not exist in the future. Indeed, the original panel explained that where a measure is not in existence at the time that a panel is established, there is no basis for a complaining party to include it in its request for panel establishment and, therefore, it cannot form part of a Panel's terms of reference:

> The 'matter' referred to the DSB by Brazil in document WT/DS267/7 consisted of the measures and claims set out in that document which was dated 6 February 2003. On that date, the Agricultural Assistance Act of 2003 did not exist, had never existed and might not subsequently have ever come into existence. Brazil anticipated adoption of that Act in its panel request and its claim in respect of that Act was entirely speculative. Therefore, Brazil could not refer it to the DSB at that time and it does not form part of the Panel's terms of reference.[204]

194. Third, the original panel explained that "[w]e consider it axiomatic that the nature of a given subsidy may play an important role in determining its effects."[205] The fact that no subsidies may be granted because the program authorizing them is itself due to expire as of a date certain is undoubtedly important in assessing whether "the effect" of the challenged subsidies is threat of serious prejudice as claimed by Brazil. Indeed, to the extent that Brazil's challenge extends to the programs and payments in the future, that fact goes to an even more fundamental question of whether there will even be a "subsidy" in the time period at issue.

195. For the reasons above, Australia's assertion that 'it is beside the point for the United States to argue that the programmes under consideration are due to expire in late 2007" is without merit.[206]

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[202] Oral Statement of Australia, para. 13.

[203] And for the reasons set out in the U.S. submissions the United States does not consider that they can be so defined.

[204] *Upland Cotton (Panel)*, para. 7.158.

[205] *Upland Cotton (Panel)*, para. 7.1191.

[206] Oral Statement of Australia, para. 13.

82. Could the United States comment on the projections of marketing loan and counter-cyclical payments in Table 26 of Brazil's First Written Submission and on the projections of prices and subsidy payments in Table 27 of Brazil's First Written Submission? Could the United States explain how the data in these Tables support its argument that producers are likely to expect low or no marketing loan payments in MY 2007? (Rebuttal Submission of the United States, para. 418)

196. As the United States explained in its paragraph 419 of its rebuttal submission, an ICAC market report released on February 1, 2007, projects the A-index at 59 cents/lb in MY 2006 and 66 cents/lb in MY 2007. This would be almost the same level achieved in MY 2003, and higher than the 20-year average for upland cotton.[207] At these price levels, any marketing loan payments – if any – are likely to be small. The United States noted that new Congressional Budget Office projections estimate that "there will be no more than a 2 cents/lb marketing loan payment [in MY 2007] (and by MY 2008, the projection is of no marketing loan payment at all)."[208]

197. The projections of prices and payments by FAPRI – shown in Table 27 of Brazil's First Written Submission – are entirely consistent with the figures cited by the United States and its analysis on the basis thereof. In fact, FAPRI projects an adjusted world price ("AWP") of 51.4 cents/lb, which would result in a marketing loan payment of only 0.6 cents/lb. However, because it provides stochastic projections, FAPRI reports projected marketing loan payments of 1.9 cents/lb – figures virtually identical to the CBO projections used by the United States.

198. Table 26 provides aggregate projections for all marketing loan payments; it does not show how much of a payment per acre U.S. farmers might receive. Although the aggregate figures shown for MY2007 are higher than those projected by FAPRI and CBO, it is not clear why this is – whether it is because of differences in projected prices, differences in projected plantings, differences in projected yields or some other factor. It is, therefore, difficult to fit these projections in with the others noted above in discussing the expectations of farmers (whose expectations are developed with respect to their own crops, not an aggregate national figure).

199. To put the CBO and FAPRI projections of at most a 2 cents/lb marketing loan payment in perspective, it is useful to consider what marketing loan payments were in the period considered in the original proceeding (MY 1999-2002). There, the original panel considered significant the fact that marketing loan payments had been made that – in some periods – accounted for close to 30 cents per pound, or almost the same amount as revenue received from the market. The situation here – with marketing loan payments projected at, at most, 2 cents/lb for MY 2007 against a backdrop of prices that are expected to be at very high levels – is substantially different.

Questions to Brazil

83. How does Brazil address the argument of the United States that footnote 13 of the SCM Agreement "does not indicate that where a panel finds that a Member is causing present serious prejudice through the use of a subsidy, the panel automatically also finds that the Member is threatening to cause serious prejudice in the future through the use of the same subsidy"? (Rebuttal Submission of the United States, footnote 624)

84. Could Brazil confirm that its claim of threat of serious prejudice is submitted on a contingent basis i.e., that it does not request the Panel to make a finding on this claim if the Panel make a finding of present serious prejudice? How is the

[207] Cotton This Month, ICAC, p. 4 (February 1, 2007) (Exhibit US-107).
[208] CBO January 2007 Baseline for CCC & FCIC (January 22, 2007) (Exhibit US-91).

contingent character of this "threat of serious prejudice" claim reflected in Brazil's request for the establishment of a panel?

85. Could Brazil explain its request that the Panel "make factual findings with respect to its 'threat of serious prejudice' claim to allow the Appellate Body to complete the analysis, in case it were to disagree with the compliance panel's interpretation"? (First Written Submission of Brazil, para. 241) What are the precise "factual findings" which Brazil requests the Panel to make in this regard?

86. How does Brazil address the argument of the United States that the definition of "threat" of injurious effects in Article 15.7 of the SCM Agreement and Article 4.1(b) of the Agreement on Safeguards "in terms of their close proximity in time and their high probability of occurring" reflects the ordinary meaning of the word "threat" and that, as such, Article 15.7 of the SCM Agreement and Article 4.1(b) of the Agreement on Safeguards provide "useful contextual guidance" for the interpretation of "threat" of serious prejudice?

87. Could Brazil comment on the argument of the United States that the standard of "significant likelihood" is without support in the text of the SCM Agreement or in the GATT/WTO dispute settlement reports cited by Brazil? (Rebuttal Submission of the United States, paras. 406, 410,413)

88. Does Brazil agree or disagree with the proposition advanced by the United States that "[a] panel may consider the ordinary meaning of a term as reflected in a particular provision to interpret the same term in another provision (especially of the same agreement) without the need for an express cross-reference." (Rebuttal Submission of the United States, para. 411, footnote 635)

89. Brazil argues that marketing loan and counter-cyclical payments for upland cotton are designed "in such a manner that payments would be made in consistently large amounts". (First Written Submission of Brazil, para. 270)

90. Could Brazil in this regard discuss the data in Table 27 of Brazil's First Written Submission that show an increase in the projected farm price and AWP over the period MY 2006 - 2010 and a decline in projected marketing loan payments?

91. How does Brazil respond to the argument of the United States that "by MY 2008, the projection is of no marketing loan payment at all"? (Rebuttal Submission of the United States, para. 419).

D. EXPORT CREDIT GUARANTEES

1. Outstanding export credit guarantees

<u>Questions to the United States</u>

92. The United States states, in para. 50 of its Opening Statement, that:

> *... nothing in the SCM Agreement provides that "withdrawing" a "subsidy" allegedly "taking the form of a program" "includes an obligation to abstain from performing on commitments outstanding under that program as of the deadline for implementation." That argument improperly equates "performing on commitments under the program" with the "subsidy" itself. Such an equation was*

> ***appropriate in Brazil – Aircraft (21.5), where Brazil continued to issue new WTO-inconsistent bonds even after the period of implementation on the basis that it had pre-existing contractual obligations to do so. However, it is not accurate here, where the guarantees are not themselves prohibited subsidies.***
>
> ***Would the United States please clarify what it meant in the underlined sentence?***

200. In the underlined sentence, the United States is referring to the fact that providing an export credit guarantee does not *per se* equate to providing an export subsidy. Rather, a "subsidy" is only "deemed to exist" under Article 1 of the *SCM Agreement* if there is (a) a financial contribution and (b) a benefit is thereby conferred. Moreover, the subsidy is an "export" subsidy only where it is contingent on export performance within the meaning of Article 3.1(a). Item (j) of the Illustrative List clarifies how this definition applies in the case of export credit guarantees. Specifically, with respect to those measures, an export subsidy exists where the premiums charged under the guarantee program are inadequate to cover the long-term costs and losses of the program.

201. Where, as here, steps are taken so that export credit guarantees are provided at premium rates that are more than adequate to cover the long-term costs and losses of the program, no export *subsidy* is being provided, even though export credit guarantees may still be being provided.

91. In paragraph 342 of its First Written Submission, Brazil indicates that the total amount of guarantees under the GSM 102, GSM 103 and SCGP programs outstanding on 1 July 2005 amounted to $8.5 billion.

(a) Does the United States agree with the figure provided by Brazil?

202. Yes.

(b) Please indicate what proportion of that amount concerns exports of unscheduled products? (please distinguish between principal and interests)

203. The United States does not maintain data related to rescheduled amounts, claims outstanding, or interest arrears by commodity. Based on figures for contingent liability, and estimating from the experience of the administrators of the programs, the United States estimates that approximately 56 percent of the outstanding $8.5 billion was associated with unscheduled products. The United States does not maintain and, therefore, is unable to provide a break-down of principal and interest.

(c) Please indicate what proportion of that amount concerns exports of scheduled products, and in particular rice (please distinguish, in each case, between principal and interest).

204. As noted above, the United States does not maintain data related to rescheduled amounts, claims outstanding, or interest arrears by commodity. Based on figures for contingent liability, and estimating from the experience of the administrators of the programs, the United States estimates that approximately 44 percent of the outstanding $8.5 billion was associated with scheduled products. The United States does not maintain and, therefore, is unable to provide a break-down of principal and interest.

Questions to Brazil

92. Is it of any relevance to the Panel's assessment of Brazil's claims concerning "outstanding" export credit guarantees that what was at issue in Brazil – Aircraft (21.5) was the issuance, after the implementation date, of new bonds, and that

bonds which had been issued prior to the implementation date could be redeemed for a number of years thereafter (see para. 46 of the US' Opening Statement at the panel meeting).

93. The Panel notes that Exhibit Bra-516 indicates outstanding amounts for GSM 5 as of 30 June 2006 rather than as of 30 June 2005 as indicated in footnote 523 of Brazil's First Written Submission. Please explain.

2. Legal Bases for Brazil's export subsidies claims

Question to the United States

94. The United States has noted that the original Panel's findings (that the export credit guarantees at issue constituted prohibited export subsidies) were based on item (j). The United States has also asserted that it has based itself on item (j) in implementing the DSB recommendations with respect to export credit guarantees. Please clarify whether the Panel should understand the United States' argument in this respect as an argument concerning the scope of the present proceeding.

205. The U.S. argument does not relate to the scope of the present proceeding except in the sense that the scope of an Article 21.5 proceeding is affected by the nature of the recommendations and rulings by the DSB.

3. "Benefit" under Articles 1.1 and 3.1(a) of the *SCM Agreement*

Questions to both parties

95. Brazil has taken the position that "different parties to a transaction involving a GSM 102 ECG derive different benefits from the GSM 102 ECG, each of which is potentially subject to assessment under Article 1.1(b) of the SCM Agreement" and has indicated that it is, in this proceeding, "primarily concerned" with the benefit received by the US exporter in the form of below-market fees (para. 404, Brazil's Rebuttal). The United States has challenged Brazil's approach of focusing on fees to the exclusion of other elements of the total cost of the loan. Please explain, referring to the provisions of the SCM Agreement and WTO jurisprudence (if any applicable), your position as to whether: (1) export credit guarantees and other types of subsidies may involve more than one type of benefit and/or recipient; (2) whether it is up to the complaining Member to decide which benefit it chooses to challenge.

206. The United States notes, as a threshold matter, that there is a provision in the *SCM Agreement* that deals with the precise issue of when – in the judgment of Members – export credit guarantees would constitute export subsidies within the meaning of Articles 1.1 and 3.1(a) of the *SCM Agreement*. This is item (j) of the Illustrative List. Moreover, there is a provision in the *SCM Agreement* that describes precisely what – in the judgment of Members – constitutes a "benefit" within the meaning of Article 1 of the *SCM Agreement*. That is Article 14(c) of the *SCM Agreement*.[209]

[209] The latter – while expressly provided for countervailing duty investigations – has been relied upon in virtually every subsidy dispute involving guarantees (even where they have not been loan guarantees) and has been recognized as important context in interpreting "benefit." *See e.g., Canada – Aircraft (Panel)*, para. 7.397 ("In considering precisely what Brazil must show in order to demonstrate the existence of a 'benefit,' we note the findings of the panel and Appellate Body in Canada – Aircraft. We therefore consider that IQ loan guarantees

207. The Panel's question necessarily turns on what significance these provisions have. Can these provisions simply be ignored by a complaining party? Can the complaining party decide to challenge an export credit guarantee on the basis of an alleged "benefit" that is not provided in either provision and that – in fact – would undermine the logic of treating loan guarantees as distinct types of subsidies in Article 14?[210] The United States submits that there is no basis to do so. The fact that the drafters went to the trouble of specifically setting out what constitutes an "export subsidy" in the case of export credit guarantees and what constitutes a "benefit" in the case of loan guarantees must have some meaning. They cannot have drafted these precise provisions simply so complaining parties could overlook them at will.

208. Indeed, the questions of what constitutes a "benefit," "subsidy," or "export subsidy" are not abstract questions that may be answered by a complaining party however it chooses. These are questions that the Members agreed must be asked to identify particular measures about which they shared certain concerns of trade distortion. In the case of export subsidies, the concern – as reflected in the focus on export *contingency* in Article 3.1(a) – is of providing inducements to export because of the structural characteristic that subsidies are made conditional on export. Members agreed that these measures had a structure and nature that trade distorting effects could simply be presumed to exist (and therefore would not need to be proven by the complaining party). When the Members set out how to examine a "benefit" for various types of measures in Article 14, these considerations of trade distortion necessarily informed what they drafted.

209. In the case of Article 14(c), they properly recognized that a loan guarantee is made for the sole purpose of supporting a loan transaction; the guarantee becomes an integral part of that transaction and has no value beyond it. The particular fee assessed for a guarantee is affected by the terms of the underlying loan transaction, who the parties are to the underlying loan transaction, the nature of the goods being purchased and sold, and any number of other factors. In turn, the terms of the underlying loan transaction and the costs and fees associated with that financing may be affected by the fees assessed. Therefore, they expressly provided that "a loan guarantee by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees." In

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will confer a "benefit" to the extent that they are made available to Bombardier customers on terms more favourable that those on which such Bombardier customers could obtain comparable loan guarantees in the market. In applying this standard, we are guided by Article 14(c) of the SCM Agreement, which provides contextual guidance for interpreting the term."); *EC-DRAMs*, para. 7.190; *see also U.S. Lumber CVDs Final (Panel)*, para. 7.49, n. 128 ("Articles 14 (b) and 14 (c) SCM Agreement concern the government's provision of a loan and a loan guarantee. In both cases, the benchmark to be used for the calculation of benefit is the 'comparable commercial loan' and the 'comparable commercial loan absent the government guarantee'"). Indeed, the article of which it is part – Article 14 – was one of the main bases for the Appellate Body's reasoning in *Canada – Aircraft*, that the term "benefit" in Article 1.1(a) generally refers to a benefit to a recipient, rather than a cost to the government. *See Canada – Aircraft (AB)*, para. 155.

[210] As the United States explained in its oral presentation before the Panel, in the case of government services, Article 14(d) applies and provides that a "benefit" may be calculated only where "the provision [of the service] is made for less than adequate remuneration" which "shall be determined in relation to prevailing market conditions for the . . . service in question in the country of provision (including price, quality, availability, marketability, transportation and other conditions of purchase. . .)." In that context, a comparison of fees for a government service against the fees charged in the market for a comparable service is the proper approach. However, Article 14(c) specifically *precludes* such an approach for loan guarantees. It provides that a government loan guarantee *shall not be considered* as conferring a benefit, *unless* is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee." Brazil argues that this provision deals solely with the *measurement* of benefit. However, by its terms, it also addresses the conditions under which a guarantee may be deemed to be "conferring" a benefit – mirroring the language in Article 1.1(a) of the *SCM Agreement*.

other words, they expressly recognized that an assessment of the total costs of the transaction is necessary to assess whether a "benefit" is *actually* conferred by the guarantee.

210. The approach of the drafters makes sense not only from a practical standpoint – *i.e.*, considering how guarantees operate and why a comparison of the fee charged for the issuance of one loan guarantee to the fee charged for another may provide an incomplete and distorted picture – but also from the standpoint of the object and purpose of the *SCM Agreement* itself. In particular, one of the main aims of the *SCM Agreement* is the discipline of trade distortion caused by subsidies. In the case of export credit guarantees, Members recognized that the potential for distortion occurs if a government-provided guarantee permits credit to be provided on terms better than would be available on the market. It is that which would have the potential to increase U.S. exports. It is difficult to see how there could be concerns about similar trade distortion where the *same* credit could be obtained on the market even without the government guarantee.[211] And, indeed, Article 14(c) reflects that very reasoning. The United States submits that this reasoning must be respected.

211. A separate example may help to put the issue in perspective. Suppose that a complaining party wishes to challenge the provision by the government of a particular good that is of a higher quality than other goods offered by private actors but for which the government charges a premium that fully accounts for the higher quality. Item (d) of the Illustrative List may apply if the claim is of an export subsidy. And Article 14(d) of the *SCM Agreement* may be relevant if the claim is otherwise. Both indicate that a proper analysis in determining whether a subsidy exists will examine the price at which the product is provided, taking into account such other relevant factors as quality.[212] For example Article 14(d) expressly recognizes that this should take into consideration the "prevailing market conditions . . . (including price, quality)." The United States submits that a complaining party could not, under these conditions, assert that the higher quality of the government-provided product is a "severable benefit" on the basis of which a subsidy should be found to exist. The United States considers that the situation is analogous here.

96. The parties differ as to whether different types of loans can be compared as long as they have the same "average life." What support (economic literature, etc.) exists for your position on this issue?

212. The United States has explained that the average life of a loan is the average number of years that principal is outstanding.[213] In a GSM-102 transaction, CCC requires principal to be payable at least annually. Consequently, on the first anniversary, one-third of principal is paid. After two years, two-thirds is paid. The final payment occurs on the third anniversary. Such a simple declining balance yields an average life of two years for this loan. To put it differently, this is the average amount of time in the loan that the obligor pays interest on a dollar of principal and the lender earns interest on a dollar of principal.

213. The United States does not understand Brazil to disagree either with this definition of the average life of a loan or with the fact that a GSM-102 guaranteed loan, to the extent it is a three-year amortizing loan with annual repayment of principal, has an average life of two years.[214] The United States also does not understand Brazil to disagree that a two-year bullet loan also has an average life of two years.[215]

[211] Adjusting for the fees paid for the government guarantee, of course, in the comparison.

[212] Item (d) talks about this in terms of the "terms or conditions" of sale and Article 14(d) talks about it in terms of "adequate remuneration."

[213] U.S. First Written Submission, para. 123.

[214] Oral Statement of Brazil, para. 213

[215] Oral Statement of Brazil, para. 214

214. Brazil contends, however, that a two-year bullet loan and a GSM-102 guaranteed 3-year loan are not comparable because "the patterns of credit risk to which the lender is exposed are very different in these two cases."[216] Brazil asks the compliance panel to "suppose" – without foundation – with respect to the particular examples offered by the United States "that the borrowing bank's credit outlook is sufficiently positive in the short-term that there is a very low default likelihood perceived in the first two years. But suppose as well that there is more uncertainty about, and a greater likelihood of default in, the third year."[217] In other words, Brazil asks the compliance panel to *ignore* the overall risk reduction arising from the first-year repayment of one-third of principal in the GSM-102 guaranteed transaction[218], adopt Brazil's "assumptions," and conclude that the credit risk on this transaction will be "much higher."[219] Brazil's argument is devoid of logic.

215. The concept of average life is commonly used for price comparability of investments and debt instruments of varying terms. "Average life is commonly used as the measure of investment life for [mortgage-backed securities (MBS)] and the yield of an MBS is typically compared against a Treasury with maturity close to the average life of the MBS."[220] Similarly, "swap dealers routinely price the fixed rate side of an interest rate swap as a spread over United States Treasuries of a similar average life."[221]

216. As a further example, an offer to invest in credit tenant lease loans extends to a portfolio of loans of "up to 25 years."[222] With loans of varying terms, the investment is indexed to "U.S. Treasury or Swap Index correlating to the average life of the remaining lease term."[223] This is without regard to the extended term of particular loans: "15/15 deal has 9 year average life; use interpolated 9-year U.S. Treasury or interpolated 9-year Swap Rate index. 20/20 deal has 12-year average life; use interpolated -year U.S. Treasury or interpolated 12-year Swap Rate index. 25/25 deal has 15-year average life; use interpolated 15-year U.S. Treasury or interpolated 15-year Swap Rate index."[224]

217. Finally, the United States notes that Brazil asks the compliance panel to "assume" "much higher" risk in year 3 of the GSM-102 transaction. Brazil offers no basis in fact for this assumption with respect to the examples offered by the United States. Brazil's "assumption" is not even sound as a theoretical matter. In a study of medium-term, U.S. government-guaranteed loans, the authors found that "as the medium-maturity loans season the likelihood of default increases initially, peaks in the second year after origination, and declines thereafter."[225] "[I]n general, the hazard curve is a concave function of time: increasing initally, then falling off toward zero as the loans season. The

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[216] Rebuttal Submission of Brazil, para. 429; *see also*, Oral Statement of Brazil, para. 219; Brazil's Comments on U.S. Answers, para. 140

[217] Oral Statement of Brazil, para. 220

[218] Brazil asserts without basis that early repayment of one-third of principal shows that "the patterns of exposure in these two types of loans are different,"and therefore supports its position. Brazil's Comments on U.S. Answers, p. 140. To the contrary, it shows only that one-third of the principal is paid fully one year before any principal is paid in the bullet loan. Solely from a risk perspective, more paid sooner can only be better.

[219] Oral Statement of Brazil, para. 221.

[220] *The Handbook of Fixed Income Securities*, 6th ed. (2001), Fabozzi, Frank J. (McGraw-Hill Professional), p. 589 (Exhibit US-149).

[221] Marshall, John F. "Futures Versus Swaps: Some Considerations for the Thrift Industry," *Review of Business*; Winter 1990/1991; 12, 3, p. 17 (Exhibit US-150).

[222] BSC Bond Street Capital; Credit Tenant Lease Loans - Minimum $10,000,000. http://www.bisonfinancial.com/loans/bsc_ctl.html (Exhibit US-151).

[223] BSC Bond Street Capital; Credit Tenant Lease Loans - Minimum $10,000,000. http://www.bisonfinancial.com/loans/bsc_ctl.html (Exhibit US-151).

[224] BSC Bond Street Capital; Credit Tenant Lease Loans - Minimum $10,000,000. http://www.bisonfinancial.com/loans/bsc_ctl.html (Exhibit US-151).

[225] Glennon, Dennis and Nigro, Peter; "Measuring the Default Risk of Small Business Loans: A Survival Analysis Approach," *Journal of Money, Credit, and Banking*, Vol. 37, No. 5 (October 2005), p. 945 (Exhibit US-152).

general shape of the hazard, and the time dependency of default implied from this result, is consistent with the expected effect of loan seasoning."[226]

218. The initial hazard of default early in the loan belies Brazil's "assumption" of "very low default likelihood perceived in the first two years."[227] This study also contradicts Brazil's further "assumption" of "much higher risk" in the last year of the GSM guaranteed transaction. Under Brazil's theory, risk would apparently increase over time. This study examined 7-year loans. As the study indicates, however, for these loans, with a tenor 4 years longer than the GSM-102 transactions, defaults "fell off toward zero" as the loans seasoned.

Questions to the United States

> ***97. Assuming that the Panel accepts the United States' argument that "benefit" is to be assessed on the basis of the "total costs of funds," what do you consider Brazil must establish in order to meet its burden of proof in that respect? Must Brazil prove that a benefit is conferred in all instances (all transactions and all recipients)? In most instances?***

219. Brazil bears the burden of proving its claims with respect to every one of the measures it challenges. The United States notes that Brazil continues to equivocate on the question of whether or not it is challenging the GSM 102 export credit guarantee program itself or particular guarantees thereunder.[228] Whatever measure Brazil is challenging, it cannot escape its burden of proof in that regard.

220. If Brazil is challenging the GSM-102 program as such – whether it challenges the entire program or parts of it – it must prove that the program itself (or the challenged part) mandates a breach. As the panel explained in *Korea – Ships* in addressing an analogous challenge against the Advance Purchase Refund Guarantee (or "APRG") program under the *SCM Agreement*, the panel stated that "[t]he issue before us . . . is whether or not the APRG programme mandates the conferral of a benefit by requiring the provision of APRGs on terms more favourable than Korean shipyards could obtain on the market."[229] That panel found that "[n]either Article 18 of the KEXIM Act nor Article 23(1) of the KEXIM Operating Manual even refer to the terms on which KEXIM shall offer APRGs, let alone require below-market guarantees."[230] For this reason, the panel rejected the EC's claim that the APRG program mandated a breach of the export subsidy provisions of the *SCM Agreement*. The same reasoning applies here. Neither the statutory nor regulatory provisions providing for export credit guarantees even mandate that *guarantees* be provided, let alone that they be provided under conditions in which they would confer export subsidies.

221. If Brazil is challenging particular guarantees under the GSM-102 program – e.g., guarantees that the United States has provided in respect of exports of rice and unscheduled products – it bears

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[226] Glennon, Dennis and Nigro, Peter; "Measuring the Default Risk of Small Business Loans: A Survival Analysis Approach," *Journal of Money, Credit, and Banking*, Vol. 37, No. 5 (October 2005), p. 935 (Exhibit US-152).

[227] Oral Statement of Brazil, para. 220.

[228] For example, in its rebuttal submission, Brazil claims that it does not "assert that the GSM 102 program itself circumvents the United States' export subsidy commitments, within the meaning of Article 10.1 of the Agreement on Agriculture" or, presumably, that the GSM 102 program as such provides prohibited export subsdiies under the *SCM Agreement*. Brazil Rebuttal Submission, para. 378. But, thereafter, Brazil has indicated that it does not even consider individual guarantees to constitute measures. Brazil Answers to Sections A-C of First Set of Questions, para. 29. Therefore, it remains entirely unclear what measures Brazil is even purporting to challenge.

[229] *Korea – Ships (Panel)*, para. 7.121.

[230] *Korea – Ships (Panel)*, para. 7.121.

the burden of showing that each of the guarantees is an export subsidy. In the U.S. view, the proper consideration in this regard is item (j) of the *SCM Agreement* and there is no "other" standard for what constitutes an export subsidy in the case of export credit guarantees. Nonetheless, even if there were some "other" such standard in Articles 1 and 3.1(a) of the *SCM Agreement*, as Brazil alleges, Brazil would bear the burden of proving that each guarantee provides a (a) financial contribution that (b) confers a benefit, and the "subsidy" thereby provided is (c) contingent upon export performance. Brazil has failed to make such a showing on the basis of a consideration of total costs for any guarantees, let alone for all the guarantees in respect of exports of rice and unscheduled products. Therefore, even under its own theory of an "alternative" standard under Articles 1 and 3.1(a), its export subsidy-related claims fail.

98. Does the United States dispute the accuracy of Brazil's comparison of GSM 102 fees with Exim Bank fees? Does the United States agree that ExIm Bank and GSM 102 guarantees are (at least in certain circumstances) similar or comparable?

222. The United States does not believe that guarantees of the Export-Import Bank of the United States and those of the GSM 102 program are similar or comparable. Brazil has proposed a comparison with two particular products of Ex-Im Bank. These are (1) the Ex-Im Bank Letter of Credit Insurance for Banks ("LCI") and (2) the Ex-Im Bank Medium-Term Export Credit Insurance ("MTI").[231]

223. The United States notes, as a threshold matter, that MTI is available exclusively in respect of capital goods and services.[232] As such, this product and its fee structure are subject to the Organization for Economic Co-operation and Development ("OECD") Arrangement on Officially Supported Export Credits ("OECD Arrangement"). As Japan has noted[233]and Brazil has acknowledged[234], the OECD Arrangement does not apply to agricultural products. As Japan has also noted, the minimum premium rates under the OECD Arrangement are for repayment terms of two years or more.[235] Under the GSM-102 program, hundreds of GSM-102 transactions, totaling hundreds of millions of dollars are in fact for terms of less than 2 years.[236] Therefore, there are important factual distinctions between the guarantees that render them not comparable.

224. These distinctions for relevant for purposes of the subsidy analysis. Recall that – typically – the comparison that is made to determine whether or not there is a "benefit" is to what the recipient "could obtain on the market."[237] Here, an exporter who would obtain a GSM 102 guarantee simply could not obtain a MTI guarantee from Ex-Im Bank, because those guarantees are not made in respect of agricultural products and also because the transaction at issue may have short (less than two-year)

[231] Brazil First Written Submission, para. 381

[232] ExIm Bank export credit insurance product description, accessed October 2006 at http://www.exim.gov/products/insurance/index.cfm (Exhibit BRA-533) and ExIm Bank Medium-Term Export Credit Insurance, ExIm Bank online, accessed October 2006 at http://www.exim.gov/products/insurance/medium_term.html. (Exhibit BRA-535).

[233] Third Party Submission of Japan, para. 25

[234] Brazil First Written Submission, para. 442

[235] Third Party Submission of Japan, para. 25

[236] Specifically:
FY 2003: 191 guarantees: $185,296,721
FY 2004: 259 guarantees: $222,967,376
FY:2005: 230 guarantees: $165,350,477
FY:2006: 185 guarantees: $176,414,190
FY:2007 (as of 5 March 2007): 43 guarantees: $46,584,911

[237] *See e.g., Korea – Ships (Panel)*, para. 7.121 ("The issue before us, therefore, is whether or not the APRG programme mandates the conferral of a benefit by requiring the provision of APRGs on terms more favourable than Korean shipyards could obtain on the market.")

repayment terms. Therefore, those guarantees are not an appropriate benchmark of what an exporter of agricultural products "could obtain on the market."

225. Equally important, however, is what Brazil has omitted from its comparisons to the Ex-Im Bank products. Brazil asserts that "Brazil's country-specific comparison methodology [] takes account of all of the variables that GSM 102 and ExIm Bank take into account in pricing their products."[238] In fact, Brazil has failed to address at least two highly significant components.

226. The most significant of these is interest cover. Under Ex-Im's MTI product the obligor is required to use a form of promissory note promulgated by Ex-Im, and Ex-Im covers "100 percent of the rate provided in the note."[239] Under Ex-Im's LCI product, "the insured interest rate is generally prime rate minus 0.5% or the rate stated in the credit agreement, whichever is less. Ex-Im Bank uses the prime rate published in the Wall Street Journal, under the table 'Money Rates.'"[240]

227. In contrast, under the GSM-102 program, CCC covers eligible interest, which is calculated as follows: "the per annum rate to be used to calculate eligible interest shall be the lesser of the interest rate specified between the U.S. bank (or exporter) and the foreign bank or 55 percent of the average investment rate of the most recent Treasury 26-week bill auction as announced by the Department of Treasury prior to the date the eligible interest rate is established or adjusted."[241]

228. A comparison of the interest cover of the LCI product[242], which coverage is less than that of the MTI product, with the interest cover under the GSM-102 guarantee shows that the LCI interest cover greatly exceeds that of the GSM-102 guarantee.

229. The United States provides in Exhibit US-155 a comparison of the CCC interest cover (55% of the applicable 26-week T-bill rate[243]) with the LCI interest cover (Wall St. Journal prime minus 0.5%). As of March 1, 2007, Ex-Im interest coverage is 491 basis points higher than the CCC interest coverage (7.75% v. 2.839%). This is an enormous difference, which can be illustrated by a simple example. Assume an export transaction in which ten million dollars is financed at 7.75 percent. Upon default of payment on the anniversary of the credit, Ex-Im would cover the full interest amount of $775,000. CCC, however, would only cover $283,900 of interest. This effect of course multiplies with each year of outstanding unpaid interest.

230. Since July 1, 2005, using the rates in effect on the first business day of each month, the difference in cover has been as much as 499 basis points (October 2, 2006) and never less than 374 basis points (August 1, 2005).[244] As the MTI interest cover is 100 percent of the stated rate in the note, one can only infer that the disparity between CCC interest cover and that product is even greater.

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[238] Brazil Rebuttal Submission, para. 434 (emphasis in original).

[239] ExIm Bank Medium-Term Export Credit Insurance, ExIm Bank online, accessed October 2006 at http://www.exim.gov/products/insurance/medium_term.html. (Exhibit BRA-535)

[240] ExIm Bank Letter of Credit Insurance for Banks, ExIm Bank online, accessed October 2006 at http://www.exim.gov/products/insurance/loc.html (Exhibit BRA-531).

[241] Notice to GSM-102 Program Participants: USDA Clarifies Method for Computing Interest Coverage Under GSM-102 Program (15 July 2005) http://www.fas.usda.gov/scriptsw/PressRelease/pressrel_dout.asp?PrNum=0105-05 (Exhibit US-153).

[242] Exhibit US-154 provides the Wall St. Journal prime rates from February, 2000 to the present. http://www.hsh.com/indices/prime00s.html (accessed 20 March 2007).

[243] Exhibit US-156 sets out 26-week T-bill rates as provided by the U.S. Department of Treasury for the period 1 July 2005 - 20 March 2007 available at http://treasurydirect.gov/RI/OFAuctions.

[244] Comparison of interest rate coverage of CCC GSM-102 export credit guarantees and Ex-Im Bank Letter of Credit Insurance for Banks (1 July 2005 - 1 March 2007) (Exhibit US-155).

231. Interest cover is a very significant component of a guarantee or insurance product and commensurately affects the fee such products can command. Brazil, however, has made no attempt to include this factor in its comparisons.

232. In addition, with respect to principal coverage, MTI covers 100 percent of the financed portion.[245] The GSM-102 only covers 98 percent. Ex-Im also allows, under the LCI product, that "the insured may arrange recourse or 'pass back' to a third party of all or any part of any uninsured amount."[246] This is not permitted under the GSM-102 program. Upon default the claimant must subrogate to CCC the claim to the entire amount in default, not just the guaranteed portion.[247] CCC then has the right to recover from the obligor all moneys in default.[248] Unlike the LCI product, the holder of the GSM-102 guarantee is therefore unable to sell the unguaranteed portion of the obligation to another party to insulate himself from any exposure to principal default. Under the MTI product, the holder is similarly insulated from any risk because of the full 100 percent coverage. Inferior coverage of principal relative to the Ex-Im products renders the GSM-102 guarantee less desirable, which is reflected in the price parties are willing to pay. Brazil has also not accounted for the difference in "pass back" policies of the programs in its comparisons.

99. Please comment on Brazil's argument that the GSM 102 fees are not sufficiently scaled to take into account country risk (i.e. they vary only minimally according with country risk) (see, inter alia, paras. 410-412 Brazil's First Written Submission).

233. The United States disagrees with Brazil's assertions as a matter of fact. GSM 102 fees are scaled to take into account country risk and the current GSM-102 fees vary greatly based on this factor. Brazil has offered no basis in the text for its assertion that this scaling is "insufficient." Indeed, the United States is not aware of any provision of the *SCM Agreement* that establishes what constitutes "sufficient" scaling. The only express discussion of sufficiency in the *SCM Agreement* pertains to the adequacy of premia to cover the long-term operating costs and losses of export credit guarantee programs under item (j) of the Illustrative List. This is the standard that the original panel appropriately applied in assessing the consistency of the export credit guarantee programs with the export subsidy provisions in Articles 3.1(a) and 3.2 of the *SCM Agreement*.

234. It was in assessing that broader question that the original panel considered the issue of country risk to be relevant. Specifically, the original panel explained that "in order objectively to assess premiums in relation to long-term operating costs and losses, we believe it is also appropriate for us to take into account aspects of the structure, design and operation of the measure before us."[249] In so doing, however, the original panel was quite clear that it was not looking at individual fees or differences among fees, but rather whether "the total of all premiums would be likely to cover the total of all operating costs and losses under the program."[250] Therefore, neither in the text of the *SCM Agreement* nor in its application in the present proceeding, is there any independent issue of "sufficient scaling" to take into account country risk. The only question is whether the structure, design and operation of the program – including any scaling – when taken as a whole indicate that the premia are *inadequate* to cover the long-term costs and losses of the program. The evidence before this Panel clearly show the adequacy of the premia charged for GSM 102 guarantees.

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[245] Ex-Im Bank Medium-Term Export Credit Insurance, ExIm Bank online, accessed October 2006 at http://www.exim.gov/products/insurance/medium_term.html (Exhibit BRA-535).

[246] ExIm Bank Letter of Credit Insurance for Banks, ExIm Bank online, accessed October 2006 at http://www.exim.gov/products/insurance/loc.html (Exhibit BRA-531).

[247] 7 CFR Section 1493.110(b)(4) (Exhibit US-142).

[248] 7 CFR Section 1493.130(a) (Exhibit US-142).

[249] *Upland Cotton (Panel)*, para. 7.805.

[250] *Upland Cotton (Panel)*, para. 7.805.

235. The changes to make fees responsive to country risk confirm the adequacy of the premia. Under the old fee structure, fees varied "only by the guaranteed dollar value of the transaction, the repayment period, and the principal repayment interval (annual or semi-annual)."[251] The premia were not risk-based at all, and the original panel noted in this regard that "a country's risk classification has no impact on the premiums payable under the United States export credit guarantee programs."[252] By contrast, under the current fee schedule, the difference in premia for the same tenor between the least risky countries and the most risky countries is in all cases between 81.5 percent and 100.6 percent.[253] Moreover, the 22 highest risk countries that were previously eligible are now entirely ineligible and cannot receive a GSM 102 guarantee at any price. This, and other evidence submitted by the United States show that the "the total of all premiums" cover the "total of all operating costs and losses under the program."[254]

Questions to Brazil

100. Assuming the Panel were to agree with the United States that the proper benchmark to determine "benefit" is the "total cost of funds" of the transactions, what elements of evidence has Brazil provided the Panel in this respect (other than evidence from the Regulations that the programme targets situations where no credit would be available on the market)? In answering, please address the United States' argument at para. 133 of its First Written Submission that "Brazil has made no attempt to provide such specific information on individual loan costs and fees or to identify comparable commercial loans and their terms".

101. Brazil argues that "[w]here guarantees are reserved for circumstances in which credit would not otherwise be available, there is no "comparable commercial loan absent the government guarantee," within the meaning of Article 14(c) of the SCM Agreement." (Brazil First Written Submission, para. 375). The Panel understands this argument of Brazil to focus on the foreign obligor. Brazil elsewhere indicates that it is principally concerned, in this proceeding, with the benefit to the US exporter (fees). Are these two arguments at tension?

4. Item (j) of the Illustrative List

Questions to both parties

102. What, in your view, explains the different results achieved by the two methods advocated, on the one side, by the United States in paragraphs 87-89 of its First Written Submission and by Brazil in Exhibit Bra-613 (other than the United States' criticism that Brazil has not taken recoveries corresponding to pre-1992 guarantees into account in its "cash basis" accounting calculations, of which the Panel is already aware)?

236. As a threshold matter, it is important to understand what Brazil's cash-basis methodology in Exhibit Bra-613 purports to show. It attempts to depict on a strictly chronological basis, for a finite period of time (FY 1993-2005), cash flows in and out related to the export credit guarantee programs.

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[251] *Upland Cotton (Panel)*, para. 7.820

[252] *Upland Cotton (Panel)*, para. 7.861

[253] GSM-102 Guarantee Fee Rate Schedule, USDA FAS Online, accessed September 2006 at www.fas.usda.gov/excredits/gsm102fees.html (Exhibit BRA-505). Compare GSM 102 Premia, Annual Payment of Principal, 36 month tenor, risk category 0 ($0.561 per US$100 of coverage) and risk category 6 ($1 per US$100 of coverage) and 30 day tenor, risk category 0 ($0.161) and risk category 6($0.323).

[254] *Upland Cotton (Panel)*, para. 7.805.

As Brazil – not the original panel – did in the original proceeding with respect to the finite period 1993-2002, it nets "program receipts against program disbursements on a fiscal year basis."[255]

237. It is also important to note that the credit reform approach was developed and imposed to avoid precisely the kind of anomalies that arise under the strict cash-basis approach that Brazil now advocates. Indeed, as Brazil articulated before the original panel: "[p]rior to passage of the [Credit Reform Act of 1990], loan guarantees were recorded on a cash basis, *which distorted their costs. [R]ecording guarantees on a 'cash basis distorted the timing of when costs would actually be incurred*.'"[256] Accordingly, Brazil championed credit reform accounting as:

> an ideal basis on which to determine whether the CCC's export credit loan guarantee programs are offered at premium rates that are inadequate to cover the long-term operating costs and losses of the programs, within the meaning of item(j) of the Illustrative List of Export Subsidies. It functions as a more sophisticated alternative to constructed cost formulas, and thoroughly accounts for all of the premium and operating cost and loss elements required by item(j). Moreover, it has the virtue of serving as the actual, real-world calculation used by the U.S. Congress, the President of the United States, and federal agencies like the CCC to "measure more accurately the costs of Federal credit programs."[257]

238. Brazil never proposed to the original panel that its cash-basis methodology supplant the credit reform approach. To the contrary, "Brazil emphasizes that it does not intend for this revised constructed formula to replace the formula used by the U.S. government itself to track the costs of the CCC guarantee programs pursuant to the U.S. Federal Credit Reform Act."[258]

239. The United States believes that the disparity between Brazil's approach and the United States approach is largely explained by the fact that the United States' credit reform methodology fully accounts for the net present value of reschedulings, and Brazil's approach only includes cash received. As explained below, the current total net present value of remaining cashflows for cohorts 1992-2005 is $590 million.[259] Exhibit BRA-613 purports to show a cash deficit (loss) of $689,144,000 through fiscal year 2005. The U.S. first written submission (table at paragraph 87) shows a profit through cohort 2005 of $166,549,780. The difference between those two figures is $855,693,780. Although $590 million does not fully explain the disparity, it approaches the appropriate order of magnitude.

240. The re-estimation process under credit reform accounting projects cashflows to and from the government over the life of the cohort, including defaults and recoveries. For the GSM 102, GSM 103 and SCGP programs, Table 1 below sets forth the net present value of the remaining cash flows for each of the cohorts 1992-2005. To the extent any remaining scheduled debt exists, the last fiscal year in which payment is projected for such rescheduled debt is indicated. The net present value of the cashflow is calculated as required under credit reform accounting.[260]

241. The annual reestimate process takes into consideration the estimated net present value of cash flows over the life of the cohort. In contrast, the Brazilian approach only takes into account the cash transactions that have actually transpired to date.

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[255] Brazil Rebuttal Submission, para. 485.

[256] Statement of Brazil - First (Original) Panel Meeting (22 July 2003), para. 128 (emphasis added).

[257] Statement of Brazil - First (Original) Panel Meeting (22 July 2003), para. 129.

[258] Brazil's Answers to Questions Posed by the Panel Following the First Substantive Meeting of the Panel, para. 164 (Question 77) (11 August 2003) (emphasis in original)

[259] $589,947,000.

[260] The United States hastens to note that this does not reflect or adopt the cash-basis approach to rescheduling rejected by the original panel. *See, Upland Cotton (Panel)*, paras. 7.846, 7.847, and 7.851.

Cohort	Debt Rescheduled Until FY	NPV of Remaining Cashflows ($000)
GSM 102		
1992	2012	$161,655
1993	2012	205,798
1996	2025	57,936
1997	2025	105,664
1998	2007	1,871
1999	2007	1,035
2000	2007	28
2001	2014	110,901
2002	2014	187
2003	2007	-1,787
2004	2008	-31,556
2005	2009	-49,367
Total GSM 102		**$562,365**
GSM 103		
1992	2012	$10,572
1993	2012	15,885
2000	2008	-122
2001	2008	-241
2003	2010	-155
Total GSM 103		**$25,939**
Supplier Credit		
2003	2010	$1,643
	Total:	**$589,947**

242. For each of the past three fiscal years, actual repayments under rescheduled debt have outperformed the estimates by 226%, 180% and 363% for FY 2004, 2005 and 2006 respectively. The amounts projected under rescheduled agreements and the actual amounts collected are shown in Table 2. For each subsequent reestimate, scheduled payments under rescheduled agreements (from which the repayments are projected) are reduced to reflect amounts already collected.

Table 2 – Projected versus actual recoveries on rescheduled debt

	Projected ($)	Actual ($)	Variance (%)
2003 reestimate -- 2004 projected and actual	89,772,079	202,970,637	226%
2004 reestimate -- 2005 projected and actual	133,267,525	240,208,256	180%
2005 reestimate -- 2006 projected and actual	139,280,938	505,481,067	363%

103. To what extent is evidence pertaining to guarantees issued under the three programmes (GSM 102, GSM 103 and SCGP) under the prior fee schedule relevant to the Panel's analysis of the revised GSM 102 programme under item (j)?

243. The evidence pertaining to guarantees issued under the prior fee schedule for the three programs (GSM 102, GSM 103, and SCGP) is useful because it helps to put in context the findings and recommendations of the original panel, the bases for such findings and recommendations, and the measures the United States has taken to comply. Moreover, evidence of the adequacy of premiums charged under those programs is relevant in this proceeding because the United States has *improved* the ability of the single remaining program – GSM 102 program – to meet its long-term operating costs and losses. To the extent that premia were charged that were adequate to cover the long-term

costs and losses of the programs even *before* the United States implemented changes to increase fees and lower possible long-term costs and losses, this is a highly relevant fact. It supports the U.S. argument that premia charged under the revised fee schedule for GSM 102 guarantees are more than adequate to cover the long-term costs and losses of the program.

244. While disaggregated figures for the three export credit guarantee programs before the 2005 cohort are not available, the aggregated figures are still very helpful in an assessment of the GSM 102 program alone.[261] Historically, the GSM 102 program has been by far the largest of the three export credit guarantee programs. Brazil has noted that export credit guarantees issued under GSM 103 accounted for only 2.36 percent (by transaction value) of all CCC guarantees, and in FY 2004 and 2005, no guarantees were issued under GSM 103.[262] Indeed, no GSM 103 guarantees have been issued since FY 2003.[263]

245. Similarly, since the inception of SCGP in FY1996[264], total guarantees under SCGP were $2.777 billion. In contrast, total GSM 102 guarantees issued in the same period were for $30.633 billion.[265] GSM-103 guarantees during that time totaled only $396.2 million. As a result, looking at the period since the inception of SCGP, GSM-102 guarantees comprised 90.6 percent of the total value of all CCC export credit guarantees issued. In light of this order of magnitude and the fact that the net lifetime reestimate for every GSM-102 cohort since 1992 is negative, it stands to reason that the relative profitability reflected in the budget data is, at a minimum, proportionately allocable to GSM-102, and that the increase in fees can only enhance that position.

104. Must a risk-based fee necessarily take into account foreign obligor risk? Please discuss and provide any relevant support for your position. Can foreign obligor risk be treated differently than country risk in this respect, and if so, why?

246. Item (j) of the Illustrative List is the only provision of the *SCM Agreement* that deals specifically with export credit guarantees. That provisions simply provides that export credit guarantees are subject to discipline where the premia charged are inadequate to cover the long-term costs and losses of the program. Other than this, neither that provision, any other provision of the *SCM Agreement*, the *Agreement on Agriculture*, or any other covered agreement dictates how a provider of guarantees must calibrate particular fees according to particular risks.

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[261] Such disaggregation appeared for the first time in the President's 2007 budget, released in February, 2006. See response to Question 110, below.

[262] Brazil First Written Submission, para. 339. Nor were any GSM 103 guarantees issued in FY 2002. *See*, Summary of Export Credit Guarantee Program Activity in FY 1991-1998 (Exhibit US-41 in the original proceedings) (Exhibit BRA-509). Only $7.6 million were issued in FY 2003. *See* Summary of FY 2003 Export Credit Guarantee Program Activity, USDA FAS Online, September 2003, accessed November 2006 at http://www.fas.usda.gov/excredits/Monthly/2003/03_09_30.pdf (Exhibit BRA-518).

[263] Brazil First Written Submission , para. 339.

[264] *Upland Cotton (Panel)*, para. 7.833; Summary of Export Credit Guarantee Program Activity in FY 1991-1998 (Exhibit US-41 in the original proceedings) (Exhibit BRA-509).

[265] Summary of Export Credit Guarantee Program Activity in FY 1991-1998 (Exhibit US-41 in the original proceedings) (Exhibit BRA-509); Summary of FY 2004 Export Credit Guarantee Program Activity, USDA FAS Online, September 2004, accessed October 2006 at http://www.fas.usda.gov/excredits/Monthly/2004/04_09_30.pdf (BRA-510); Summary of FY 2005 Export Credit Guarantee Program Activity, USDA FAS Online, September 2005, accessed October 2006 at http://www.fas.usda.gov/excredits/Monthly/2005/05_09_30.pdf (BRA-511); Summary of FY 2006 Export Credit Guarantee Program Activity, USDA FAS Online, September 2006, accessed October 2006 at http://www.fas.usda.gov/excredits/Monthly/2006/06_09_30.pdf (BRA-513); and Summary of FY 2003 Export Credit Guarantee Program Activity, USDA FAS Online, September 2003, accessed November 2006 at http://www.fas.usda.gov/excredits/Monthly/2003/03_09_30.pdf (Exhibit BRA-518).

247. For GSM-102 guarantees, CCC imposes graduated fees based on both tenor and the applicable country risk. In addition, CCC imposes strict limits on exposure to individual bank obligors. Brazil dismisses this in arguing that the only way to achieve "prudent fiscal management" is to do it in the exact manner Brazil dictates, requiring not only the tight exposure limits that CCC employs, but also different fees for different banks. Brazil provides no basis in the text for the obligation it asserts.

248. Private sector creditors have individual methodologies for risk-rating and pricing of their products. And there is no reason to assume that the discretion of Members has been eliminated in this regard, especially in the absence of express obligations in the covered agreements to this effect. Indeed, to illustrate the myriad vehicles for risk management available to lenders, the United States provides in Exhibit US-157 the June 12, 2006 remarks of Ben Bernanke, the Chairman of the United States Federal Reserve Board on "Modern Risk Management and Banking Supervision." CCC chooses to manage its risk by setting the fee based on country risk and the relative repayment risk presented over time (tenor risk). To address the potential risk of default from the obligor bank, CCC opts instead to constrain its total potential exposure by establishing rigid limits for each particular obligor.[266] Brazil has provided no basis to reject these choices by the United States.

105. What considerations must guide the Panel's decision to accept or refuse new evidence or arguments on issues that were addressed by the original Panel? Please discuss in light of the following:

(a) The original Panel found that original subsidy estimates, while not reflecting 'actual' figures, nevertheless provide a reliable measure of the United States government's own assessment of the profitability of the export credit guarantee programmes. Is the United States asking the Panel to revisit that conclusion (see paras 108 ff. of the United States' First Written Submission).

(b) The United States presents evidence which, it argues, demonstrates that the three programmes examined by the original panel were operated at no net cost to the US government. Is there any issue as to whether the Panel can or should accept the United States' evidence in this respect?

249. The United States assumes that the Panel's question above relates to the arguments set out in paragraphs coming before – not after – paragraph 108. The response that follows is based on this assumption.

250. First, the United States does not find any limitation in the DSU on the evidence and arguments that parties may submit in a compliance proceeding. This makes sense given that "Article 21.5 proceedings involve, in principle, not the original measure, but rather a new and different measure which was not before the original panel."[267] The question is simply one of the weight to be given to the evidence and arguments that are presented to the compliance panel. The United States has explained its views on that matter before in response to Question 2 in the first set of questions from the Panel and again under Question 54 above. Specifically, under Article 11 of the DSU, the Panel is tasked with, *inter alia*, making "an objective assessment of the matter before it, including an objective assessment of the facts of the case." In doing so, the panel is not bound by the findings of the original panel. Indeed, according to the Appellate Body, "the relevant facts bearing upon the 'measure taken to comply' may be different from the relevant facts relating to the measure at

[266] In this respect, CCC applies the CAMEL approach to its financial analysis, discussed in the response to Question 112, below

[267] *Canada – Aircraft (21.5 Brazil) (AB)*, para. 41.

issue in the original proceedings."[268] Moreover, "the claims, arguments and factual circumstances which are pertinent to the 'measure taken to comply' will not, necessarily, be the same as those which were pertinent in the original dispute."[269] The Appellate Body has, therefore, clarified that:

> the utility of the review envisaged under Article 21.5 of the DSU would be seriously undermined if a panel were restricted to examining the new measure from the perspective of the claims, arguments and factual circumstances that related to the original measure, because an Article 21.5 panel would then be unable to examine fully the 'consistency with a covered agreement of the measures taken to comply,' as required by Article 21.5 of the DSU.[270]

251. Nonetheless, the Panel may well consider that the reasoning of the original panel to be persuasive on points that are apposite.[271] This would be true, for example, where the evidence before this Panel confirms that the same reasoning is appropriate in this proceeding.

252. In the case of export credit guarantees, however, it is especially important to consider the data that is becoming available regarding the actual performance of the programs. Much of this evidence was simply not available at the time of the original panel proceeding. And, in fact, the limited nature of the data available at that point constrained the conclusions that could be reached. There is no reason why this Panel should be similarly constrained even though fuller and more accurate information about the performance of the programs is now available.

253. Second, with respect to the original panel's findings regarding the original subsidy estimates, the United States notes that the original panel considered the significance of "original subsidy estimates" principally in the context of assessing the past performance of the programs. The original panel recognized that these are "initial estimates," subject to "re-estimations over the lifetime of the guarantees involved."[272] The original panel then proceeded to examine numerous other elements of the evidence on the record, all of which, in the original panel's view, buttressed a determination that the programs in fact did result in a net cost to the United States. This included, in significant respect: (1) the arguments of the parties concerning re-scheduled debt[273], (2) the cumulative re-estimates on a cohort-specific basis that then still showed a positive subsidy of approximately $230 million[274], and (3) the credit guarantee liability figure in the CCC financial statements.[275] Consideration of those factors together led the original panel to conclude that the three programs before it were "run at a net cost to the United States government."[276] In that context, the role of the "original subsidy estimates" was but one factor among an array of factors that, in the aggregate, led the original panel to reach its final conclusion about the profitability of the programs.

254. The facts now before the compliance panel are different and show a clearer and different picture of profitability. Two of the three programs that were at issue before are no longer operational, and the fee schedule and eligibility conditions for the GSM-102 program have been substantially modified. More significantly, as the United States has demonstrated, the subsidy estimate net of

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[268] *Canada – Aircraft (21.5 – Brazil) (AB)*, para. 41.

[269] *Canada – Aircraft (21.5 – Brazil) (AB)*, para. 41.

[270] *Canada – Aircraft (21.5 – Brazil) (AB)*, para. 41.

[271] *United States – Shrimp (21.5 – Malaysia) (AB)*, para. 108 (citing *Japan – Alcoholic Beverages (AB)* at 108).

[272] *Upland Cotton (Panel)*, para. 7.843

[273] *Upland Cotton (Panel)*, paras. 7.847, 7.851.

[274] *Upland Cotton (Panel)*, para. 7.852.

[275] *Upland Cotton (Panel)*, para. 7.855.

[276] *Upland Cotton (Panel)*, para. 7.856.

reestimate reflects a profit for the programs for all cohorts 1992-2006 of $403,714,701.[277] The original panel did not have – indeed, could not have had – this evidence before it as context in assessing whether not the original subsidy estimates provide a reliable measure of the United States government's assessment of the profitability of the export credit guarantee programmes. The United States has explained that they do not (and *why* they do not).[278] The evidence now fully bears out the U.S. explanations.

255. In any event, in the original panel's conclusions, the original subsidy estimates were not dispositive on the question of whether the three export credit guarantee programs met the test of item(j). It was but one factor in the original panel's analysis. The original panel, however, also recognized the significance and relevance of re-estimation and the resulting net subsidy figure, whether positive or negative. An objective assessment of the facts before the compliance panel now indicates that premia under the GSM-102 program are adequate to cover the long-term operating costs and losses of the program.

106. The parties disagree as to whether Brazil should include recoveries for pre- 1992 guarantees in its cash basis accounting formula (Exhibit Bra-613). Is the Panel correct in understanding that Brazil's formula does not includes amounts for (1) claims paid after 1992 under pre-1992 guarantees; (2) fees paid on pre-1992 guarantees? If so, please explain the relevance or non-relevance of including recoveries under pre-1992 guarantees in light of the non-inclusion of costs and other revenues related to the same guarantees.

256. The Panel is correct in understanding that Brazil's formula does not include amounts for (1) claims paid after 1992 under pre-1992 guarantees and (2) fees paid on pre-1992 guarantees.

257. Regarding Brazil's cash basis approach, the United States recalls again what the methodology purports to do – namely, to depict on a strictly chronological basis, for a finite period of time (FY 1993-2005), cash flows in and out related to the export credit guarantee programs. As Brazil – not the original panel – did in the original dispute with respect to the finite period 1993-2002, the methodology nets "program receipts against program disbursements on a fiscal year basis."[279] To the extent Brazil's approach is abandoning the credit reform approach and reverting to a strict cash-in, cash-out approach, it would be internally consistent and highly relevant to account for all of the cash in and all of the cash out during the specified finite period. To that end, in addition to the cash numbers presented by Brazil, the United States has noted the additional cash received and the additional cash out during the same time frame (FY1993-2005).[280]

258. The United States also recalls that the U.S. credit reform approach was developed and imposed to avoid precisely the kind of anomalies that arise under the strict cash-basis approach that Brazil now advocates. Indeed, as Brazil articulated before the original panel: "[p]rior to passage of the [Credit Reform Act of 1990], loan guarantees were recorded on a cash basis, which distorted their costs. [R]ecording guarantees on a 'cash basis distorted the timing of when costs would actually be incurred.'"[281]

259. Brazil championed credit reform accounting, instead, as:

[277] *See* Answer of the United States to Question 111 below, updating the table in paragraph 87 of the U.S. First Written Submission.
[278] *See e.g.,* U.S. First Written Submission, paras. 100-104; U.S. Oral Statement, paras.22-23.
[279] Brazil Rebuttal Submission, para. 485
[280] U.S. Rebuttal Submission, para. 98 and fn. 150.
[281] Statement of Brazil - First (Original) Panel Meeting (22 July 2003), para. 128

> an ideal basis on which to determine whether the CCC's export credit loan guarantee programs are offered at premium rates that are inadequate to cover the long-term operating costs and losses of the programs, within the meaning of item(j) of the Illustrative List of Export Subsidies. It functions as a more sophisticated alternative to constructed cost formulas, and thoroughly accounts for all of the premium and operating cost and loss elements required by item(j). Moreover, it has the virtue of serving as the actual, real-world calculation used by the U.S. Congress, the President of the United States, and federal agencies like the CCC to "measure more accurately the costs of Federal credit programs."[282]

260. Again, Brazil never proposed to the original panel that its cash-basis methodology supplant the credit reform approach. To the contrary, "Brazil emphasize[d] that it does *not* intend for this revised constructed formula to *replace* the formula used by the U.S. government itself to track the costs of the CCC guarantee programs pursuant to the U.S. Federal Credit Reform Act."[283]

261. With respect to the cash-basis methodology that Brazil advances, Brazil accuses the United States of presenting a "skewed picture of the CCC's performance," because it allegedly does not take into account "defaults, write-offs or other losses on the same ECGs."[284] However, as an initial matter, the United States notes that it has never suggested that Brazil's methodology is an appropriate approach to examining the question at issue. It is *Brazil* that has championed the approach of examining cash flows from 1992 forward; the United States has simply identified the flaws in Brazil's analysis.[285] Therefore, it is inexplicable – and entirely disingenuous – that Brazil criticizes the United States for not including recoveries received before 1992 (indeed as far back as *1980*).[286] The methodology is Brazil's preferred approach. The United States considers it to inappropriate *in toto*.

262. Second, Brazil's accusation that the United States has not addressed "write-offs or unspecified 'other adjustments'"[287] is simply without merit. For example, in its oral statement, Brazil mentions specifically a $2 billion write-off in FY 2005 and suggests that the United States has not addressed this. Brazil is wrong. As is clear from the citation that Brazil provides, the cash-basis picture presented by the United States fully accounts for this figure. Brazil cites to "the U.S. Budget, CCC ECG Liquidating Account, FY 2007, p. 118, line 2364."[288] The $2 billion figure is shown as a net downward adjustment in the "Status of Guaranteed Loans." This item reflects a write-off of the outstanding *receivable* in the amount of approximately $2 billion owed from Iraq. This is *not* a cash expense. Indeed, the corresponding cash expense had already been accounted for in the $2 billion in claims that CCC paid and which were previously reflected in the "default claims" line 00.01, referred to in Exhibit Bra-613. The write-off of the *receivable* pertains to the reduction in value of an asset on the balance sheet of CCC. It has no bearing on the cash accounting that Brazil advances. The other two examples Brazil cites in footnote 290 of its Oral Statement are similar instances of a reduction in a receivable, not a cash outlay or expense.[289]

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[282] Statement of Brazil - First (Original) Panel Meeting (22 July 2003), para. 129

[283] Brazil's Answers to Questions Posed by the Panel Following the First Substantive Meeting of the Panel, para. 164 (Question 77) (11 August 2003) (emphasis in original)

[284] Oral Statement of Brazil, para. 262.

[285] Brazil Rebuttal Submission, para. 133.

[286] Oral Statement of Brazil, para. 263

[287] Oral Statement of Brazil, para. 262.

[288] *See* Oral Statement of Brazil, para. 263, n.290.

[289] Line 2361 in the 1996 budget explicitly states that it shows "write offs of loans receivable"

Questions to the United States

107. What can explain the discrepancy between the "credit guarantee liability" recorded in the CCC's financial statements (which suggest that the program is provided at a net cost to the US government) and the evidence presented by the US in para. 87 of its First Written Submission?

108. Please explain why the "liability" figure in the CCC's financial statements should not be considered by the panel to provide, if not the amount of actual losses, at least a reliable estimate of the CCC's own perception of the cost to the government of the programmes since their inception. Is the Panel wrong in understanding that a "credit guarantee liability" in this context means that the CCC considers that the programmes will not cover their costs and losses in the long term?

263. As Questions 107 and 108 are closely related, the United States addresses both together.

264. The "credit guarantee liability" figure recorded in the CCC's financial statements and the evidence presented by the United States in paragraph 87 of its first written submission represent two very different things:

- The "negative subsidy estimate net of re-estimates" in paragraph 87 of the U.S. first written submission represents profit.[290] Brazil has recognized that negative subsidy amounts reflect overall profitability of the program.[291]

- The "credit guarantee liability" figure, on the other hand, does not reflect either profit or loss. It is a balance sheet entry of liability *for which there is an offsetting balance sheet entry of an asset*. It does not reflect or suggest a "net cost" or "net profit" to the U.S. government. Similarly, as a credit guarantee liability is only on one side of a balance sheet, it does not purport to be an estimate of the ability of CCC to have adequate revenue to cover the costs and losses of the program in the long-term.

265. The U.S. Standard General Ledger provides a uniform chart of accounts and technical guidance to be used in standardizing federal agency accounting.[292] The U.S. Government Standard General Ledger sets forth instructions for all U.S. Government account transactions, including those for the CCC. The particular instruction applicable to credit guarantee liability is instruction C428.[293] That instruction prescribes how "to record loans and interest receivable from non-Federal sources for defaulted guaranteed loans." The instruction directs that upon the occurrence of a default on a guaranteed loan, the government agency is to record a credit for "loan guarantee liability" and an offsetting debit for loans receivable.[294] Instructions for treatment of "loan guarantee liability" are peppered throughout the Standard General Ledger, but each instruction directs an offsetting entry on the opposite side of the ledger.

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[290] U.S. First Written Submission, para. 83, fn. 126, and citations therein.

[291] U.S. First Written Submission, para. 96, fn. 158, and citations therein.

[292] Overview: US Standard General Ledger http://www.fms.treas.gov/ussgl/about.html (Exhibit US-158).

[293] Exhibit US-159 reproduces the Standard General Ledger cover; Treasury Financial Manual Transmittal Letter No. S2 06-02 (14 July 2006), which immediately follows the cover, and pages III-146 and III-151 of the Ledger. The Standard General Ledger itself is 1354 pages in length and is available in full in pdf format at: http://fms.treas.gov/ussgl/tfm_releases/06-02/ussgl_06-02.pdf
Pages III-146 and III-151 correspond to pages 972 and 977, respectively, in that format.

[294] In addition, it directs the agency to record a credit for "allowance for subsidy" and a debit for interest receivable. For each defaulted loan the total debits of interest receivable and loans receivable should equal the total credits of allowance for subsidy and loan guarantee liability.

266. In addition, each agency of the United States government, including CCC, has financial reporting requirements. The Office of the Management and Budget ("OMB") issues guidance and requirements in respect of financial reporting that are applicable throughout the federal government.[295] OMB Circular A-136 sets forth the required form and content of agency financial statements, including the CCC financial statements.[296]

267. Section 9 of the Circular sets forth the parameters for "Notes to the Financial Statements."[297] Note 8 of Section 9 specifically addresses Note Disclosures for "Direct Loans and Loan Guarantees, Non-Federal Borrowers" and the format of that note.[298] This is the portion of the required financial reporting requirements directly applicable to the "credit guarantee liability" figure.[299]

268. Consistent with the approach reflected in the Standard General Ledger, the instructions for Circular A-136 direct,"for each program with post-1991 Loan Guarantees, report gross receivables from defaulted guaranteed loans assumed for direct collection [] in column 2 [of Section I]."[300] Column 2 of Section I (Defaulted Guaranteed Loans from Post-1991 Guarantees) is entitled "Defaulted Guaranteed Loans Receivable, Gross".[301] The sum of the amounts reported in Section I "shall equal the amount reported on the Balance Sheet as loans receivables [sic] and related foreclosed property, net."[302] These are receivables *on the asset side of a balance sheet*.

269. *On the liability side of the balance sheet* is Section K: "Liability for Loan Guarantees."[303] The instructions for Section K state: "For each program with post-1991 loan guarantees, report in column 3 [of Section K] the present value of the estimated net cash flows (outflows less inflows) to be paid by the entity as a result of the loan guarantees."[304] This figure is then reported in the "total liabilities for loan guarantees (column 4 [of Section K])."[305]

270. ***Consequently, every federal government agency, including CCC, is required to reflect on its financial statements for each defaulted guaranteed loan: (1) an asset of a "gross receivable from defaulted guaranteed loan assumed for direct collection" and (2) an offsetting "credit guarantee liability."***

271. Turning to the Panel's question as to whether the liability figure may be considered a loss, the United States notes the original panel's explanation that a "liability" is defined as "... a probable future outflow or other sacrifice of resources as a result of past transactions or events."[306] The United States considers that this is an accurate and proper definition of liability. The original panel specifically

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[295] Office of Management and Budget Circular A-136 (Exhibit US-160).

[296] Office of Management and Budget Circular A-136, Overview, pp. 1-2 (Exhibit US-160).

[297] Office of Management and Budget Circular A-136, pp.63-105 (Exhibit US-160).

[298] Office of Management and Budget Circular A-136, p. 70-84 (Exhibit US-160).

[299] Compare CCC Notes to Financial Statements, p. 26 (Exhibit BRA-585) with Office of Management and Budget Circular A-136, Schedule for Reconciling Loan Guarantee Liability Balances, p.77 (Exhibit US-160).

[300] Office of Management and Budget Circular A-136, pp. 82, 74 (Exhibit US-160). Analogously, "when the reporting entity has made payments on behalf of borrowers which should be collected from the borrowers, the resulting receivables shall be reported in the same column as loans receivable for either direct loans or defaulted guaranteed loans." Office of Management and Budget Circular A-136, p. 79 (Exhibit US-160).

[301] Office of Management and Budget Circular A-136, p. 74 (Exhibit US-160).

[302] Office of Management and Budget Circular A-136, p. 82 (Exhibit US-160).

[303] Office of Management and Budget Circular A-136, pp. 82, 75 (Exhibit US-160).

[304] Office of Management and Budget Circular A-136, p. 82 (Exhibit US-160).

[305] Office of Management and Budget Circular A-136, p. 82 (Exhibit US-160).

[306] *Upland Cotton (Panel)*, para. 7.855

noted that such a "probable future outflow" does not equate with "loss."[307] Citing the Federal Accounting Standards Advisory Board Statements of Federal Financial Accounting Concepts and Standards, the panel noted that the definition of "loss," in contrast, is "any expense or irrecoverable cost, often referred to as a nonrecurring charge, an expenditure from which no present or future benefit may be expected."[308] CCC clearly has an expectation of recovery on the receivable it has obtained in exchange for its payment for a default on a guaranteed loan. Therefore, the receivables are not properly considered to be "losses."

272. The United States notes in this regard that Brazil has attempted to characterize the credit guarantee liability figure as a "new cumulative loss figure of $220 million" for all export credit guarantees issued after fiscal year 1991.[309] This is simply inaccurate. As discussed above, the credit guarantee liability figure does not in any way depict or purport to depict a retrospective cumulation of loss.

273. On the question of whether or not to consider the credit guarantee liability figure to be some indicator of the U.S. government's perception of the cost of the programmes since their inception, the United States considers that it is not such an indicator for the reasons just explained – namely, it represents only one side of the equation. The original panel appeared to ascribe such significance to it[310] on the understanding that the credit guarantee liability represented a prospective estimate of anticipated experience under the program.[311] While it does provide such an estimate, it cannot be viewed alone without considering the offsetting entries on the asset side, arising from the expectation of recovery on loans receivable as a result of CCC's subrogated position to collect on such loans following default.

109. Please indicate to the Panel whether there have been occurrences of reschedulings prior to the occurrence of defaults and the payment of claims by the CCC.

274. To the best of the U.S. knowledge, the CCC has never rescheduled any obligations guaranteed under the export credit guarantee programs prior to the occurrence of default.

110. Is it possible to calculate the "subsidy estimate net of reestimates" for GSM 102 alone (similar to what the US has done for all three programmes in para. 87)? If so, please provide a table recording the results of this exercise.

275. The United States has only maintained and published disaggregated figures for each of GSM 102, GSM 103, and SCGP as of the budget for fiscal year 2007. Before that time the three programs were grouped together for purposes of calculation of the subsidy estimate net of reestimate reflected in paragraph 87 of the U.S. first written submission. To calculate this figure specifically for each cohort of the GSM 102 guarantees would require an original subsidy estimate for each such GSM 102 cohort. Unfortunately, the United States does not have such data for any cohorts before FY 2005. The table below reflects the data for GSM-102 cohorts 2005 and 2006.

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[307] *Upland Cotton (Panel)*, para. 7.855

[308] *Upland Cotton (Panel)*, para. 7.855, fn. 1030

[309] Brazil Rebuttal Submission, para. 484.

[310] *Upland Cotton (Panel)*, para. 7.855.

[311] U.S. Answers to (Original) Panel's Question 227 Following Second Panel Meeting (22 December 2003)

GSM-102 Export Credit Guarantee Program
Subsidy Estimates and Reestimates by Cohort
FY 2005 and 2006 Cohorts
(Dollars in Thousands)

Cohort	Original Subsidy Estimate		Total Lifetime Reestimates a/	Subsidy Estimate Net of Reestimates
2005	$142,000	b/	-$92,209	$49,791
2006	71,000	c/	-18,324	52,676

a/ 2008 U.S. Government Budget Federal Credit Supplement: Table 8 – Loan Guarantees: Subsidy Reestimates; p. 45 (Exhibit US-74)
b/ 2007 U.S. Government Budget Appendix: CCC Export Loans Program Account line 233001; p.116 (Exhibit BRA-544)
c/ 2008 U.S. Government Budget Appendix: CCC Export Loans Program Account line 233001; p.105 (Exhibit US-161)

276. Although the subsidy estimate net of reestimates for these very recent cohorts is currently positive, it is important to note the precipitous decline in the subsidy estimate for both cohorts in only the short time that has elapsed since the issuance of these cohorts. The United States has explained why original subsidy estimates are routinely too high.[312] The United States will not repeat its arguments here, but will simply note that the considerations reflected in the U.S. submissions are equally applicable to the 2005 and 2006 cohorts of GSM-102 guarantees. In this context, the United States also refers the Panel to the response of the United States to Question 102 above.

111. In paragraph 7.853, the original Panel stated that it "disagree(d) with the United States that we should 'eliminate' the data for certain, more recent, cohorts in our analysis." Is the United States asking that this Panel eliminate such data for the most recent cohorts (the table at para. 87 of the United States' First Written Submission includes data up to 2005 only). Why should this Panel do what the original refused to do? What would be the result of the United States "re-estimates" exercise if the original subsidy estimate for the 2006 and 2007 cohorts were included?

277. The United States has not asked this Panel to eliminate data for the most recent cohorts. The data in the table at paragraph 87 of the U.S. First Written Submission includes data up to 2005 only because, as Brazil has noted, that was the most recent year for which full data was available.[313] Enough time has elapsed now to include data for FY 2006. This data is reflected in the table below. As FY 2007 is still on-going, reestimates for that year are not yet available.

[312] U.S. First Written Submission, paras. 102-104; U.S. Rebuttal Submission, paras. 108-126.
[313] Rebuttal Submission of Brazil, para. 486.

GSM-102/GSM-103/Supplier Credit Guarantee Programs
Subsidy Estimates and Reestimates by Cohort

Cohort	Original Subsidy Estimate		Total Reestimates a/	Subsidy Net of Reestimates
1992	$267,426,000		-$783,477,474	-$516,051,474
1993	171,786,000		-364,465,718	-192,679,718
1994	122,921,000		-133,746,048	-10,825,048
1995	113,000,000		-160,155,549	-47,155,549
1996	328,000,000		-390,121,131	-62,121,131
1997	289,000,000		-287,071,897	1,928,103
1998	301,000,000		-290,034,778	10,965,222
1999	158,000,000		-181,797,405	-23,797,405
2000	195,000,000		-210,481,742	-15,481,742
2001	103,000,000		-175,810,225	-72,810,225
2002	97,000,000		-95,302,249	1,697,751
Subtotal 1992-2002	**2,146,133,000**		**-3,072,464,216**	**-926,331,216**
2003	170,000,000		-111,539,816	58,460,184
2004	457,000,000		-199,652,868	257,347,132
2005	152,000,000		2,133,680	154,133,680
2006	71,000,000	b/	-18,324,481	52,675,519
Subtotal 2003-2006	**850,000,000**		**-327,383,485**	**522,616,515**
Total	**2,996,133,000**		**-3,399,847,701**	**-403,714,701**

a/ 2008 U.S. Government Budget Credit Supplement: Table 8 – Loan Guarantees: Subsidy Reestimates; p. 45 Exhibit US-74

b/ 2008 U.S. Government Budget Appendix: CCC Export Loans Program Account line 00.02; p. 105. (Exhibit US-161)

278. Indeed, the numbers are now even more favorable than as set forth in the U.S. First Written Submission. For cohorts 1992-2002, examined by the original panel, the negative subsidy net of reestimates (*i.e.*, profit) is now $926,331,216 (up from $762,676,594). For all cohorts 1992-2006, the negative subsidy net of reestimates has improved from a profit of $166,549,780 to a profit of $403,714,701.

112. Please explain whether and how the CCC limits risks or control costs of the GSM 102 programme as regards foreign banks' individual credit ratings.

279. Under the GSM-102 program, CCC limits its risk of exposure to default by obligor banks by establishing a particular credit limit for each bank. CCC will not issue credit guarantees in respect of a particular bank beyond its applicable credit limit. In conducting its analysis of individual banks to establish such credit limits, CCC maintains a matrix indicating the correspondence of CCC's categorization of bank risk with that used by various external rating agencies such as Fitch Ratings, Moody's Investor Services, Standard and Poors, and Capital Intelligence. Such external ratings are used as a comparative tool in the establishment of the CCC ratings. Most of the banks for which CCC has established credit limits are not rated by all of these external rating agencies. Some banks, in fact, may not be rated by any of these external rating agencies.

280. In addition, CCC takes the applicable country risk rating into account. In general, the bank does not receive a more favorable rating than the country in which it is domiciled.

281. CCC also conducts an independent financial and risk analysis of each bank as part of the process to establish a risk rating for such bank. To the extent they exist, external agency ratings are an important component of the overall analysis and assessment.

282. CCC uses the traditional CAMEL approach in its analysis.[314] This approach analyzes capital adequacy (C), asset quality (A), management (M), earnings (E), and liquidity (L) of the particular bank. Other factors, such as franchise value, market risk, and operational risk are also taken into consideration.

283. CCC further uses another matrix to assure that credit limits as a percentage of net worth reflect the bank's risk rating - a bank with a better risk rating can have a higher credit limit as a percentage of net worth than a bank with a lower risk rating.

113. Please explain whether and how CCC country risk categories correspond to ICRAS ratings.

284. Eligible countries for CCC export credit guarantees are graduated in seven CCC risk grades enumerated 0 through 6.[315] ICRAS provides two risk ratings for each country – a sovereign rating and a non-sovereign rating. Each country is rated on an 11-category scale.[316] ICRAS country risk grades are a significant component in the development of CCC country risk grades.

<u>Question to Brazil</u>

114. Brazil argues that "(t)hat the United States has, on one view of the data, beaten the odds and met its costs and losses over a series of years does not mean that ECG programs are structured and designed to do so" (para. 503, Brazil's Rebuttal). Is Brazil arguing that evidence regarding the actual operation and "profitability" of the programme (i.e. retrospective evidence) is irrelevant to the Panel's analysis under item (j)

[314] *See, e.g.*, Federal Reserve Board Supervisory Letter SR 94-12 http://www.federalreserve.gov/BOARDDOCS/SRLETTERS/1994/SR9412.HTM (Exhibit US-162); "Applying the CAMEL Framework", Asian Development Bank http://www.adb.org/Documents/Guidelines/Financial part060302.asp (Exhibit US-163).

[315] GSM-102 Guarantee Fee Rate Schedule, USDA FAS Online, accessed September 2006 at www.fas.usda.gov/excredits/gsm102fees.html (Exhibit BRA-505).

[316] For further information see Government Accountability Office's report #GAO-04-531 (Exhibit US-164).

ANNEX D-14

BRAZIL'S COMMENTS ON THE RESPONSES OF THE UNITED STATES TO THE PANEL'S SECOND SET OF QUESTIONS

(24 April 2007)

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LIST OF ABBREVIATIONS

Arrangement	OECD Arrangement on Officially Supported Export Credits
AWP	Adjusted World Price
BSC	Bond Street Capital
CCC	U.S. Commodity Credit Corporation
CCPs	Counter-Cyclical Payments
DSB	Dispute Settlement Body
DSU	Understanding on Rules and Procedures Governing the Settlement of Disputes
ECG	Export Credit Guarantee
ERS	USDA's Economic Research Service
FAPRI	Food and Agricultural Policy Research Institute
FAS	USDA's Foreign Agriculture Service
FCRA	Federal Credit Reform Act
FSRI Act	Farm Security and Rural Investment Act of 2002
FY	Fiscal Year
GATT	General Agreement on Tariffs and Trade
GAO	Government Accountability Office
GSM 102	General Sales Manager 102
GSM 103	General Sales Manager 103
LCI	ExIm Banks Letter of Credit Insurance
MBS	Mortgage-backed securities
MPRs	Minimum Premium Rates
MTI	ExIm Bank's Medium-Term Export Credit Insurance
MY	Marketing Year
NCC	National Cotton Council of America
NPV	Net Present Value
OECD	Organization for Economic Co-operation and Development
SCGP	Supplier Credit Guarantee Program
SCM Agreement	*Agreement on Subsidies and Countervailing Measures*
SPS Agreement	*Agreement on Sanitary and Phytosanitary Measures*
TBT Agreement	*Agreement on Technical Barriers to Trade*
U.S.	United States
USDA	U.S. Department of Agriculture
WTO	World Trade Organization

TABLE OF CASES

Short Title	Full Case Title and Citation
Australia – Salmon (21.5)	Panel Report, *Australia – Measures Affecting Importation of Salmon*, WT/DS18/R and Corr.1, adopted 6 November 1998, modified by Appellate Body Report, WT/DS18/AB/R, DSR 1998:VIII, 3407
Canada – Aircraft	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377
Canada – Aircraft (21.5)	Appellate Body Report, *Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU*, WT/DS70/AB/RW, adopted 4 August 2000, DSR 2000:IX, 4299
Canada – Aircraft Credits and Guarantees	Panel Report, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R and Corr.1, adopted 19 February 2002, DSR 2002:III, 849
Canada – Dairy (21.5 II)	Appellate Body Report, *Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Second Recourse to Article 21.5 of the DSU by New Zealand and the United States*, WT/DS103/AB/RW2, WT/DS113/AB/RW2, adopted 17 January 2003, DSR 2003:I, 213
Chile – Alcoholic Beverages	Award of the Arbitrator, *Chile – Taxes on Alcoholic Beverages – Arbitration under Article 21.3(c) of the DSU*, WT/DS87/15, WT/DS110/14, 23 May 2000, DSR 2000:V, 2583
EC – Bed Linen (21.5)	Panel Report, *European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by India*, WT/DS141/RW, adopted 24 April 2003, modified by Appellate Body Report, WT/DS141/AB/RW, DSR 2003:IV, 1269
EC – CVDs on DRAMs	Panel Report, *European Communities – Countervailing Measures on Dynamic Random Access Memory Chips from Korea*, WT/DS299/R, adopted 3 August 2005
EC – Sugar	Appellate Body Report, *European Communities – Export Subsidies on Sugar*, WT/DS265/AB/R, WT/DS266/AB/R, WT/DS283/AB/R, adopted 19 May 2005
Guatemala – Cement I	Appellate Body Report, *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico*, WT/DS60/AB/R, adopted 25 November 1998, DSR 1998:IX, 3767
Mexico – Corn Syrup (21.5)	Appellate Body Report, *Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States – Recourse to Article 21.5 of the DSU by the United States*, WT/DS132/AB/RW, adopted 21 November 2001, DSR 2001:XIII, 6675
U.S. – 1916 Act	Award of the Arbitrator, *United States – Anti-Dumping Act of 1916 – Arbitration under Article 21.3(c) of the DSU*, WT/DS136/11, WT/DS162/14, 28 February 2001, DSR 2001:V, 2017
U.S. – Byrd Amendment	Award of the Arbitrator, *United States – Continued Dumping and Subsidy Offset Act of 2000 – Arbitration under Article 21.3(c) of the DSU*, WT/DS217/14, WT/DS234/22, 13 June 2003, DSR 2003:III, 1163
U.S. – Export Restraints	Panel Report, *United States – Measures Treating Exports Restraints as Subsidies*, WT/DS194/R and Corr.2, adopted 23 August 2001, DSR 2001:XI, 5767

Short Title	Full Case Title and Citation
U.S. – FSC (21.5 II)	Appellate Body Report, *United States – Tax Treatment for "Foreign Sales Corporations" – Second Recourse to Article 21.5 of the DSU by the European Communities*, WT/DS108/AB/RW2, adopted 14 March 2006
U.S. – Gambling (21.5)	Panel Report, *United States – Measures Affecting the Cross-Border Supply of Gambling and Betting Services*, WT/DS285/R, adopted 20 April 2005, modified by Appellate Body Report, WT/DS285/AB/R
U.S. – OCTG from Argentina (21.5)	Appellate Body Report, *United States – Sunset Reviews of Anti-Dumping Measures on Oil Country Tubular Goods from Argentina - Recourse to Article 21.5 of the DSU by Argentina*, WT/DS268/AB/RW, adopted 12 April 2007
U.S. – OCTG Sunset Reviews	Appellate Body Report, *United States – Sunset Reviews of Anti-Dumping Measures on Oil Country Tubular Goods from Argentina*, WT/DS268/AB/R, adopted 17 December 2004, DSR 2004:VII, 3257
U.S. – Softwood Lumber IV	Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada*, WT/DS257/AB/R, adopted 17 February 2004, DSR 2004:II, 571
U.S. – Softwood Lumber IV (21.5)	Appellate Body Report, *United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada – Recourse by Canada to Article 21.5 of the DSU*, WT/DS257/AB/RW, adopted 20 December 2005
U.S. – Softwood Lumber V	Appellate Body Report, *United States – Final Dumping Determination on Softwood Lumber from Canada*, WT/DS264/AB/R, adopted 31 August 2004, DSR 2004:V, 1875
U.S. – Softwood Lumber VI (21.5)	Appellate Body Report, *United States – Investigation of the International Trade Commission in Softwood Lumber from Canada – Recourse to Article 21.5 of the DSU by Canada*, WT/DS277/AB/RW, adopted 9 May 2006
U.S. – Upland Cotton	Appellate Body Report, *United States – Subsidies on Upland Cotton*, WT/DS267/AB/R, adopted 21 March 2005
U.S. – Upland Cotton	Panel Report, *United States – Subsidies on Upland Cotton*, WT/DS267/R, and Corr.1, adopted 21 March 2005, modified by Appellate Body Report, WT/DS/267/AB/R

TABLE OF EXHIBITS

Expected Upland Cotton Yields	Exhibit Bra-688
Freedom of Information Act Rejection Letter	Exhibit Bra-689
Crop Losses and Profits 2002-2005	Exhibit Bra-690
Average January to March Price of the December 2007 futures contract	Exhibit Bra-691
LIBOR and Prime rates, 1997 to the present	Exhibit Bra-692
GSM 102 fees as a percentage of ExIm LCI and MTI fees for GSM 102 transactions involving annual repayment of principal	Exhibit Bra-693
GSM 102 fees as a percentage of ExIm LCI and MTI fees for GSM 102 transactions involving semi-annual repayment of principal	Exhibit Bra-694

A. SCOPE OF THIS PROCEEDING

Questions to both parties

44. The European Communities argues in respect of the preliminary objection raised by the United States regarding the claims of Brazil relating to export credit guarantees for pig meat and poultry meat under the GSM 102 programme that "the important issue is the nexus or the degree of interrelatedness or interdependence between different elements of the measure". (Oral Statement of the European Communities, para. 6) The European Communities submits in this regard that:

> "the Panel should examine the original measure at issue and the 'measures taken to comply', and, with particular reference to the 'elements of the measure' that the United States argues are outside the Panel's terms of reference, enquire into the extent to which these are inter*related* or inter*dependent* with measures or 'elements of measures' that the United States accepts are within the Panel's terms of reference". (Oral Statement of the European Communities, para. 11)

Do the parties agree with the approach suggested by the European Communities and with the considerations in paragraph 13 of the Oral Statement of the European Communities?

1. The United States' response addresses whether Brazil's claims regarding the amended GSM 102 pig meat and poultry meat are properly within the scope of these Article 21.5 proceedings.

2. The first issue for the compliance Panel in assessing the scope of these proceedings is to identify the measure(s) taken to comply with respect to the DSB's recommendations on the application of the GSM 102 program.[1]

3. By way of implementation, the United States modified the guarantee fee schedule of the GSM 102 program. This is intended to eliminate the "subsidy" component of the original program. There is no dispute between the Parties that the amended GSM 102 program, in particular the revised guarantee fee schedule, is a "measure taken to comply". The amended GSM 102 program remains the United States' declared "measure taken to comply" whether or not, as the United States suggests, the original panel's findings related to specific guarantees issued under the original GSM 102 program for specific products.[2]

4. Under Article 21.5, this Panel is required to examine the declared compliance measure – the amended GSM 102 program – "*in its totality*" for "consistency" with the United States' obligations under the *Agreement on Agriculture*, because it is a measure taken to comply that is included in Brazil's panel request.[3] In *U.S. – OCTG from Argentina (21.5)*, the Appellate Body emphasized that there are important reasons of principle for requiring compliance panels to examine "fully" the WTO-consistency of compliance measures. These include promoting the prompt settlement of disputes by avoiding the delay resulting from new proceedings, and "making efficient use of the original panelists and their relevant experience".[4] The fact that the United States objected to two members of the original panel hearing this dispute cannot alter the importance of this last factor in interpreting Article 21.5 generally.

5. The United States relies on the rulings in *EC – Bed Linen (21.5)* to suggest that its voluntary decision to amend the GSM 102 program with respect to pig meat and poultry meat is beyond the scope of Article 21.5 proceedings. However, this dispute is very different from *EC – Bed*

[1] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, para. 142.
[2] U.S. 2 April response to question 44, para. 8.
[3] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, para. 146 (emphasis in original).
[4] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, para. 151.

Linen (21.5). In that dispute, the EC took a single measure to comply with its WTO obligations (Regulation 1644/2001). Thereafter, it adopted two formally separate and unrelated measures (Regulations 160/2002 and 696/2002) that, while addressing substantive issues similar to those raised in the original proceedings in *EC – Bed Linen*, related to imports from other countries that were not part of the WTO proceedings. The panel found that these two *separate measures* (Regulations 160/2002 and 696/2002) were not measures taken to comply, because they dealt with imports unconnected to the original WTO dispute.

6. In contrast, in this dispute, with respect to export credit guarantees, Brazil challenges the application of a *single measure* – the amended GSM 102 program – which the Parties agree is a measure taken to comply. The United States did not take a measure to comply that relates solely to GSM 102 ECGs for unscheduled products and rice, and separately adopt an unrelated measure relating solely to GSM 102 ECGs for pig meat, poultry meat and other scheduled products other than rice. Rather, the United States adopted a single measure taken to comply – the amended GSM 102 program – which has a single set of provisions that apply in exactly the same way to all eligible products.

7. The United States appears to argue that the Panel should parse the single compliance measure into components that relate to pig meat and poultry meat, and other components. The components relating to pig meat and poultry meat would, under the United States' approach, be excluded from these proceedings.

8. In *U.S. – OCTG from Argentina (21.5)*, the Appellate Body held that, where the challenged components of a compliance measure are not "separable", but "integral parts" of that measure, the measure must be examined "in its totality".[5] In this dispute, there are no "separable" provisions of the amended GSM 102 program that apply to pig meat and poultry meat, but not to other products. Instead, the provisions of the program, in particular the revised fee schedule on the basis of which "benefits" are conferred, constitute an integrated package that applies to all eligible products in exactly the same way. There is, therefore, no basis for dividing the measure taken to comply into different components.

9. Where the challenged components of a compliance measure are integral parts of the measure, the Appellate Body also found it "difficult to conceive" how two different panels (the first composed under Article 21.5, and the second in entirely new proceedings) could review inseparable elements of a single measure.[6] As a result, the Appellate Body held that the compliance panel must examine the integrated compliance measure "in its totality". In this dispute, Brazil challenges the revised GSM 102 fee schedule, which is an integrated schedule that does not distinguish between products. In Brazil's view, institutional efficiency and considerations of legal certainty require that a single panel assess this schedule "in its totality".

10. The United States also argues that, in revising the guarantee fee schedule, it was not taking action with respect to DSB recommendations regarding pig meat and poultry meat.[7] The panel in *U.S. – Gambling (21.5)* also recently ruled that measures cannot be excluded from the scope of compliance proceedings "due to the *purpose* for which they have been taken".[8] In *U.S. – Softwood Lumber IV (21.5)*, the Appellate Body also found the "first assessment review" to be a "measure taken to comply" even though the United States Department of Commerce did *not* adopt it "with the intention of complying with the DSB's recommendations and rulings."[9] It is, therefore, irrelevant whether the United States intended to implement the DSB's recommendations with respect to pig meat and poultry

[5] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, paras. 146 and 148.
[6] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, paras. 151.
[7] U.S. 2 April response to question 44, para. 18.
[8] Panel Report, *U.S. – Gambling (21.5)*, para. 6.24 (emphasis in original).
[9] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, paras. 15, 67 and 92.

meat when it adopted the amended GSM 102 program. The issue is whether the amended program "in its totality" is "fully" consistent with the covered agreements, including with respect to the United States' export subsidy commitments for pig meat and poultry meat.

11. The United States also contends that this dispute may relate to specific guarantees issued for specific products[10], and professes confusion whether Brazil is "challenging" the "GSM 102 program as such", or "particular guarantees under the GSM 102 program".[11]

12. The United States' assertion that the measure at issue is only specific guarantees for specific products, and its feigned confusion concerning Brazil's "challenge", is disingenuous. As the United States is aware, Brazil's claims under Articles 10.1 of the *Agreement on Agriculture* involve a number of elements. One such element is a showing that the United States is providing "export subsidies".

13. The original panel found that the *original GSM 102 program*, without reference to specific guarantees or specific products, constituted an export subsidy under item (j) of the Illustrative List in Annex I of the *SCM Agreement*.[12] In these Article 21.5 proceedings, Brazil similarly establishes, in a number of ways, that the *amended GSM 102 program* is an export subsidy.

14. First, Brazil has demonstrated that the amended GSM 102 program constitutes an export subsidy under item (j). Nothing about this showing is product-specific.

15. Second, Brazil has demonstrated that according to official, normative statements by the U.S. government in the GSM 102 regulations, FAS publications and FAS' self-assessment of the program, the program always offers export-contingent financial contributions that confer "benefits" on recipients. Nothing about this showing is product-specific.

16. Third, Brazil has demonstrated that under the amended GSM 102 fee schedule, GSM 102 ECGs will necessarily constitute export-contingent financial contributions that confer "benefits" on recipients. With its ExIm Bank comparison exercise, Brazil has provided exhaustive proof of this, demonstrating methodically that on a country-by-country, tenor-by-tenor basis, GSM 102 ECGs issued under the amended GSM 102 fee schedule are export subsidies.[13] As a practical matter, this amounts to a showing that the amended GSM 102 program is an export subsidy itself. Nothing about this showing is product-specific.

17. Turning to another element of Brazil's claims, Brazil has demonstrated, as in the original proceedings, that the United States has "applied" the export subsidy in a manner that results in circumvention of U.S. export subsidy commitments, within the meaning of Article 10.1 of the *Agreement on Agriculture*. The "application" of the GSM 102 program that results in circumvention is, as it must be, established with respect to specific scheduled products (as well as with respect to the category of unscheduled products). In assessing whether the program is "applied" in a manner that circumvents export subsidy commitments, the original panel considered evidence relating to the cumulative level of the guarantees issued for the specific products that were the subject of claims. However, the individual guarantees issued under the program did not thereby become the export subsidies at issue; nor do they become the export subsidies at issue in these proceedings.

[10] U.S. 2 April response to questions 44 and 46, paras. 12 and 52.
[11] U.S. 2 April response to question 97, paras. 224-225.
[12] Panel Report, *U.S. – Upland Cotton*, para. 7.869.
[13] In comments on Question 98, Brazil shows that the amended GSM 102 program is an export subsidy by comparison with ExIm Bank products, even taking account of the differing interest rate coverage of the products. In its 2 April response to question 100, Brazil has also demonstrated that this same evidence proves that GSM 102 ECGs lower the "total cost of funds" in GSM 102-supported transactions.

18. In any event, even if the individual GSM 102 guarantees issued for specific products are the export subsidies at issue in these compliance proceedings, all of those guarantees – for rice, pig meat and poultry meat, and all unscheduled products – have a sufficient nexus to the amended GSM 102 program, the declared compliance measure, that they are part of the compliance measures for purposes of whether the program is "applied" consistently with Article 10.1.

19. In this regard, Brazil notes that it is the United States that has suggested that the individual guarantees are the challenged "measures taken to comply".[14] It appears to accept that these new individual guarantees could, in theory, be "measures taken to comply" with DSB recommendations. Yet, when it comes to marketing loan and counter-cyclical *payments*, the United States vehemently objects that new payments cannot be "measures taken to comply" with DSB recommendations concerning earlier payments under the same programs. Brazil argues below that the correct approach is to recognize – as the United States does for individual guarantees – that the new payments are sufficiently closely connected to the DSB's recommendations regarding the old payments to be "measures taken to comply".[15]

20. Having identified the amended GSM 102 program as a declared "measure taken to comply", a second question arises for the compliance Panel with respect to the scope of the claims that can be made regarding that measure. Brazil's claims concern the application of the program to three scheduled agricultural products (rice, pig meat and poultry meat) and unscheduled agricultural products.

21. The United States' argument is that the DSB's recommendations did not impose any implementation obligations with respect to pig meat and poultry meat. As a result, it says, even though its compliance measure applies to these products, no claims can be made regarding them. This position incorrectly assumes that Article 21.5 proceedings are limited to examining whether the implementing Member has eliminated the WTO-inconsistencies identified in the DSB's recommendations.

22. According to the text of Article 21.5, a compliance panel is the appropriate forum for resolving any "*disagreement*" relating to the *general* "*consistency with a covered agreement*" of a "measure taken to comply". Thus, in *Canada – Aircraft (21.5)*, the Appellate Body expressly "disagreed" with the panel's view that Article 21.5 proceedings are confined to examining whether the implementing Member "*has implemented the DSB recommendation*".[16] In *U.S. – OCTG from Argentina (21.5)*, citing *Canada – Aircraft (21.5)*, the Appellate Body reiterated that a compliance panel must "examine ***<u>fully</u>*** the '*consistency with a covered agreement* of the measures taken to comply', as required by [Article 21.5]".[17] As noted, it also affirmed that a compliance panel must examine the compliance measure "*in its totality*".[18]

23. As a result, the precise scope of the DSB's recommendations does *not* determine the scope of Article 21.5 proceedings. Moreover, Article 21.5 proceedings can, therefore, involve claims and arguments regarding the WTO-"consistency" of a measure taken to comply, even though these claims were not the subject of DSB's recommendations.[19]

24. In effect, the United States asks the Panel, in essence, to reverse the Appellate Body's interpretation because it asserts that this Panel can – indeed, must – examine *exclusively* whether the measure taken to comply has eliminated the WTO-inconsistencies established in *the DSB's*

[14] U.S. 2 April response to question 97, paras. 224-225.
[15] *See* Brazil's comments on U.S. responses to questions 45, 47 and 48, below.
[16] Appellate Body Report, *Canada – Aircraft (21.5)*, para. 40.
[17] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, paras. 151.
[18] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, paras. 146.
[19] Appellate Body Report, *Canada – Aircraft (21.5)*, para. 41.

recommendations. The Panel should reject this argument, and follow the wording of Article 21.5. The Panel may, therefore, examine whether the application of the amended GSM 102 program is "consistent" with the United States' obligations under Article 10.1 of the *Agreement on Agriculture*.

25. There remain, of course, limitations on the claims that can be made regarding a measure taken to comply. In particular, certain panels have ruled that *no new claims* can be made with respect to *unchanged elements* of the original measure; equally, the *same claim* cannot be made with respect to *unchanged elements* of the measure *if that claim was rejected* in the original proceedings. As Brazil has previously explained, neither of these limitations apply.[20] Brazil's claims regarding pig meat and poultry meat concern a *new element of the measure taken to comply*, namely the revised guarantee fee schedule in the amended GSM 102 program. There are no limits on the claims (much less the arguments) that can be made with respect to a new element of the compliance measure.

45. Could the parties comment on the observations made by the European Communities in paras. 15-24 of its Oral Statement on the issue of whether the marketing loan and counter-cyclical payment programmes are within the scope of the Panel's proceeding?

26. The United States' response to question 45 clouds the issue it raised in its preliminary objection. Brazil's request for the establishment of a panel identifies two measures that it claims cause adverse effects under Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*. These measures are: (1) the marketing loan and counter-cyclical payment programs and (2) payments made under these programs.[21] The key issue is whether these two categories of measures are properly within the scope of compliance proceedings. Brazil addresses these measures in turn below.

(i) Subsidy Programs

27. In *U.S. – OCTG from Argentina (21.5)*, the Appellate Body recalled that determining the scope of "measures taken to comply", or the absence thereof, involves an examination of the recommendations and rulings contained in the original panel report, which is adopted by the Dispute Settlement Body ("DSB").[22]

28. With respect to the subsidy programs, the issue that divides the Parties is whether the original panel's findings of "present" serious prejudice included findings regarding the programs themselves. Brazil has presented a straightforward reading of the original panel report that logically ties together: (1) the panel's identification of the measures at issue in the "present" serious prejudice section; (2) its reasoning regarding the "effect" of those measures, which included a lengthy exposition of the "effects" of the programs; (3) its reasoning for declining to examine Brazil's claims of threatened of serious prejudice; (4) its reasoning for declining to examine Brazil's claims of "as such" violations; and (5) its description of the implementation action that the United States was obliged to take.

29. Brazil has addressed these factors in detail in earlier submissions, and will not repeat its arguments.[23] All of these factors point in one direction: the original panel's findings of "present" serious prejudice included the subsidy programs, as well as the payments mandated by these programs. In these circumstances, the EC's arguments on the nexus between the programs and the payments, and the United States' criticism of those arguments, are moot because they are premised on the assumption that the original panel made no findings regarding the programs.

[20] Brazil's 26 February response to question 6, paras. 32-60.

[21] WT/DS267/30, paras. 13 and 17.

[22] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, para. 142, circulated 12 April 2007, not yet adopted.

[23] *See, in particular*, Brazil's 26 February response to question 11 and its 2 April response to question 45.

30. In rebutting Brazil's reading of the original panel report, the United States relies heavily on fragments of Brazil's arguments in the original proceedings in an attempt to demonstrate that the original panel's findings did not include the programs. However, as the Appellate Body held in *U.S. – OCTG from Argentina (21.5)*, the DSB's recommendations and rulings are framed in terms of the findings made by the original panel and the Appellate Body, and not by the complainant's arguments.[24] The compliance Panel must, therefore, focus on the original panel's findings, and the reasoning explaining those findings.

31. The United States accuses Brazil of "grasp[ing] at isolated statements in the original panel report".[25] However, it is the United States that relies on isolated phrases, and misreads the original panel report. The United States attaches considerable importance to the alleged temporal limitation on the scope of the measures. Yet, it asserts no basis in the original panel report for its conclusion that the original panel's findings were limited to payments made in MY 1999-MY 2002.

32. The original panel's general description of the measures at issue included the statement that "[t]he *programmes and legislation* identified [in Brazil's request for establishment of a panel] *include payments* made before the date of establishment of the Panel, *and those made subsequently*."[26] This statement reveals that the panel saw a necessary link between the programs and payments because it stated expressly that the programs "*include payments*". Further, the relevant "payments" were found to be both those made before and those to be made after the date of establishment.

33. The United States also contends that a footnote in the Peace Clause section of the report decisively addresses the scope of the measures addressed in the separate "present" serious prejudice section.[27] This is absurd, because the original panel included a separate statement of the measures at issue in each section of the report. The footnote in the Peace Clause section, by its own terms, does not address the other sections of the report. It cannot, therefore, alter the scope of the measures examined in the "present" serious prejudice section.

34. Instead, in that section, in paragraph 7.1107 of the report, the original panel stated that serious prejudice measures included the "*legislative and regulatory provisions*", in addition to the payments.[28] The United States' explanation of this statement is that the reference to the "*legislative and regulatory provisions*" merely captures the "*application*" of those provisions.[29] This is a distortion of the panel's words. As Brazil has noted, the original panel refers to the "provisions" as measures, without any qualification or other hint that the "provisions" are not, in fact, measures – as the United States now argues.[30] Further, it would have been utterly redundant for the original panel to identify the "application" of the "provisions" separately from the listed payments, because the payments *are* the "application" of the provisions.

35. The United States also suggests that it is not "surprising" that the original panel considered the operation of the subsidy programs in examining the effects of payments.[31] However, the United States overlooks that, in examining the effects of the three programs, the panel referred to them as the "*three measures*" and the "*subsidies in question*".[32]

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[24] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, para. 142, circulated 12 April 2007, not yet adopted.
[25] U.S. 16 March comments, para. 65.
[26] Panel Report, *U.S. – Upland Cotton*, para. 7.187.
[27] U.S. 16 March comments, para. 63.
[28] Panel Report, *U.S. – Upland Cotton*, paras, 7.1107.
[29] U.S. 16 March comments, para. 68.
[30] Brazil's 2 April response to question 44, para. 13.
[31] U.S. 16 March comments, para. 68.
[32] Brazil's 2 April response to question 44, paras. 14 to 16.

36. Thus, once again, the original panel stated that the programs themselves were the "measures"; and it examined "their effects" in a particular reference period, finding that these effects included "present" serious prejudice to the interests of Brazil. It concluded that the United States was "***obliged*** to take action concerning its *present statutory and regulatory framework* as a result of our 'present' serious prejudice finding."[33]

37. In its 2 April responses, the United States also suggests that, if the original panel's findings included the programs, this would erode the distinction between "as such" and "as applied" findings.[34] This is incorrect. The original panel found that an examination of the "*effects*" of the subsidies (programs and payments) "*cannot be conducted in the abstract*".[35] The original panel, therefore, examined the effects of the subsidies (programs and payments), in the marketplace, *in a defined reference period* developed by the panel. Accordingly, the original panel did not find that the programs "*as such*" cause adverse effects at all times. Brazil has demonstrated, in these proceedings, that subsequent to the implementation period, the unchanged programs and new mandatory payments continue to cause adverse effects, as shown by the analysis of their effects in a different reference period.

38. Finally, the United States has failed to offer any explanation whatsoever why the original panel would have decided not to rule upon Brazil's threat claims, and its "as such" claims, if the "present" serious prejudice claims were limited to payments last made in MY 2002 – more than a year before the original panel issued its ruling. If the United States were correct, the original panel *chose* to rule exclusively on past payments that it *knew* might no longer produce "effects" in the marketplace because, by the time of its ruling, these payments had been superseded by payments made in MY 2003 and MY 2004; and it simultaneously *chose not* to rule on subsidy programs and future payments that it knew would still be producing "effects" during the implementation period.

39. It is simply not credible to believe that the original panel would have decided not to rule on the threat and "as such" claims in these circumstances. Nothing suggests that the original panel decided to undermine the utility of its own work in this way. To the contrary, the original panel was highly sensitive to the importance of implementation of its rulings, and decided not to rule on the threat and "as such" claims because "the United States is ***obliged*** to take action concerning its *present statutory and regulatory framework* as a result of our 'present' serious prejudice finding."[36]

40. In sum, the marketing loan and counter-cyclical subsidy *programs*, including payments mandated under these programs, are properly within the compliance Panel's terms of reference because the original panel's "present" serious prejudice findings included these programs.

(ii) Payments in MY 2005 and Thereafter

41. The second category of measures that Brazil challenges in these proceedings covers payments made under the marketing loan and counter-cyclical programs. Brazil's arguments have focused on the adverse effects caused by these measures in MY 2005 and thereafter. Although the United States disputes that the original panel made findings on the subsidy *programs*, it accepts that, at a minimum, the panel made findings regarding payments made in MY 1999 to 2002. Even on the assumption that the United States is correct (*quod non*), Brazil demonstrates in this section, as it did in its 26 February responses[37], that the marketing loan and counter-cyclical payments made in MY 2005 and thereafter must be regarded as (WTO-inconsistent) "measures taken to comply" because of their extremely close connection to the payments found to be causing serious prejudice in the original proceedings. These

[33] Panel Report, *U.S. – Upland Cotton*, para. 7.1501.
[34] U.S. 2 April response to question 45, paras. 27 ff.
[35] Panel Report, *U.S. – Upland Cotton*, para. 7.1198.
[36] Panel Report, *U.S. – Upland Cotton*, para. 7.1501.
[37] Brazil's 26 February response to question 15, paras. 145-150.

arguments are, obviously, made without prejudice to Brazil's principal argument that the original panel found that the subsidy programs, including the payments mandated by the programs, were found to be WTO-inconsistent.

42. In *U.S. – OCTG from Argentina (21.5)*, the Appellate Body last week reiterated that it is for a compliance panel to determine whether the measures listed in a panel request are "measures taken to comply".[38] As noted above, citing the Appellate Body ruling in *U.S. – Softwood Lumber IV (21.5)*, the panel in *U.S. – Gambling (21.5)* also recently ruled that measures cannot be excluded from the scope of compliance proceedings "due to the *purpose* for which they have been taken".[39] It is, therefore, irrelevant whether the United States granted the new marketing loan and counter-cyclical payments for the specific purpose of complying with the DSB's recommendations.

43. Rather, as the United States accepts, the determination whether the new payments are "measures taken to comply" depends on the closeness of their relationship ("interrelatedness") to the DSB's recommendations.[40] Because the DSB's recommendations are "directed" at the measures originally found to be WTO-inconsistent, the compliance Panel must assess the relationship between the alleged measures taken to comply and the original measures.[41]

44. In *U.S. – Softwood Lumber IV (21.5)*, the Appellate Body also held that a compliance panel must examine the alleged measures taken to comply "in their *full context*, including *how such measures are introduced* into, and *how they function* within, the particular system of the implementing Member."[42] Further, in its 2 April responses, the United States acknowledges that, in *U.S. – Softwood Lumber IV (21.5)*, *Australia – Leather (21.5)* and *EC – Bed Linen (21.5)*, measures that "*undid*" or "*undermined*" the implementing Member's compliance efforts were found to have a sufficiently close connection to the DSB's recommendations to be "measures taken to comply".[43]

45. In view of these considerations, the new payments are (WTO-inconsistent) "measures taken to comply" with the DSB's recommendations regarding the original payments. These payments and the new payments collectively constitute an unbroken stream of identical subsidies. As Brazil has noted, the payments subject to the DSB's recommendations and the payments subject to these proceedings are mandated by the very same subsidy programs under the FSRI Act of 2002; they are made to the same recipients; they support the same crop; and they are granted on the same terms and conditions.[44] Thus, under U.S. domestic law, the original and the new payments are all "*introduced*", and "*function*", in precisely the same way.[45]

46. Significantly, the new payments "undermine" – indeed, eviscerate – the United States' compliance efforts. Assuming that the original panel confined its findings to payments (*quod non*), the United States came under an obligation, on 21 March 2005, to take steps to remove the adverse effects of, at a minimum, the marketing loan and counter-cyclical payments made in MY 1999 to MY 2002, or to withdraw these payments.

[38] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, para. 140.

[39] Panel Report, *U.S. – Gambling (21.5)*, para. 6.24 (emphasis in original). Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, paras. 15, 67 and 92. The Appellate Body found the "first assessment review" to be a "measure taken to comply" even though the United States Department of Commerce did not adopt it "with the intention of complying with the DSB's recommendations and rulings."

[40] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, para. 142 and Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 68. *See* United States 2 April response to question 44, paras. 8 and 9.

[41] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 68.

[42] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 67 (emphasis added).

[43] U.S. 2 April response to question 44, footnotes 5 and 22, and para. 17.

[44] Brazil's 26 February response to question 15, para. 147.

[45] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 67 (emphasis added).

47. Yet, instead of taking any action of that nature, the United States simply continued to provide the very same marketing loan and counter-cyclical payments throughout MY 2005, and thereafter. Thus, rather than taking appropriate implementation action, the United States simply substituted the WTO-inconsistent payments with new payments that, given the annual nature of both the payments and the crops, superseded the adverse effects of the original payments. Thus, the effects of the original payments have simply been replaced by adverse effects caused by the new payments. The United States thereby makes effective implementation under Article 7.8 impossible. As the Appellate Body held in *U.S. – FSC (21.5 II)*, a Member fails to implement when it "replaces" one WTO-inconsistent subsidy with another.[46]

48. The United States' *sole* defense to this line of argument is that Brazil attempts to "add" to the original measures found to be WTO-inconsistent by challenging the new payments, which were not found to be WTO-inconsistent.[47] Brazil is *not* seeking to "add" anything to the original ruling. Brazil accepts that the new payments were not part of the DSB's recommendations because the original panel exercised judicial economy with respect to the threat claims that would have included the new payments when they were still possible future payments. In *U.S. – OCTG from Argentina (21.5)*, the Appellate Body held that complaining Members are not prevented from making claims in Article 21.5 proceedings that were the subject of judicial economy in the original proceedings.[48] In short, complaining Members are not prejudiced in compliance proceedings by the original panel's decision to exercise judicial economy.

49. Thus, in the circumstances of this dispute, where *possible future* payments were challenged in an original *threat* claim that was subject to judicial economy, nothing in the DSU prevents those payments from being "measures taken to comply" after they are *actually made*, provided that they have a sufficiently close connection to the DSB's recommendations.

50. Finally, the United States incorrectly rejects the view that WTO dispute settlement becomes a "moving target", and is reduced to a "Groundhog Day", if the U.S. approach is accepted.[49] The United States observes that the Parties are "bound" by the "outcome" of the original dispute.[50] Yet, the United States believes that it can evade the "outcome" of the original panel's "present" serious prejudice findings regarding payments simply by making more payments. After every round of payments, it says that the complaining Member could contest the new payments *solely* in new proceedings. However, on this view, the complaining Member could never take retaliatory action under Article 22 of the DSU for an endless stream of identical recurring payments because there would never be any compliance measures. As a result, the WTO disciplines regarding the "present" effects of the most obvious form of subsidies – cash payments – would be reduced to inutility.

(iii) Conclusion

51. In conclusion, Brazil argues that the marketing loan and counter-cyclical subsidy *programs* are properly within the panel's terms of reference because the original panel's rulings, and the DSB's recommendations, regarding "present" serious prejudice include these programs.

52. In addition, Brazil argues that subsidy payments made in MY 2005, and thereafter, are "measures taken to comply" with the DSB's recommendations regarding payments made in MY 1999 to MY 2002 because of the extremely close connection between these new payments and the DSB's recommendations. The new payments cause "present" serious prejudice.

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[46] Appellate Body Report, *U.S. – FSC (21.5 II)*, para. 84.
[47] U.S. 16 March comments, para. 100; and U.S. 2 April response to question 47, para. 53.
[48] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, para. 148.
[49] U.S. 2 April response to question 48, para. 54.
[50] U.S. 16 March comments, para. 101; U.S. 2 April response to question 48, paras. 54 ff.

46. In its Oral Statement, the European Communities characterizes Brazil's and the United States' respective approaches as the "measure model" and the "element of the measure model" (Oral Statement of the European Communities, para. 7). Please discuss whether you agree with this characterization and whether, in your view, the application of a measure alleged to be a subsidy to different agricultural products relates to a "measure" (or elements thereof) or if, rather it relates to a "claim". Would it be permissible for a compliance panel to examine a "claim" that relates to subsidies (granted as part of measures taken to comply) provided to agricultural products to which the "initial measure" did not apply?

53. Brazil's comments on the United States' answer to Question 44 also address relevant aspects of the United States' answer to this question. Brazil also notes that the United States acknowledges that the "group of agricultural products" eligible to receive ECGs has not been altered since the original proceedings.[51]

54. The United States professes "difficult[y]" in seeing why a Member would comply with the DSB's recommendations relating to subsidies provided to one product by providing subsidies in respect of other products.[52] There are very straightforward reasons why a Member may wish to adopt precisely this course of action. Subsidies are, generally, provided to benefit *producers*, *not products*. A Member may very well attempt to maintain the level of prior support afforded to a particular group of producers by altering the group of products eligible to receive subsidies. In that event, a "disagreement" may arise as to whether the subsidies granted to different products under the compliance measure are consistent with the WTO covered agreements. The implementing Member could argue that the DSB's recommendations did not require it to take action with respect to the newly eligible products and, in consequence, this element of the measure is not a measure taken to comply. Yet, this is a good example of why the Appellate Body confirmed in *U.S. – OCTG from Argentina (21.5)* that Article 21.5 disputes extend to assessing "fully" the "consistency with a covered agreement" of a measure taken to comply "*in its totality*", and are not limited by the terms of the DSB's recommendations.[53]

Questions to the United States

47. The United States has raised a preliminary objection regarding Brazil's claims of (threat of) serious prejudice in respect of the marketing loan and counter-cyclical payment programmes. Is the Panel's understanding correct that, apart from this preliminary objection regarding programmes, the United States also considers that the issue of whether payments made under the marketing loan and counter-cyclical payment programme after 21 September 2005 cause serious prejudice to the interests of Brazil is not properly within the scope of this proceeding?

55. Brazil refers the compliance Panel to its comments on the U.S. response to question 45, above.

48. How does the United States address the argument of Brazil that "[i]f the United States were to prevail on its view that subsequent mandatory and price-contingent marketing loan and CCP payments are not properly before this Panel, the grant of annual recurring subsidies becomes 'a moving target that escape from [the WTO subsidy] disciplines' "? (Closing Statement of Brazil, para. 4)

56. Brazil refers the compliance Panel to its comments on the U.S. response to question 45, above.

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[51] U.S. 2 April response to question 46, para. 52.
[52] U.S. 2 April response to question 46, para. 51.
[53] Appellate Body Report, *U.S. – OCTG from Argentina (21.5)*, paras. 146 and 151 (emphasis in original).

49. Could the United States comment on the argument of the European Communities that the text of Article 21.5 of the DSU does not limit the temporal scope of that provision in the manner suggested by the United States? (para. 29 of the Oral Statement of the European Communities)

57. Brazil makes claims regarding the non-existence of compliance measures between 21 September 2005, the end of the implementation period under Article 7.9 of the *SCM Agreement*, and 1 August 2006, when the United States adopted certain compliance measures with respect to the Step 2 program. The United States response is that "Brazil has not identified any textual basis that requires the Panel to make findings regarding compliance as of the end of the six-month period set out in Article 7.9 of the *SCM Agreement* rather than as of the date of panel establishment pursuant to Article 21.5 of the DSU."[54]

58. This argument is absurd. Article 7.9 of the *SCM Agreement* provides a clear textual basis for Brazil's claim. The provision states:

> *In the event* the Member has not taken appropriate steps to remove the adverse effects of the subsidy or withdraw the subsidy *within six months from the date when the DSB adopts the panel report or the Appellate Body report*, and in the absence of agreement on compensation, *the DSB shall grant authorization to the complaining Member to take countermeasures*, commensurate with the degree and nature of the adverse effects determined to exist, unless the DSB decides by consensus to reject the request.

59. The provision sets forth that the DSB "shall", by negative consensus, authorize "countermeasures" when ("in the event") the implementing Member fails to implement "within six months" of the date of adoption. Thus, according to the treaty text, a right to "countermeasures" arises on that date, subject only to negative consensus. By pursuing its claim regarding the non-existence of measures on 21 September 2005, Brazil seeks a multilateral basis for the DSB to authorize countermeasures against the United States for its failure to take any implementation measures by the date required in Article 7.9 of the *SCM Agreement*.

60. Brazil also notes that additional textual support for its position is found in the DSU. Although Articles 7.8 and 7.9 are "special or additional rules and procedures" under Article 1.2 of the DSU, they do not supplant the DSU. Instead, the DSU continues to apply to the extent that the rules in the DSU do not conflict with the special or additional rules.[55]

61. Articles 3.7 and 21.3 of the DSU indicate that "prompt compliance" with the DSB's recommendation, in principle, implies "immediate" compliance.[56] If "immediate" compliance is not "practicable", Article 21.3 envisages, as an exceptional matter, a grace period for implementation. Accordingly, under these provisions, the implementing Member must have complied with the DSB's recommendations, at the latest, by the end of the implementation period. None of these rules in the DSU conflicts with Article 7.9 of the *SCM Agreement*.

62. Under Article XVI:4 of the *WTO Agreement*, the United States was bound to comply with its WTO obligations in the *SCM Agreement* and the DSU by the end of the six month implementation period. Under Article 21.5 of the DSU, as part of the "*continuum of events*"[57] from the original

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[54] U.S. 2 April response to question 49, para. 59.

[55] Appellate Body Report, *Guatemala – Cement I*, para. 65.

[56] *See* Award of the Arbitrator, *Chile. – Alcoholic Beverages*, para. 38; Award of the Arbitrator, *U.S. – Byrd Amendment*, para. 40; Award of the Arbitrator, *U.S. – 1916 Act*, para. 30.

[57] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 103 (emphasis added) citing Appellate Body Report, *Mexico – Corn Syrup (21.5)*, para. 121. *See* Brazil's First Written Submission, para. 28.

proceedings, a complaining Member is entitled to obtain a ruling, for purposes of its compensation rights in the dispute, that the implementing Member failed to implement by the required date.

63. Besides being supported by the text of the covered agreements, Brazil's position is fully supported by the ruling of the compliance panel in *Australia – Salmon (21.5)*, which ruled that Australia had failed to take appropriate compliance measures with effect from the end of the implementation period.[58] It stated that "Australia was under an obligation to comply with DSB recommendations and rulings by the end of the reasonable period of time. If it did not do so, Australia could face suspension of concessions or other obligations under Article 22.6 of the DSU."[59]

64. Brazil's argument does not preclude a Member from coming into compliance with its WTO obligations after the end of the implementation period. Nor does it exclude measures from the scope of compliance proceedings simply because they were not adopted during the implementation period. However, if the implementing Member *chooses* to implement later than required by the *SCM Agreement* and the DSU, the complaining Member is entitled to a finding by a compliance panel to that effect, and to seek "countermeasures" for the delay.

65. The United States relies on two panel reports in which the panel ruled that the appropriate date for declaring the non-existence of compliance measures is the date of the compliance panel's establishment. However, these panels failed to consider the significance of this date for the implementing Member's compensation rights. The United States also refers to the fact that the parties in those disputes entered into sequencing agreements, like the agreement in this dispute, which address procedures under Articles 21 and 22 of the DSU. However, these agreements do not diminish the *substance* of complaining Member's rights under the covered agreements. In particular, the sequencing agreement in this dispute does not, in any way, diminish Brazil's right to seek authorization for countermeasures under Article 7.9 of the *SCM Agreement* for the United States' failure to implement by 21 September 2005.[60]

B. CLAIMS OF BRAZIL REGARDING PRESENT SERIOUS PREJUDICE

1. Significant price suppression - Article 6.3(c) of the *SCM Agreement*

Questions to both parties

51. The parties disagree on whether or not the marketing loan and counter-cyclical payments have more than minimal effects on production of upland cotton. Could each party explain how its approach to the analysis of the impact of these payments on production of upland cotton is supported by the provisions of Articles 5 and 6 of the SCM Agreement and by any other relevant WTO provisions?

66. At the outset, Brazil notes that, in response to a strictly legal question, the United States embarks on a lengthy summary of its various factual arguments regarding alleged "expectations" of U.S. farmers and the alleged absence of *anything* more than *minimal* effects from the billions of dollars of marketing loans and counter-cyclical subsidies provided to U.S. upland cotton producers. These U.S. arguments would certainly come as a surprise to the National Cotton Council, one of whose primary functions is to lobby the U.S. Congress for huge marketing loan and counter-cyclical subsidies in order to maintain the commercial viability of U.S. upland cotton production.[61] These

[58] Brazil's 26 February response to question 21, paras. 154 ff.

[59] Panel Report, *Australia – Salmon (21.5)*, para. 7.30. *See*, *also*, para. 8.1(i) of the panel's findings and conclusions (underlining added).

[60] WT/DS267/29.

[61] Panel Report, *U.S. – Upland Cotton*, footnote 1471 referring to Exhibit Bra-109 (Testimony (Full) of Robert McLendon, Chairman, NCC Executive Committee, Before the House Agricultural Committee. National

arguments would also surprise the typical U.S. cotton farmer, embodied by Mr. Stephen Houston, Sr. who was recently quoted as stating that "[market] prices don't have anything to do with what we're doing … [w]e're just looking at the government payments."[62] And these arguments certainly would have surprised the original panel which, when confronted with the *same* U.S. arguments, found that there was "no doubt that marketing loan payments stimulate production and exports and result in lower world market prices."[63] Finally, these arguments would surprise the 58 U.S. Senators that recently wrote to President Bush expressing concerns about reductions in U.S. agricultural subsidies. The Senators states that a deal in the Doha Development Agenda would "reduce[] net farm income through steep cuts in farm programs," indicating their belief that government subsidies play a fundamental role in allowing U.S. farmers, including U.S. upland cotton farmers, to generate sufficient profits from growing crops.[64]

67. Brazil has responded to these arguments in numerous previous submissions.[65] Therefore, Brazil will not repeat the overwhelming evidence demonstrating that U.S. upland cotton farmers have received, do receive, and expect to receive huge marketing loan and counter-cyclical subsidies supporting the production of upland cotton. Brazil's arguments and evidence demonstrating that, but for marketing loan and counter-cyclical subsidies, U.S. upland cotton acreage, production, exports and stocks would be much lower and world market prices for upland cotton would be much higher are summarized in Brazil's answer to question 69[66] and found throughout Brazil's many submissions.

68. Brazil explained that the most basic facts concerning the U.S. subsidies at issue and the conditions of competition in the world market for upland cotton suffice to establish a causal link between the subsidies and significant price suppression in the world market.[67] These facts are as follows: It is undisputed that U.S. upland cotton is "like" Brazilian upland cotton as well as the upland cotton produced by many other countries.[68] It is undisputed that there is a closely integrated world market for upland cotton and that heavily subsidized U.S. upland cotton competes directly in that world market with upland cotton from Brazilian and other third country producers.[69] It is undisputed that the price of U.S. upland cotton, like that of other upland cotton producers, is reflected in a world market price, the A-Index.[70] Finally, it is undisputed that the United States maintains a 40 percent world export market share and accounts for 20 percent of total world production resulting in a substantial proportionate influence on the world market price of upland cotton.[71]

69. These undisputed facts, combined with the fact that massive price-contingent U.S. marketing loan and counter-cyclical subsidies represent a 40 percent *ad valorem* subsidization rate over the

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Cotton Council (NCC)). *See also* Exhibit Bra-324 (NCC Chairman's Report by Kenneth Hood, 24 July 2002, p. 2).

[62] Exhibit Bra-563 ("Cotton bailout: How your tax dollars prop up big growers and squeeze the little guy," Atlanta Journal-Constitution, 1 October 2006, p. 2, accessed December 2006 at http://www.ajc.com/search/content/metro/stories/cotton1.html).

[63] Panel Report, *U.S. – Upland Cotton*, para. 7.1291.

[64] A letter to the President dated 12 April and signed by 58 U.S. Senators states "We cannot support a deal that directly reduces net farm income through steep cuts in farm programs in return for minimal market access gains whose effects on farm gate receipts is speculative at best," available at http://conrad.senate.gov/issues/statements/agriculture/070412_WTO_Ag_Letter.pdf.

[65] Brazil's First Written Submission, paras 126-150; Brazil's Rebuttal Submission, paras. 101-113, 180-194, 209-231; Brazil's Oral Statement, paras. 63-78.

[66] *See* Brazil's 2 April response to question 69, paras. 90-106.

[67] Brazil's 2 April response to question 69, paras. 92-96.

[68] Brazil's First Written Submission, Section 7.4.

[69] Brazil's First Written Submission, Section 7.4.

[70] Brazil's First Written Submission, Section 7.4; Brazil's Oral Statement, para. 148 and Declaration by Andrew Macdonald, Brazil's First Written Submission, Annex II, para. 18.

[71] Exhibit Bra-559 ("Potential Challenges to U.S. Farm Subsidies in the WTO: A Brief Overview," Congressional Research Service Report for Congress, 25 October 2006, p. 5).

lifetime of the FSRI Act of 2002, *alone* are sufficient for the compliance Panel to find that these subsidies cause significant price suppression in the world market for upland cotton. This is all the more true in light of the consistent inability of the average U.S. upland cotton producer to cover its costs of production without these two subsidies.

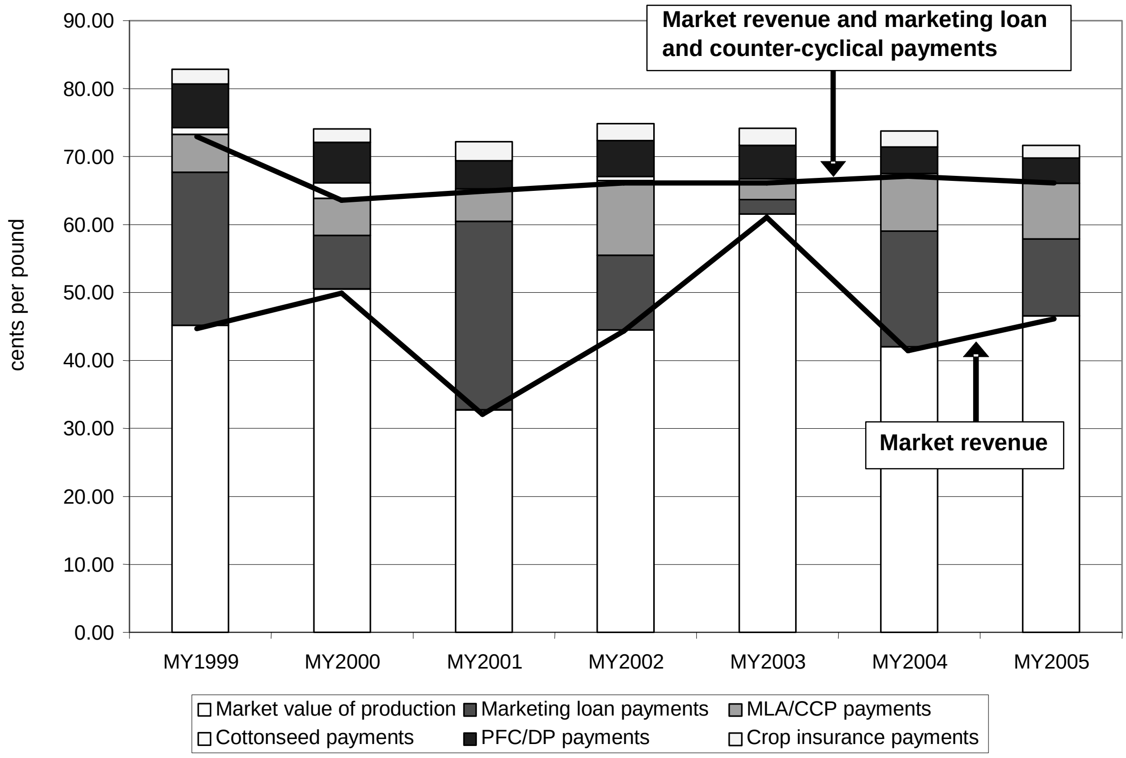
70. In these comments, Brazil focuses on the general theme of the U.S. response, *i.e.*, "expectations" allegedly held by U.S. upland cotton farmers at the time of planting. Brazil agrees that an analysis of U.S. upland cotton producers' expectations, at the time of planting, about market prices and subsidy revenue is a useful supplement to the basic facts identified above. Indeed, Brazil conducted just such analyses in its First Written Submission[72], Rebuttal Submission[73] and Oral Statement.[74] However Brazil considers that an assessment of the basic facts noted above is sufficient for the compliance Panel to find that the U.S. marketing loan and counter-cyclical subsidies cause significant price suppression in the world market for upland cotton, in violation of Articles 5(c) and 6.3(c) of the *SCM Agreement*.

71. The United States emphasizes that it is "important to look at the way that the marketing loan and counter-cyclical payment programs *actually* operate and interact with production decisions."[75] Brazil agrees with this general proposition. U.S. upland cotton farmers, like any other businesses, function to generate revenue and make a profit. One of the questions before this compliance Panel is from what source typical U.S. upland cotton farmers expect to receive revenue sufficient to cover production costs and generate profits from their business. Do market returns alone provide sufficient revenue, or are U.S. marketing loan and counter-cyclical subsidies necessary to achieve the current levels of U.S. upland cotton supply? Both an assessment of actual costs and returns and expected costs and returns are relevant in considering these questions.

72. Expectations of U.S. upland cotton farmers, almost all of whom grow on upland cotton base acres benefiting from upland cotton counter-cyclical payments, are usefully summed up by Figure 8 of Brazil's First Written Submission, showing a consistent high stream of total revenue.[76]

[72] Brazil's First Written Submission, paras. 126-150.
[73] Brazil's Rebuttal Submission, paras. 101-113, 180-194, 209-231.
[74] Brazil's Opening Statement, paras. 63-78.
[75] U.S. 2 April response to question 51, para. 69 (emphasis in original).
[76] Brazil's First Written Submission, Table 8 at para. 133.

Figure 1 – Support to Upland Cotton[77]



73. This figure demonstrates the critical impact of marketing loans and counter-cyclical subsidies. U.S. upland cotton farmers can expect high total revenue even if prices turn out to be low, for instance due to a collapse of Chinese demand or expanded Indian exports. Indeed total revenue will be high regardless of whether prices plunge for demand- or supply-related reasons. Every U.S. upland cotton farmer knows that, year-in and year-out, no matter what happens, he or she *will* receive a guaranteed revenue for the upland cotton he or she produces. During the lifetime of the FSRI Act of 2002, marketing loan and counter-cyclical subsidies accounted for an average of 40 percent of the market value of upland cotton.

74. The United States now claims that it is "not remarkable" that marketing loans and counter-cyclical payments have this revenue-stabilizing effect.[78] Yet, labelling these payments as "income support" and suggesting that this is a normal and expected effect of price-contingent subsidies disregards the critical role of these subsidies for U.S. upland cotton production. Indeed, the U.S. arguments boil down to the following: the planting decisions of the typical U.S. upland cotton farmer have no, or at most minimal connection, to the two price-contingent subsidies that provide revenue worth an average of 40 percent of the market revenue of the crop produced. That argument is totally inconsistent with, to quote the United States, "the way that the marketing loan and counter-cyclical payment programs *actually* operate and interact with production decisions."[79]

75. Contrary to the U.S. arguments, which attempt to minimize the revenue-stabilizing effect of these subsidies[80], Brazil's "expectation" arguments have always heavily relied on the fact that U.S. upland cotton farmers know, at the time of planting, that they will receive guaranteed and profit-

[77] Brazil's First Written Submission, Table 8 at para. 133.
[78] U.S. 2 April response to question 53(c), para. 94.
[79] U.S. 2 April response to question 51, para. 69.
[80] U.S. 2 April response to question 51, para. 71.

making revenue by virtue of the price-contingent subsidies, no matter how market prices develop in the months ahead. The Appellate Body recognized this when finding that "*although farmers had expected higher prices in making their planting decisions, they were also aware that if actual prices were ultimately lower, they would be 'insulated' by … marketing loan program payments [and]also counter-cyclical payments, which were based on a target upland cotton price of 72.4 cents per pound*."[81]

76. Brazil, of course, does not assert that marketing loan and counter-cyclical subsidies are the *only* consideration for U.S. upland cotton farmers. Certain other factors, such as the current record high corn prices, will influence the planting decisions of upland cotton farmers. This is because even the generous U.S. marketing loan and counter-cyclical subsidies for upland cotton are no match for the returns that a farmer can expect from growing corn in MY 2007.[82] Against this background, the remarkable fact is not, as the United States asserts[83], that U.S. upland cotton acreage for MY 2007 is down. The remarkable fact is that despite vastly most attractive corn prices, the significant majority of U.S. upland cotton acreage stays in the production of upland cotton.

77. The original panel and Appellate Body found that marketing loan and counter-cyclical subsidies *numb* U.S. farmer's reactions to market forces – not totally *deaden* them.[84] The considerable weight of the evidence shows that, over the life-time of the FSRI Act of 2002, for *many* farmers, these government subsidies made the difference between earning a long-term profit and having to leave the business of growing upland cotton.[85] This is the background to the planting decisions made by thousands of U.S. upland cotton farmers like Mr. Houston. The result of these guaranteed and price-contingent subsidies is a U.S. upland cotton supply that is much larger than it would otherwise be. This is what USDA economists[86] and the original panel found[87], what the Appellate Body affirmed[88], and what the evidence on record before this compliance Panel demonstrates.

78. In its response to the compliance Panel's narrow legal question, the United States also repeats a number of arguments, at paragraph 72, that Brazil previously responded to in detail. Brazil briefly recalls those responses and cross-references to its own argumentation refuting these points.

79. First, the United States claims that Brazil improperly focuses on actual prices and payments received by U.S. farmers at the time of harvest.[89] Of course, actual prices in an isolated marketing year cannot be relevant to planting decisions taken before their realization. However, the collective knowledge of historic actual prices – and large subsidies resulting therefrom – constitute highly relevant evidence showing that, year-in and year-out, U.S. upland cotton farmers know that their revenue will be supported no matter what happens to prices. A typical U.S. farmer planting upland cotton in the spring of 2006, knew that when prices collapsed in MY 2004 against expectations, he received price-contingent subsidies accounting for 60 percent of market revenue.[90] This experience is highly relevant to the farmer's planting decision in MY 2006. In any event, Brazil has also provided

[81] Appellate Body Report, *U.S. – Upland Cotton*, para. 445.
[82] Brazil's Oral Statement, paras. 70-71.
[83] U.S. 2 April introduction to responses to questions, paras. 1-4.
[84] Panel Report, *U.S. – Upland Cotton*, para. 7.1294. Appellate Body Report, *U.S. – Upland Cotton*, para. 445.
[85] Brazil's Oral Statement, paras. 54-91.
[86] Panel Report, *U.S. – Upland Cotton*, para. 7.1295.
[87] Panel Report, *U.S. – Upland Cotton*, para. 8.1(g)(i).
[88] Appellate Body Report, *U.S. – Upland Cotton*, para. 763.
[89] U.S. 2 April response to question 51, para. 72, first bullet point.
[90] Brazil's First Written Submission, Table 6 at para. 111, as amended by updated marketing loan subsidy amounts (*see* Brazil's 16 March Comments on U.S. Answer to Question 4, para. 14) and an updated counter-cyclical subsidy amount in MY 2005 (*see* Brazil's Oral Statement, paras. 40, 107-119).

detailed evidence showing that the typical U.S. upland cotton farmer expected to receive marketing loan and counter-cyclical subsidies every year under the FSRI Act of 2002.[91]

80. Brazil also notes Professor Sumner's explanation that farmers' price expectations are fundamentally unobservable and that "it is impossible to know precisely what individual growers expect."[92] However, given past experience with the price volatility of upland cotton and the price-contingent U.S. subsidies at issue in this dispute, it is appropriate to assume that farmers learn from their experience. Thus, an examination of historical payments is important. The United States asserts that "farmers cannot rewind time."[93] But farmers certainly can – and no doubt do – learn from previous time periods. In trying to predict the future, farmers will rely on their past receipt of large marketing loan and counter-cyclical subsidies.

81. Moreover, Brazil demonstrated, relying on the Appellate Body's findings[94] and much other evidence[95], that farmers' expectations take account of their experience of past very high counter-cyclical and marketing loan subsidies, and the knowledge that, whatever happens to prices, their revenue will be protected by U.S. subsidies at profitable levels.[96] The United States has not and cannot explain how such subsidies today suddenly no longer affect planting decisions and how they no longer have significant supply-enhancing and world market price-suppressing effect.

82. Second, the United States claims that Brazil has ignored net revenue and other conditions regarding competing crops vis-à-vis upland cotton.[97] This is simply false. Among other evidence, Brazil demonstrated in figures 1-12 of its Oral Statement[98] and its Comments on the U.S. Oral Statements[99] that it was *upland cotton* marketing loan and counter-cyclical subsidies that allowed U.S. upland cotton farmers to expect higher profits from planting upland cotton than from switching to substitute crops, such as soybeans or corn.[100]

83. Third, the United States claims that Brazil has focused on total production, as opposed to plantings, and ignored other factors affecting production that are outside of a farmer's control.[101] That is also false. Brazil has recognized that factors such as weather and yields do impact total production and total exports.[102] Yet, Brazil has demonstrated that, in MY 2005, but for the two challenged subsidies, U.S. production and exports would actually have been 18 and 25 percent lower, respectively.[103] The subsidy-induced extra acreage benefits from good weather or increased yields and significantly contributes to higher U.S. production and higher U.S. exports.[104] Brazil also noted that the original panel conducted its analysis at a time when a significant percentage of U.S. upland

[91] Brazil's First Written Submission, paras. 126-150; Brazil's Rebuttal Submission, paras. 101-113; 180-194, 209-231; and Brazil's Opening Statement, paras. 63-78.

[92] *See* Quantitative Simulation Analysis by Professor Daniel Sumner, Annex I to Brazil's Further Submission before the original panel, 9 September 2003, para. 18, available at http://www.mre.gov.br/portugues/ministerio/sitios_secretaria/cgc/analisequantitativa.pdf.

[93] U.S. 2 April response to question 51, para. 71.

[94] Appellate Body Report, *U.S. – Upland Cotton*, para. 445.

[95] *See, e.g.*, Brazil's Rebuttal Submission, Sections 7.7, 7.8, 7.9, 7.11, 7.12.

[96] Brazil notes that even using the futures price analysis for the December contract, U.S. upland cotton farmers expected to receive significant marketing loan and counter-cyclical payments in every year under the FSRI Act of 2002.

[97] U.S. 2 April response to question 51, para. 72, second bullet point.

[98] Brazil's Opening Statement, paras. 63-77

[99] Brazil's Comments on U.S. Oral Statements, paras. 13-34.

[100] *See* also Brazil's comments on the U.S. responses to questions 53 and 59, below.

[101] U.S. 2 April response to question 51, para 72, third and fourth bullet points.

[102] Brazil's Rebuttal Submission, paras. 201-202.

[103] "Analysis of Effects of U.S. Upland Cotton Subsidies on Upland Cotton Prices and Quantities by Daniel A. Sumner," Brazil's First Written Submission, Annex I, Table

[104] Brazil's Rebuttal Submission, paras. 226-231.

cotton was already grown from biotech varieties[105], and that also during the reference period assessed by the original panel yields had increased.[106]

84. Fourth, the United States claims that Brazil improperly focuses on total costs and not variable costs. In fact, Brazil's evidence addresses both types of costs. Brazil refers the compliance Panel to its comments on the U.S. response to question 59, below. Indeed, it is the United States that improperly downplays the crucial importance of covering total costs in light of the enormous long-term deficit of $12.4 billion in losses that U.S. upland cotton farmers would have accumulated over the past seven marketing years based only on market revenue.[107]

85. Fifth, the United States claims that Brazil fails to take into account demand from China in the world market for upland cotton.[108] Brazil acknowledged that China plays an important role in the discovery of the A-Index world market prices, primarily from the demand side.[109] But Brazil also emphasized that the United States – with a commanding 40 percent world market share of exports – plays a crucial role on the *supply* side of that price discovery process.[110] Indeed, Brazil demonstrated that while Chinese demand skyrocketed in MY 2004 and MY 2005, prices actually fell due, in significant part, to record high U.S. production and exports.[111] Thus, Brazil demonstrated that the impact of Chinese demand on the world market prices does not break the genuine and substantial relationship of cause and effect between the challenged subsidies and significant price suppression in the world market.

86. Finally, the United States' response to question 51 summarizes a number of arguments that it elaborates on in more detail in response to other questions. Brazil refers the compliance Panel to its comments on the U.S. response to question 53 with respect to additional planting decision and expectations related arguments[112], questions 56/57 with respect to studies on the effects of counter-cyclical payments[113], and question 59, with respect to the U.S. cost of production.[114] Brazil also notes that the United States again repeats its criticism of Professor Sumner's simulation model that it advanced in its First Written Submissions[115], but that the United States has not even attempted to rebut any of the arguments, explanations and rebuttals submitted by Brazil and Professor Sumner in their many submissions since.

52. In its Third Party Submission New Zealand observes:

> "Marketing loan payments are amber box measures, the category in which are included the non-prohibited measures with the most trade distorting effect on production and trade." (para. 5.19)

Do the parties consider that the fact that under the Agreement on Agriculture a subsidy is included in the "amber box" is relevant to the analysis of the subsidy's consistency with Articles 5 and 6 of the SCM Agreement?

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[105] Brazil's Comments on the U.S. Oral Statement, para. 31.
[106] *See* Exhibit Bra-562 (Cotton and Wool Situation Outlook and Yearbook, USDA, November 2006, Table 2, accessed November 2007 at http://usda.mannlib.cornell.edu/usda/current/CWS-yearbook/CWS-yearbook-11-21-2006.pdf.
[107] *See*, *e.g.*, Brazil's comments on the U.S. response to question 59, below.
[108] U.S. 2 April response to question 51, para. 72, fifth bullet point.
[109] Brazil's Rebuttal Submission, paras. 335-336.
[110] Brazil's Rebuttal Submission, paras. 324-345.
[111] Brazil's Rebuttal Submission, paras. 337-339.
[112] U.S. 2 April response to question 51, paras. 75-76.
[113] U.S. 2 April response to question 51, para. 77.
[114] U.S. 2 April response to question 51, para. 78.
[115] U.S. 2 April response to question 51, para. 73.

87. Brazil refers the compliance Panel to its own response to this question.

Questions to the United States

53. The United States argues that Brazil has not provided evidence of "actual production inducing" effects of marketing loan and counter-cyclical payments and that Brazil "purports to demonstrate indirect production effects through its claim that the US planting, production, and exports are not responsive to prices". (Opening Statement of the United States at the meeting of the Panel with the parties, paras. 62 and 69, emphasis in original)

a) Could the United States explain further the distinction between what it terms "*actual production inducing effects* "*and* "*indirect production effects*"*? Could the United States also elaborate on how this distinction is legally relevant in the context of Articles 5 and 6 of the SCM Agreement?*

88. Brazil agrees with the United States that there is no legally relevant distinction between "actual" and "indirect" production effects recognized in Articles 5 and 6 of the *SCM Agreement*.[116] That should have been the extent of the U.S. answer. Unfortunately, the United States went on to provide an extensive and unresponsive recap of its *factual* arguments. Brazil briefly responds to these unresponsive assertions and cross-references to Brazil's earlier submissions where these arguments have been addressed.

89. Brazil's comments on the U.S. response to question 51 summarize a number of Brazil's arguments concerning "expectations" of farmers and how the marketing loan and counter-cyclical subsidies "numb" those farmers response to market forces.[117] In an attempt to counter this core finding by the original panel, the United States now argues that "it is unrealistic to suggest that there should be a one-to-one link between upland cotton planting, production, and export and upland cotton prices."[118] Yet, Brazil's claims never required such a "one-to-one" link and the original panel never based its findings on such a precise link. Nor does Brazil claim that U.S. producers are incapable of *any* response to market price signals.[119] Rather, Brazil's claim is that the updated evidence continues to demonstrate the correctness of the original panel's finding concerning the "*numbness*" of U.S. producers to market prices. That is, U.S. upland cotton producers do not react to market price signals and/or do not react to the extent that would be expected absent the price-contingent U.S. subsidies at issue in this dispute.

90. Brazil demonstrated that, as in the earlier MY 1999-2002 reference period, Brazilian and other non-subsidized low-cost producers continued during MY 2002-2006 to react to lower expected world market prices by lowering their acreage and decreasing production.[120] In fact, in every year between MY 2002-2006, total foreign harvested acreage moved in the same direction as futures

[116] U.S. 2 April response to question 53(a), para. 83.
[117] These Comments respond to many of the expectation-related arguments in the U.S. 2 April response to question 53(a).
[118] U.S. 2 April response to question 53(a), para. 85.
[119] *See*, *e.g*., Brazil's Rebuttal Submission, para 188 (Brazil agrees that there are some factors that may influence planting decisions for some upland cotton producers in addition to expected prices and expected subsidy revenue . . . However, these exogenous factors do not reduce the importance or U.S. upland cotton producers of <u>the</u> key economic factor based on what farmers decide to produce upland cotton: expected revenue from selling upland cotton as topped up by massive U.S. marketing loan and counter-cyclical payments.").
[120] Brazil's Rebuttal Submission, para 221-222 discussing Figure 8 – Futures Prices and Planted Acreage; *see also* U.S. Rebuttal Submission, Figure in para. 306 (showing that since 2002, foreign harvested acreage has increased when prices were predicted to be higher, and decreased when prices were predicted to be lower; by contrast, the U.S. harvested acreage did not show any correlation to price movements in MY 2003, MY 2005, and MY 2006).

prices.[121] By contrast, the planting decisions of subsidized, high-cost U.S. upland cotton producers, in general, did not correlate with changes in cotton market prices.[122] For example, between MY 2002-2006, U.S. harvested acreage moved in opposite directions to those expected based on price movements in three out of five years – MY 2003, MY 2005, and MY 2006. The United States attempts to explain this by claiming that, in MY 2003 and MY 2006, this is because "U.S. harvested acreage reacts more *conservatively* than foreign acreage to increasing futures prices …."[123] Yet, it is the *lack* of a correlation to prices that illustrates how U.S. producers are "numbed" from reacting to market forces.

91. More importantly, the degree and magnitude to which U.S. producers respond to market signals is also muted compared to their non-U.S. counterparts. In the past 5 years (MY 2002-2006), the change in U.S. harvested acreage from the previous year averaged 7 percent. Annual changes in Brazil, by contrast were 36 percent.[124] These facts constitute evidence sustaining Brazil's point and that of Mr. Houston[125] – that expected upland cotton market prices do not play an important role in the planting decisions of many U.S. upland cotton farmers.[126]

92. The United States repeats several times the unsupported assertion that "[s]ince the [FSRI Act of 2002] came into effect, U.S. export behavior has been entirely consistent with that of foreign counterparts."[127] This is incorrect. A recent USDA analysis of the cotton market found that "[o]n the export side of the world trade equation, *the United States has accounted for the lion's share of global gains*, with 11 million bales of increased exports since 1999/2000."[128] Brazil recalls that record U.S. export volumes were achieved in MY 2001, 2002, 2003, 2004 and 2005. The 40 percent U.S. share of world exports is more than three times higher than the share of Uzbekistan, the second largest exporter.[129]

93. The dramatic 55 percent increase in absolute U.S. export volumes between MY 2002 and 2005[130] inevitably came at the expense of producers in non-subsidizing countries. Australia's average export market share of 12 percent between MY 1999-2001 was cut in half to 6 percent by

[121] U.S. Rebuttal Submission, Figure in para. 306 (showing that since 2002, foreign harvested acreage has increased when prices were predicted to be higher, and decreased when prices were predicted to be lower; by contrast, the U.S. harvested acreage did not show any correlation to price movements in MY 2003, MY 2005, and MY 2006).

[122] Brazil's Rebuttal Submission, para. 224 discussing Figure 9 – Changes in Acreage and Percentage Changes in Futures Prices; Brazil's First Written Submission, paras 141-143 discussing Figure 9 – Futures Prices and Planted Acreage; Brazil's Oral Statement, para. 61-62.

[123] U.S. 2 April response to question, para. 89.

[124] Exhibit Bra-629 (Brazilian Harvested Acreage, Producer, Supply & Distribution Database, FAS, USDA, accessed February 2007 at http://www.fas.usda.gov/psdonline/psdquery.aspx). *See also* Exhibit Bra-570 (Producer, Supply & Distribution Database, FAS, USDA, accessed January 2007 at http://www.fas.usda.gov/psdonline/psdquery.aspx).

[125] Citations by Stephen Houston Sr., a cotton farmer from Georgia, can be found in Exhibit Bra-563 ("Cotton bailout: How your tax dollars prop up big growers and squeeze the little guy," Atlanta Journal-Constitution, 1 October 2006, p. 2, accessed December 2006 at http://www.ajc.com/search/content/metro/stories/cotton1.html).

[126] *See* also Professor Sumner's analysis regarding the magnitude of the reaction of U.S. upland cotton producers to an elimination of marketing loan and counter-cyclical subsidies, Brazil's First Written Submission, Annex I.

[127] U.S. 2 April response to question 53, paras. 88 and 90 ("the data show … that U.S. production and exports shift consistently with production and exports elsewhere in the world.").

[128] *See* "Cotton Backgrounder," USDA, March 2007, accessed April 2007 at http://www.ers.usda.gov/Publications/CWS/2007/03Mar/CWS07B01/).

[129] Producer, Supply and Distribution Database, Foreign Agriculture Service, USDA, accessed April 2007 at http://www.fas.usda.gov/psdonline/psdQuery.aspx.

[130] Exhibit Bra-447 (Upland Cotton Supply and Use).

MY 2005.[131] Similarly, West and Central Africa's share of the world market declined to a ten-year low in MY 2005. The UN Food and Agricultural Organization recently summed up what has been occurring:

> Subsidies maintain cotton production at otherwise unprofitable levels in industrialized countries, reducing the opportunities for developing countries to export to subsidizing country markets and displacing their exports to third countries.[132]

94. Of course, exports of upland cotton are the consequence of planting decisions and other factors, including subsidies, yields, domestic demand, etc. The relevant question is, therefore, what would U.S. exports be but for marketing loan and counter-cyclical subsidies. As discussed above, U.S. upland cotton planting are higher than they would be but for the U.S. subsidies at issue. Brazil has demonstrated that *but for* the two U.S. subsidies at issue, U.S. exports would have been 25 percent lower in MY 2005.[133]

95. But even accepting, *arguendo,* the U.S. argument that U.S. and foreign exports *did* react in roughly the same manner as non-subsidized foreign exports, the United States ignores the reason *why* this may have occurred. Many of these non-subsidized foreign producers have far lower costs of production than U.S. producers.[134] Brazil recalls ICAC's finding that it costs U.S. upland cotton producers $0.67 to grow a pound of upland cotton, while it costs producers in West and Central Africa $0.45 and producers in Brazil just $0.38.[135] Such lower costs are essential to the survival of Brazilian and African producers, because they do not have the benefit of 40 percent *ad valorem* <u>subsidies for the same basic commodity product as U.S. producers.</u> These lower costs allow them to withstand certain levels of lower prices and still cover their total costs. U.S. producers are only able to compete with foreign producers in MY 2005 because marketing loan and counter-cyclical subsidies allowed them to sustain high levels of planted acreage. Brazil has demonstrated that *but for* these two subsidies, U.S. producers would have reacted to lower expected prices in MY 2005 (combined with higher costs) by reducing acreage, reducing production, and reducing exports.[136] And with lower U.S. exports available to meet world demand, world market prices would be higher.

96. Finally, against this backdrop, the United States claims that the elimination of Step 2 payments caused a major shift in U.S. exports.[137] While complete data for MY 2006 is, of course, not available, USDA projects that U.S. exports in MY 2006 will be at their second highest level in history. USDA further projects that the U.S. world market share of exports will be 36 percent in MY 2006. While this does constitute a decline in the U.S. world market share of exports, the United States still holds a commanding market share. As Brazil explained at the Panel meeting, the decline in the U.S. share of world exports in MY 2006 is largely due to the rise of Indian exports to China and the surge of U.S. exports just prior to the termination of the Step 2 program at the end of MY 2005.[138] Further, with over 9 million bales of U.S. upland cotton sitting in U.S. warehouses, USDA and FAPRI project that the United States will increase its exports in MY 2007. In fact, FAPRI's 2007 baseline

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[131] Producer, Supply and Distribution Database, Foreign Agriculture Service, USDA, accessed April 2007 at <u>http://www.fas.usda.gov/psdonline/psdQuery.aspx</u>.

[132] Exhibit Bra-579 ("Cotton: Impact of Support Policies on Developing Countries – Why Do the Numbers Vary?" FAO Trade Policy Brief, p. 1, accessed December 2006 at <u>ftp://ftp.fao.org/docrep/fao/007/y5533e/y5533e00.pdf</u>).

[133] "Analysis of Effects of U.S. Upland Cotton Subsidies on Upland Cotton Prices and Quantities by Daniel A. Sumner," Brazil's First Written Submission, Annex I, Tables 2.A.1-2.A.3.

[134] *See* Brazil's First Written Submission, para. 162. *See also* Exhibit Bra-480 (Survey of the Cost of Production of Raw Cotton, ICAC, November 2004, p. 13).

[135] *See* Brazil's First Written Submission, para. 162. *See also* Exhibit Bra-480 (Survey of the Cost of Production of Raw Cotton, ICAC, November 2004, p. 13).

[136] *See* Brazil's First Written Submission, paras. 167-180.

[137] U.S. 16 March comments on Brazil's answer to question 28(a), para. 121.

[138] *See* Brazil's Closing Statement, para. 11.

projects the U.S. share of the world export market to rise to 43 percent in MY 2007 and remain above 40 percent through MY 2011.[139]

b) *What is the response of the United States to the argument that the fact that "U.S. upland cotton producers know that their overall revenue will always be protected by marketing loans and counter-cyclical payments ... plays a major role in their planting decisions"? (Rebuttal of Brazil, para. 185; see also Third Party Submission of New Zealand, paras 5.20-5.21)*

97. The United States asserts that the "mere" fact that income support programs support the income of agricultural producers "does not, however, mean that the payments have 'major' effects on planting or cause any of the adverse effects listed in Articles 5 and 6 of the *SCM Agreement*."[140] Brazil agrees that different forms of income support may have different effects on production and that Articles 5 and 6 do not contain a presumption of adverse effects from income support. As the complaining Member, Brazil must demonstrate that the particular price-contingent subsidies at issue in this dispute cause serious prejudice to its interests. Contrary to the U.S. assertion, all of the evidence submitted by Brazil in this proceeding is sufficient to more than discharge this burden.

98. In commenting on the U.S. response, Brazil recalls its 2 April response to question 69, its comments on the U.S. response to questions 51 and 53(a), above, and 53(c), below, and the many arguments and evidence provided in its earlier submissions.

99. Brazil does not consider it "mere" or unimportant facts that, during the lifetime of the FSRI Act of 2002, marketing loan and counter-cyclical subsidies represented an *average* 40 percent *ad valorem* subsidization rate, covered an average 29 percent of total costs of production[141], and were received by 96 percent of U.S. upland cotton producers holding upland cotton base acres.[142] Nor is it "mere" fact that, *but for* these subsidies, U.S. production would be 15 to 16 percent lower[143] and U.S. exports 21 to 22 percent lower.[144] Nor is it "mere" fact that the original panel found that the subsidy payments are mandatory, *i.e.*, they must be made by the U.S. Secretary of Agriculture without exceptions, and that they are contingent upon world and U.S. prices, *i.e.*, they function to guarantee U.S. producers revenue regardless of how low prices fall. As both the Appellate Body and the original panel found[145], the knowledge of U.S. upland cotton producers that these subsidies will be received at times of low prices is an important factor affecting their planting decisions and, consequently, affecting U.S. supply of upland cotton to the world market.

100. While it is possible that some forms and low levels of income support may not cause serious prejudice under particular conditions of competition, this is certainly not the case with respect to the two subsidies at issue: U.S. marketing loan and counter-cyclical subsidies for upland cotton. These particular mandatory, price-contingent subsidies cause serious prejudice in view of their nature and

[139] *See* "World Cotton," 2007 FAPRI Baseline, accessed April 2007 at http://www.fapri.iastate.edu/brfbk07/CottonTables2007.xls.

[140] U.S. 2 April response to question 53, para. 92.

[141] Exhibit Bra-477 (Upland Cotton Costs and Returns).

[142] Brazil's Rebuttal Submission, Table 3 at para. 157. Results are from U.S. First Written Submission, table at para. 224.

[143] Average effects from MY 2002-2005, *see* "Analysis of Effects of U.S. Upland Cotton Subsidies on Upland Cotton Prices and Quantities by Daniel A. Sumner," Brazil's First Written Submission, Annex I, Tables 2.A.1-2.A.3.

[144] Average effects from MY 2002-2005, *see* "Analysis of Effects of U.S. Upland Cotton Subsidies on Upland Cotton Prices and Quantities by Daniel A. Sumner," Brazil's First Written Submission, Annex I, Tables 2.A.1-2.A.3.

[145] Appellate Body Report, *U.S.–Upland Cotton*¸ para. 445; Panel Report, *U.S. – Upland Cotton*, paras. 7.1290-7.1303.

magnitude, and in view of the product they support and the particular conditions of competition in which that product is traded in international markets.[146]

c) *In its Opening Statement at the meeting of the Panel with the Parties, Brazil observed:*

> "...we have demonstrated that these subsidies stabilized cotton producers' revenue despite wildly fluctuating market prices, thereby insulating and numbing acreage response to market price signals. These subsidies also cover the huge long-term gaps between market returns and total costs of production. Both effects are closely interrelated." (para.55)

Is the United States only arguing that Brazil has not empirically substantiated that these two "effects" have actually occurred or is it also the position of the United States that these effects are in any event legally irrelevant to an analysis of whether a subsidy causes significant price suppression within the meaning of Article 6.3 (c) of the SCM Agreement?

101. The passage cited by the compliance Panel ties together two important themes in Brazil's causation arguments and two important effects of the U.S. marketing loan and counter-cyclical subsidies. The planting decisions analysis presented in the paragraphs that follow this portion of Brazil's Oral Statement shows how marketing loan and counter-cyclical subsidies (i) numb farmers' planting decisions and (ii) cover their total costs of production, resulting in higher levels of planting and supply than would exist but for the subsidies.

102. In its response, the United States accepts that marketing loan and counter-cyclical subsidies stabilize upland cotton producers' revenue, *i.e.*, constitute price-contingent subsidies, but submits that Brazil's demonstration to that effect is not "remarkable".[147] Yet, the conciseness of this fact and the simplicity of its demonstration does not make it any less important. It is crucial that every U.S. producer growing upland cotton on upland cotton base knows that he or she will receive a profitable return regardless of market prices at the time of harvest. This knowledge is *the* key aspect of revenue "expectations" at the time of planting.[148]

103. While the United States presents a number of arguments concerning the alleged absence of any effects on production of marketing loan subsidies (responses to which are largely set out in Brazil's comments to U.S. response to question 51), the United States fails to demonstrate <u>*any*</u> fundamental change in the conditions of competition in the U.S. or world upland cotton market between the reference year of MY 2002 and the reference year of MY 2005 (or MY 2006). The *same* basic facts continue to exist. Therefore, and because the U.S. arguments raised are without merit, there is no basis for the compliance Panel to deviate from the findings of the original panel, as upheld by the Appellate Body. The FSRI Act of 2002 mandates the payment of marketing loan subsidies for every pound of upland cotton grown in the United States, *without limitation*, if the adjusted world price falls below $0.52 per pound.[149] Farmers know that the more upland cotton they produce, the more they will receive in marketing loan subsidies. Perversely, the operation of this subsidy means that when U.S. supply surges and world prices fall as a result, *more* marketing loan subsidies are made, perpetuating the cycle of high levels of production.[150] In view of this fact, there is little wonder that the original panel found that "[w]e have *no doubt* that the payments stimulate production and

[146] *See*, *e.g*., Brazil's 2 April response to question 69.
[147] U.S. 2 April response to question 53(c), paras. 94-95 citing Brazil's Oral Statement, para. 55.
[148] Brazil's comments on the U.S. response to question 51, above, address the arguments in paragraphs 95-96 in the Answer to Question 53(c).
[149] For more details on the functioning of the marketing loan program, *see* Section 7.3.1 of Brazil's First Written Submission or *see* 7 U.S.C. §7931(a) in Exhibit Bra-442 (7 U.S.C. §§ 7901-7939, Legal Information Institute, Cornell Law School, accessed July 2006 at http://www.law.cornell.edu/uscode/).
[150] Panel Report, *U.S. – Upland Cotton*, paras. 7.1294-7.1295.

exports and result in lower world market prices than would prevail in their absence."[151] Moreover, the original panel found that "the text of the measure indicates that the payments are mandatory, where certain market conditions prevail."[152] Brazil notes that marketing loan subsidies in MY 2005 were 41 percent larger than in MY 2002.[153]

104. The United States repeats its argument that the actual payment of marketing loan and counter-cyclical subsidies is irrelevant and that only expectations matter.[154] As Brazil has repeatedly demonstrated[155], actual payments of these subsidies provide U.S. producers with payments worth 40 percent of the market value of a highly price-sensitive commodity.[156] The experience of U.S. upland cotton farmers, who received very large subsidies over the years due to actual prices below the trigger prices, is a crucial fact that forms part of the background against which U.S. farmers' build their expectations about future revenue from the market and the subsidy programs.[157] This remains unchanged from the facts before and the findings of the original panel and the Appellate Body.[158] The U.S. expectation analysis narrowly and incorrectly assumes that farmers expect to receive subsidies only on the basis of a firmly expected price and disregard the possibility (i) that actual prices might deviate from this projection and (ii) that U.S. price-contingent subsidies provide a revenue guarantee against such changes in volatile upland cotton prices.[159]

105. With respect to the U.S. arguments regarding the absence of effects from counter-cyclical subsidies[160], Brazil refers the compliance Panel to its rebuttal of similar arguments made in response to questions 56/57 below.

106. Next, the United States raises several new arguments (or new variations on older arguments) and presents new evidence in its response to question 53(c). In particular, it argues that "in every single marketing year since the FSRI Act came into effect, it would have been economically rational for upland cotton farmers to plant upland cotton rather than allowing their land to sit idle because the farmers expected that, even without any payment from the government, market revenue for upland cotton was more than sufficient to cover variable costs."[161]

107. This assertion is fundamentally flawed for a number of reasons. First, Brazil has never suggested that all or even most upland cotton acreage would be left idle without marketing loan and counter-cyclical subsidies. The counter-factual before this compliance Panel concerns the question whether, in the absence of marketing loan and counter-cyclical subsidies, upland cotton acreage would decline. Whether that land would be left idle or would be switched to the production of alternative crops that continue to benefit from U.S. subsidies, such as corn, soybeans, wheat, and rice, is not relevant for this assessment.

108. Further, contrary to the U.S. assertion, it is not economically rational to plant upland cotton year after year unless producers are able to cover their *total* costs, not merely *variable* costs. The

[151] Panel Report, *U.S. – Upland Cotton*, para. 7.1291.
[152] Panel Report, *U.S. – Upland Cotton*, para. 7.1291.
[153] Brazil's First Written Submission, Table 6 at para. 111, as amended by updated marketing loan subsidy amounts (*see* Brazil's 16 March Comments on U.S. Answer to Question 4, para. 14) and an updated counter-cyclical subsidy amount in MY 2005 (*see* Brazil's Oral Statement, para. 40). *See also* Brazil's 2 April Answer to question 69, para. 99.
[154] *See* also Brazil's comment on the U.S. response to question 51, above.
[155] *See* also Brazil's comment on the U.S. response to question 51, above.
[156] Brazil's First Written Submission, paras. 111-113 and Table 6.
[157] *See* Brazil's comment on the U.S. response to question 51, above.
[158] Appellate Body Report, *U.S. – Upland Cotton*, para. 445; Panel Report, *U.S. – Upland Cotton*, paras. 7.1290-7.1303.
[159] *See* Brazil's comment on the U.S. response to question 51, above.
[160] U.S. 2 April response to question 53, para. 97.
[161] U.S. 2 April response to question 53, para. 98.

original panel recognized this fact when it found that "[w]e believe that the existence of this gap between upland cotton producers' total production costs and market revenue, on the one hand, and the effect of the subsidies, on the other hand, was to sustain a higher level of output than would have occurred in the absence of the United States subsidies at issue."[162] Brazil refers the compliance Panel to its 2 April response to question 71 for a discussion of why total costs, in addition to variable costs, are highly relevant to planting decisions.[163]

109. Moreover, a significant portion of upland cotton farmers are *not* able to cover their *variable* production costs with market revenue alone, nor do many upland cotton farmers expect to be able to do so at the time of planting.[164] The portion of upland cotton farmers that are not able to cover their variable costs of production depend on which costs are considered variable.[165] As explained in Brazil's Oral Statement, whether or not a cost is variable depends on the time period being considered.[166]

110. However, in addition to the time period under consideration, the categorization of cost items depends on the nature of the counterfactual examination. In this dispute, the compliance Panel is tasked to examine the effect of permanently removing a major source of upland cotton producers' income.[167] This question is fundamentally different from examining the effects of annual fluctuations in market price levels. The counterfactual involving a permanent removal of the subsidies calls for the inclusion of costs in a planting decisions analysis that might not always be included when assessing planting decisions based solely on limited annual price fluctuations. For instance, if a drop in prices is expected to be isolated (*i.e.*, only lasting a single year), a farmer would be more willing to continue producing even if he or she is unable to cover fully the opportunity cost of labor and land and special machineries. However, if the farmer knows that, due to the termination of a government program, a source of revenue representing an average 40 percent *ad valorem* subsidization rate will permanently be lost, no rational farmer would continue planting upland cotton unless he or she can cover operating, land and labor costs. Instead, the farmer would shift production to other crops or potentially lease his or her land to other farm operators. In other words, a producer's supply response would be greater if the reduction in subsidies was fully anticipated and permanent.[168]

111. Next, the United States claims that "in each of the years under FSRI Act, shifts in U.S. planted acreage were consistent with what one would expect if there were no marketing loan payments or counter-cyclical payments and U.S. farmers were basing their planting decisions solely on market prices signals and other considerations relevant to planting and production."[169] This assertion is based on a flawed U.S. analysis of upland cotton planting decisions. The new U.S. analysis appears to have been engineered to make upland cotton appear more attractive relative to corn and soybeans than it actually was.[170]

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[162] Panel Report, *U.S. – Upland Cotton*, para. 7.1354.
[163] *See* also Brazil's comments on the U.S. response to question 59, below.
[164] Brazil's Rebuttal Submission, paras. 254-283.
[165] The United States does not consider unpaid labor, land or capital recovery costs to be variable, *see* U.S. Rebuttal Submission, paras. 324-332. Brazil considers these costs to be fully, or in part, variable, *see* Brazil's Rebuttal Submission, para. 254-283.
[166] Brazil's Oral Statement, paras. 87-88
[167] *See* Brazil's 2 April response to question 73; Brazil's First Written Submission, Annex I.
[168] *See* Brazil's Rebuttal Submission, Annex I, para. 11. Brazil also notes that it addresses the other U.S. cost of production related arguments in its comments on the U.S. response to question 59, below.
[169] U.S. 2 April response to question 53(c), para. 99.
[170] Brazil notes that it is impossible to verify much of the new information presented by the United States. Exhibit U.S.-139, which contains the U.S. analysis, was not provided electronically and much of the information does not appear to be publicly available. Brazil's analysis, by contrast, was based on publicly available information and provided to the Panel and the United States in electronic format.

112. The first major flaw in the United States analysis is the manner in which the United States calculates expected market prices (*i.e.*, the farm price). It derives that price by applying a "basis" (or discount) to the January-March average closing price of the harvest period *futures* contract. For example, the United States discounts the futures price for soybeans and corn by $0.14 and futures prices for upland cotton by $0.05 a pound.[171] The United States cites a USDA website in support of its "basis" for corn, soybeans and upland cotton.[172] However, the website applies only to soybeans, corn and wheat, but not upland cotton.[173] Thus, the United States provides no explanation or any data to justify why its basis of $0.05 per pound is appropriate.

113. While trumpeting FAPRI's analysis in its repeated critique of Professor Sumner's model, the United States rejects Brazil's use of projected prices published in FAPRI's baseline projections. However, the United States does not explain why FAPRI's projected prices should not be used. Nor does the United States explain why the compliance Panel should find that prices calculated by the United States for purposes of this litigation – and not supported by the source cited by the United States – should be adopted by the compliance Panel as superior to FAPRI's published price projections. (Brazil notes that USDA is prohibited by U.S. law from publishing its own price projections for upland cotton.)

114. As noted, Brazil's alternative crop expectations exercise relies on prices projected by FAPRI and published in its baseline during the planting period.[174] The differences between these FAPRI-projected prices and the prices constructed by the United States are very significant for most marketing years, and especially for those crucial to the compliance Panel's assessment. The table below shows the expected prices for upland cotton under the two approaches:

Table 2 – Expected Upland Cotton Prices[175]

	2002	**2003**	**2004**	**2005**	**2006**	**2007**
New U.S. Expected Prices	0.38	0.54	0.62	0.48	0.54	0.54
FAPRI Expected Prices	0.39	0.47	0.57	0.44	0.48	0.53

115. The bias of the new U.S. analysis becomes apparent when applying these two sets of prices. When the FAPRI-projected prices are inputted into the U.S. planting decisions analysis, upland cotton is no longer the most attractive crop to plant in any year other than MY 2004.[176] In other words, correcting solely for this single flaw in the U.S. analysis leads to the collapse of the U.S. assertion that "shifts in U.S. planted acreage were consistent with what one would expect."[177] Given the absence of *any* evidence supporting the U.S. "basis" for upland cotton of $0.05 per pound, there is no basis for the compliance Panel to accept its use.

116. Another significant flaw in the U.S. planting decisions analysis concerns the manner in which the United States derives expected yields. The first error in the U.S. yield analysis is that the

[171] U.S. Comments on Brazil's Oral Presentation, Annex I, Section 1 "Expected Market Prices."
[172] U.S. Comments on Brazil's Oral Presentation, Annex I, Section 1 "Expected Market Prices."
[173] *See* http://www.ers.usda.gov/Data/PriceForecast/, accessed April 2007.
[174] Brazil used CBO's projection of MY 2007 prices because the corresponding FAPRI projection was not yet available. *See* Exhibit Bra-634 (Analysis of Planting Decisions Based on Expected Returns).
[175] *See* expected prices for upland cotton in Exhibit Bra-634 (Analysis of Planting Decisions Based on Expected Returns) and Exhibit US-139 (Data Supporting Expected Market Returns Above Variable Costs Chart)
[176] Compare expected net outlays in Exhibit US-139 (Data Supporting Expected Market Returns Above Variable Costs Chart, p. 1).
[177] U.S. 2 April response to question 53(c), para. 99.

United States erroneously overstates expected yields by relying on yields per *harvested* acres[178], whereas the planting decision analysis should be based on expected yields by *planted* acre.[179] Correcting this error would reduce expected yields (and expected market returns) by an average 12 percent each year.[180]

117. The United States also improperly constructs yield projections based on a linear regression analysis of actual yields per harvested acre for MY 1995-2006.[181] In other words, the United States derives projected yields for, *e.g.*, MY 2003 taking into account information of actual yields in MY 2004-2005 and assuming that farmers fully anticipated the record high yields achieved in the MY 2004 and MY 2005.[182] An examination of the annual USDA baselines released prior to the planting periods from MY 2002 through MY 2007 confirms that USDA did not project yields to increase to the extent that they did. Much less could U.S. upland cotton producers have made that projection.

Table 3 – USDA Yield Projections[183]

	2002	2003	2004	2005	2006	2007
	Yield per planted acre					
2002 USDA Baseline Projection	**572**	577	578	579	579	581
2003 USDA Baseline Projection		**574**	579	581	581	582
2004 USDA Baseline Projection			**587**	589	590	591
2005 USDA Baseline Projection				**612**	612	616
2006 USDA Baseline Projection					**699**	706
2007 USDA Baseline Projection						**725**
Actual Yield	**579**	**643**	**806**	**799**	**668**	**NA**
Percent greater than USDA projection	1%	12%	37%	31%	-4%	NA
Yield used by U.S. in their analysis	**723**	**745**	**766**	**788**	**809**	**831**
Percent greater than USDA projection	26%	30%	31%	29%	16%	15%

118. Table 3 shows that USDA *projections* of upland cotton yields in the upcoming marketing year were significantly less than *actual* yields achieved every year. Of course, it is impossible for farmers

[178] *See* US-139 (Data Supporting Expected Market Returns Above Variable Costs Chart, p. 20). For convenience, Brazil's replicates and provides citations to the United States yield calculations in Exhibit Bra-688 (Expected Upland Cotton Yields).

[179] USDA cost of production of data clearly specifies that yields are in terms of planted acres, not harvested acres. *See*, e.g. Exhibit Bra-475 (U.S. Cotton Producers Costs and Returns Per Planted Acre, Excluding Government Payments, Economic Research Service, USDA, accessed October 2006 at http://www.ers.usda.gov/data/costsandreturns/testpick.htm).

[180] The United States provided very little documentation as to how it constructed its "linear trend equation" of expected yields in US-139 (*see* U.S. Comments on Brazil's Oral Statement, Annex I). Brazil has reconstructed the U.S. calculation for the panel's convenience, using both yields per harvested acre and yields per planted acre in Exhibit Bra-688 (Expected Upland Cotton Yields).

[181] *See* US-139 (Data Supporting Expected Market Returns Above Variable Costs Chart, p. 20). For convenience, Brazil's replicates and provides citations to the United States yield calculations in Exhibit Bra-688 (Expected Upland Cotton Yields).

[182] By contrast, Brazil used a three year rolling average of yields per planted acre actually achieved on farms in USDA's cost survey. *See* Exhibit Bra-634 (Analysis of Planting Decisions Based on Expected Returns).

[183] USDA baseline projections are from Exhibit Bra-635 (2002-2007 USDA Agricultural Baseline Projections). Actual yields are from Exhibit Bra-562 (Cotton and Wool Situation Outlook and Yearbook, USDA, November 2006, Table 2, available at http://usda.mannlib.cornell.edu/usda/current/CWS-yearbook/CWS-yearbook-11-21-2006.pdf). Yields used by the U.S. in their planting decisions analysis is from Exhibit US-139.

to predict both the weather and their yields. And it is unreasonable for the United States to now suppose that U.S. farmers, but not USDA, anticipated the dramatic increases in yield in MY 2004 and MY 2005. Table 3 also shows that the yields used by the United States in their planting decisions analysis significantly overstated the expectations of upland cotton farmers. The yields used by the United States in its analysis are, on average, 24 percent greater than USDA baseline projections. Correcting this flaw in the U.S. analysis, once again, invalidates the U.S. conclusions that "shifts in U.S. planted acreage were consistent with what one would expect."[184]

119. In sum, the new U.S. planting decision analysis is based on unsupported assertions that result in a biased and result-orientated conclusion to attempt to argue that mandatory and price-contingent subsidies constituting 40 percent of the market value of a basic commodity product have no effect on production. This analysis should be rejected by the compliance Panel.

120. As Brazil demonstrated in its own analysis, a proper assessment of U.S. upland cotton producers' plantings decisions demonstrates that, but for marketing loan and counter-cyclical subsidies, it would have been economically rational for them to switch to the production of alternative crops nearly every year.[185]

121. Finally, even assuming, *arguendo*, that the flawed U.S. analysis demonstrates that upland cotton farmers planting decisions move generally in the <u>same direction</u> as might be expected from market signals, the U.S. analysis fails to refute the original panel's basic finding that these subsidies "numb" U.S. producers reactions. The United States analysis does *not* demonstrate that the <u>extent</u> to which U.S. producers have changed upland cotton plantings is consistent with the extent to which U.S. upland cotton producers would have changed their plantings *but for* the subsidies.

122. The original panel found, and Brazil demonstrates with updated evidence, that upland cotton producers are numbed from market signals, not completely deadened. The elimination of subsidies that account for an average of 40 percent of the market value of upland cotton and cover an average of 29 percent of total costs over the life-time of the FSRI Act of 2002 would cause a significant shift of acreage to alternative uses now providing higher net returns. Brazil again recalls that the issue before the compliance Panel is not whether the general *direction* of U.S. planted acreage correlates with expected revenue from upland cotton and other crops. The issue before the compliance Panel is whether U.S. upland cotton acreage would be lower and world market price higher but for marketing loan and counter-cyclical subsidies. One relevant piece of evidence of the effects of these subsidies is the fact that their revenue-stabilizing effect numbs U.S. upland cotton producers' reactions to market price signals.

54. Could the United States explain whether, and, if so, why, it is of the view that this Panel should not rely on the findings and analysis by the original Panel regarding the effects of marketing loan and counter-cyclical payments on production and exports? Please comment in particular on paras. 7.1291, 7.1295, 7.1302, 7.1349, 7.1353 of the Panel Report.

123. In its response, the United States asks the compliance Panel to revisit the original panel's findings regarding marketing loan and counter-cyclical subsidies. These adopted findings should be followed by the compliance Panel. Prior adopted panel and Appellate Body reports create "legitimate expectations" among WTO Members, and should be taken into account by panels when they are relevant to the resolution of a dispute.[186]

[184] U.S. 2 April response to question 53(c), para. 99.
[185] *See* Brazil's Oral Statement, paras. 63-78 and Brazil's Comments on the U.S Oral Statements, paras. 13-27. As Brazil explained in its Comments on the U.S. Oral Statements, using total costs or variable costs does not change the relative attractiveness of producing upland cotton versus corn or soybeans.
[186] Appellate Body Report, *U.S. – Softwood Lumber V*, para. 111.

124. This is particularly the case where particular issues and questions of fact before a panel are the same as those previously examined by the Appellate Body. In such a situation, it is "not only appropriate," but to "be expected," that the panel would follow the Appellate Body's earlier conclusions.[187] With respect to compliance proceedings, in particular, the Appellate Body has stated that "Article 21.5 proceedings do not occur in isolation but are part of a '*continuum of events*.'"[188] The Appellate Body observed that "doubts could arise about the *objective nature* of an Article 21.5 panel's assessment if, on a specific issue, that panel were to *deviate* from the reasoning in the original panel report in the absence of any change in the underlying evidence."[189] The compliance panel in *U.S. – Gambling (21.5)* noted that "[a] re-assessment in a compliance proceeding of an issue that had already been ruled upon in an original proceeding in an adopted report, even with better arguments by the respondent but without a change relevant to the underlying facts in the intervening period, would run counter to the prompt settlement of disputes."[190] The United States is not entitled to re-litigate an issue that has been definitively resolved for purposes of this dispute.

125. As a factual matter, Brazil recalls that the evidence regarding the nature of marketing loan and counter-cyclical payments remains unchanged, that their magnitude in MY 2005 is even larger than the magnitude assessed by the original panel for MY 2002 and that the conditions of competition in the world market for upland cotton have not changed in any fundamental way since the original panel's assessment. Therefore, there is no basis of the United States to argue that the compliance Panel should disregard and/or overturn the findings of the original panel, as upheld by the Appellate Body. Brazil addresses the specific U.S. arguments raised in response to this question in the context of its comments on other U.S. responses. Specifically:

- With respect to the U.S. arguments concerning the production effects of marketing loan subsidies[191], Brazil refers to the compliance Panel to its comments on the U.S. response to question 53, above.

- With respect to the issue of production effects from counter-cyclical payments supporting the production of upland cotton, Brazil refers the compliance Panel to its comments on the U.S. response to questions 53, above, and 56/57, below.[192]

- With respect to the cost of production related issues raised by the United States in response to this question[193], Brazil refers the compliance Panel to its comments on the U.S. response to question 59, below.

56. The United States has cited new empirical research on the production effects of counter-cyclical payments. How does the United States address Brazil's criticism that none of this research has dealt specifically with the effects of countercyclical payments under the FSRI Act of 2002 on upland cotton? (Rebuttal Submission of Brazil, para. 120)

57. The United States has offered the Lin and Dismukes (Exhibit US-34) and Westcott (US-35) studies as examples of new empirical research on the production effects of countercyclical payments.

a) Is it not more accurate to characterize the Lin and Dismukes study as a simulation of the possible effect of countercyclical payments on production rather than a study on

[187] Appellate Body Report, *U.S. – OCTG Sunset Reviews*, para. 188.
[188] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 103 (emphasis added) citing Appellate Body Report, *Mexico – Corn Syrup (21.5)*, para. 121. *See* Brazil's First Written Submission, para. 28.
[189] Appellate Body Report, *U.S. – Softwood Lumber VI (21.5)*, para. 103 (emphasis added).
[190] Panel Report, *United States – Gambling (Article 21.5)*, para. 6.53.
[191] U.S. 2 April response to question 54, paras. 108-110.
[192] U.S. 2 April response to question 54, paras. 111-115.
[193] U.S. 2 April response to question 54, paras. 117-120.

the actual impact of the payments since it does not statistically estimate the effect of the actual payments (which began only in 2002) on crop production? (Please refer to pages 9-12 of the paper which describe the data, covering the period 1991-2001, used for the study).

b) How does the United States deal with Brazil's characterization of the Westcott study as offering no new empirical evidence, and instead, being a qualitative discussion, much like that presented to the original panel (see para 128 of Brazil's rebuttal)?

126. Brazil provides below consolidated comments on the U.S. responses to questions 56 and 57.

127. The United States argues that since the original proceeding there "have been a number of studies conducted regarding the effects of the [counter-cyclical] program."[194] This statement is not correct with respect to counter-cyclical payments for upland cotton. No empirical study has specifically examined the effect of counter-cyclical payments on upland cotton production and the United States has cited one empirical study on the effect of counter-cyclical payments generally.[195] As noted by the compliance Panel in question 57(a), this study, by Lin and Dismukes, is a simulation of the possible effect of counter-cyclical payments on production, rather than a study on the actual impact of the subsidies. The dearth of studies, as implied by the compliance Panel's question, is due to the fact that the program is relatively new. However, the absence of specific studies does not constitute a basis for the United States to argue that Brazil has not met its burden of demonstrating that there remains a the strong positive link, found by the original panel, between counter-cyclical payments and the production of U.S. upland cotton.

128. The original panel found that counter-cyclical contributed to serious prejudice based on an examination of the structure, design and operation of the program.[196] As Brazil explained, the few studies that have been conducted since then support the finding that counter-cyclical subsidies contribute to serious prejudice.[197]

129. As explained by Professor Sumner, there are at least five major mechanisms through which counter-cyclical payments have the potential to affect production.[198] The study by Lin and Dismukes examined only two of these mechanisms.[199] Beyond that, the study solely examined counter-cyclical subsidies for corn, wheat and soybeans in the Midwest. In its 2 April response to questions 64 and 65, Brazil provided a number of reasons why counter-cyclical subsidies for upland cotton would be expected to have significantly greater effects on production that counter-cyclical subsidies for these field crops in the Midwest. [200] For convenience, Brazil lists these factors in the following chart, comparing counter-cyclical subsidies for upland cotton to counter-cyclical subsidies for the commonly studied field crops in the Midwest.

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[194] U.S. 2 April response to question 56, para. 123.

[195] Brazil also cited one study by McIntosh, Shrogren and Dohlman on the effect of counter-cyclical payments that found significant production impacts from counter-cyclical subsidies. *See* Brazil's 2 April response to question 64.

[196] Panel Report, *U.S. – Upland Cotton*, paras. 7.1301-7.1302.

[197] Brazil's First Written Submission, paras. 167-185; Brazil's Rebuttal Submission, paras. 69-70, 119-123 or Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments), paras 42-47.

[198] These include reducing risk associated with price variability, increasing investment through wealth effects, reducing risk aversion through wealth effects, constraining production choices because of planting restrictions, and increasing incentives to plant because of base acre updating. *See* "Analysis of Effects of U.S. Upland Cotton Subsidies on Upland Cotton Prices and Quantities by Daniel A. Sumner," Brazil's First Written Submission, Annex I, paras. 59-64.

[199] These include reducing risk associated with price variability and reducing risk through wealth effects. *See* Exhibit Bra-659 (Statement of Professor Sumner Concerning Various U.S. Arguments, para.)

[200] Brazil's 2 April response to questions 64 and 65.

Table 4 – Comparison of CCPs for Cotton and CCPs for Soybeans, Corn and Wheat in the Midwest

	Upland Cotton	Soybeans, Corn and Wheat in the Midwest
Frequency of CCP Subsidies[201]	• Every year under the FSRI Act • Maximum CCPs in three out of four years	• No CCPs for wheat • No CCPs for soybeans • CCPs for corn in two out of four years; subsidies below their maximum in both years
Maximum Size of Payments[202]	• CCP of $75 per acre (19 percent of target price)	• Corn CCP of $39 per acre (15 percent of target price) • Wheat CCP of $20 per acre (17 percent of target price) • Soybean CCP of $10 per acre (6 percent of target price)
Maximum CCPs and Production Costs[203]	• 14 percent of production costs	• Corn: 10 percent of cost of production • Wheat: 10 percent of production costs • Soybean: 4 percent of production costs
Substitute Crops	• Peanuts, rice, corn, soybeans, hay, sorghum, fruits, vegetables, melons and wild rice	• Very few substitute crops • Many regions plant corn and soybeans exclusively
Supply Elasticities	• High supply elasticities	• Low supply elasticities

130. As demonstrated in Table 4, upland cotton counter-cyclical subsidies are larger and paid out far more frequently than counter-cyclical subsidies for major field crops in the Midwest. In addition, counter-cyclical subsidies cover a greater portion of upland cotton producers' costs of production then they do for soybeans, corn and wheat. It follows from these basic differences that the effect of counter-cyclical subsidies for upland cotton is greater than that for major field crops in the Midwest. The availability of substitute crops is another significant reason why counter-cyclical payments for upland cotton have a larger effect on acreage and production that they do for corn, wheat and soybeans. Upland cotton acreage can more readily switch to the production of other crops and, thus, has a higher elasticity of supply than soybeans, corn and wheat. The collective effect of these differences is to dramatically increase the ability of upland cotton counter-cyclical payments to reduce risks associated with price variability and ultimately, increase supply as compared with counter-cyclical payments for soybeans, corn and wheat.

131. For all these reasons, upland cotton counter-cyclical subsidies greatly reduce the risk of producing upland cotton. They do so, however, only when upland cotton is grown on upland cotton base, as only under this scenario is there the revenue stabilizing effect resulting from the combination of *upland cotton* market revenue and *upland cotton* price-contingent counter-cyclical subsidies. This is the reason that the vast majority of U.S. upland cotton is grown on upland cotton base.

132. The studies cited by the United States do not and can not address this crucial issue because the data on upland cotton base and upland cotton plantings is not available in the public domain.[204] Yet, this information was available to the original panel, and the same data is available to the

[201] Exhibit Bra-675 (Updated Program Crop Comparison, March 2007).
[202] Exhibit Bra-675 (Updated Program Crop Comparison, March 2007).
[203] Compare Exhibit Bra-675 (Updated Program Crop Comparison, March 2007) to U.S. 2 response to question 53, para. 101.
[204] *See, e.g.,* Brazil's attempt to obtain this data through a Freedom of Information Act request was rejected. *See* Exhibit Bra-689 (Freedom of Information Act Rejection Letter).

compliance Panel. Based on the data available to the original panel, it correctly rejected the United States attempt to argue that counter-cyclical payments were "decoupled" from production.[205] Instead, it found a "strongly positive relationship"[206] between historic upland cotton producers receiving upland cotton counter-cyclical subsidies and *current* upland cotton producers. It also found that these subsidies allowed U.S. producers to remain farming upland cotton because they were an important contributor to the total cost of production.[207] None of the studies of counter-cyclical subsidies discuss such crucial data.

133. In response to this finding, the United States now claims that the fact that 96 percent of U.S. upland cotton is produced on farms with upland cotton base acres[208] should not be surprising because upland cotton was grown historically, and continues to be grown today, on land particularly suited for upland cotton.[209] Yet, this is precisely the basis for the original panel's finding that the high per-acre upland cotton counter-cyclical payments were connected with the *current* production of upland cotton.[210] By this admission, the United States confirms that when Congress set very high per-acre payments for upland cotton base acres, it did so intending that the payments would be used to allow producers of upland cotton to cover their high costs of production. That is exactly what the National Cotton Council asked for prior to the FSRI Act of 2002.[211] Congress would not provide counter-cyclical subsidies to historic cotton producers that are *seven* times higher per-acre than those for historic soybean producers if it thought that the upland cotton producers would grow soybeans.[212]

134. Thus, the structure, design and operation of the counter-cyclical subsidies is to specifically enable farmers that historically had planted high-cost upland cotton to continue to plant upland cotton. This is exactly what has happened. Almost all (96 percent) of U.S. upland cotton continues to be grown on farms with upland cotton base acres.[213] These farmers know that the counter-cyclical subsidy will be paid if the price received by the U.S. producer falls below the target price of $0.724 per pound. And the average U.S. upland cotton farmer covered 10 percent of its total cost of production with counter-cyclical payments over the life-time of the FSRI Act of 2002.[214] This evidence, not studies of counter-cyclical subsidies for other crops, demonstrates the linkage between U.S. counter-cyclical subsidies, upland cotton plantings, supply and world market prices.

58. The Unites States stated that the key consideration in assessing a farmer's decision to grow upland cotton is whether the farmer has been covering his variable costs of production. In this connection, it presented upland cotton costs and returns estimates for marketing years 1999-2005 (Exhibit US-47). Brazil has disputed the absence of certain items – land, labour and capital recovery costs - in the US calculations of variable costs. In response, the United States has referred to the Commodity Costs and Returns Estimation Handbook (Exhibit US-88) prepared by a Task Force of the American Agricultural Economics Association as the basis for leaving out these items in its

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[205] Panel Report, *U.S. – Upland Cotton*, paras. 7.634-7.647.

[206] *See, e.g.*, Panel Report, *U.S. – Upland Cotton*, paras. 7.6377.1362.

[207] The original panel stated that "United States upland cotton producers would not have been economically capable of remaining in the production of upland cotton had it not been for the United States subsidies at issue and that the effect of the subsidies was to allow United States producers to sell upland cotton at a price lower than would otherwise have been necessary to cover their total costs." Panel Report, *U.S. – Upland Cotton*, para. 7.1353.

[208] Brazil's Rebuttal Submission, Table 3 at para.157. Results are from U.S. First Written Submission, table at para. 224.

[209] U.S. 2 April response to question 54, para. 115.

[210] Panel Report, *U.S. – Upland Cotton*, para. 7.1362.

[211] Exhibit Bra-109 (Testimony (Full) of Robert McLendon, Chairman, NCC Executive Committee, Before the House Agricultural Committee. National Cotton Council (NCC)).

[212] Exhibit Bra-675 (Updated Program Crop Comparison, March 2007).

[213] Brazil's Rebuttal Submission, Table 3 at para.157. Results are from U.S. First Written Submission, table at para. 224.

[214] *See* Exhibit Bra-477 (U.S. Upland Cotton Costs and Returns).

calculations. However, the Task Force which authored the Handbook does not use the categories "fixed" or "variable" costs and in fact recommends that the microeconomic concepts of fixed and variable costs not be used in preparing and reporting cost and return estimates. Page 2-67 of the Handbook states:

> The Task Force therefore recommends that costs should be categorized only as to whether they are associated with expendable factors or the services of capital assets. The division of costs into categories such as fixed and variable should generally be avoided in preparing CAR estimates. For the purpose of preparing CAR estimates for specific enterprises, the Task Force recommends that all the costs of all expendables be allocated to the generic group OPERATING COSTS and that all other costs be allocated to the group ALLOCATED OVERHEAD.

Would the United States clarify whether the categories "operating costs" and "allocated overhead" correspond to the economic concepts of fixed and variable costs? In particular, are "operating costs" variable costs or not? Would the United States please indicate whether, and if so, where, the Handbook makes these clarifications or distinctions.

135. Brazil welcomes the United States' acknowledgement that operating costs are distinct from variable costs.[215] However, having done so, the United States continues to blur the distinction between the two. For example, the United States claims that "Brazil has attempted to include as 'variable' or 'operating' costs, costs that are not in fact 'expendable in a single defined period' including land, unpaid labor, and capital recovery costs."[216]

136. This statement is not consistent with the earlier U.S. acknowledgment[217] that "operating costs" and "variable costs" are distinct economic concepts. Nor is it correct. To clarify, Brazil does not consider land, unpaid labor and capital recovery costs to be "operating costs". Brazil does, however, consider these costs to be wholly, or in part, "variable costs".[218] Brazil's approach is entirely consistent with the approach detailed in the American Agricultural Economics Association ("AAEA") Handbook.

137. Brazil also welcomes the United States acknowledgment that "allocated overhead" differs from "fixed costs".[219] The United States then criticizes Brazil's inclusion of fixed costs and/or imputed (or non-cash) cost as part total costs in its cost of production and planting decision analyses.[220] Brazil responds to these arguments in its comments on the U.S. response to question 59, below, in which Brazil address comprehensively issues related cost of production and plantings decisions that the United States raised in its 2 April responses to questions.

59. In discussing the impact of long-term costs of production (and hence long-term profitability) of upland cotton production on farmers' decisions to exit cotton farming, the United States argues that income from other crops and off-farm income must be into account. Why does the United States consider these issues relevant given the original Panel's decision that "off farm income" is not a legally relevant consideration. (Panel Report, para. 7.1354, footnote 1470) Please respond to Brazil's arguments on this matter in paragraphs 249-253 of its Rebuttal Submission.

[215] U.S. 2 April response to question 58, para. 132.
[216] U.S. 2 April response to question 58, para. 134 (emphasis added).
[217] U.S. 2 April response to question 58, para. 133.
[218] Brazil's Rebuttal Submission, paras. 254-283.
[219] U.S. 2 April response to question 58, para. 136.
[220] U.S. 2 April response to question 58, paras. 135-136.

138. In response to a limited question by the compliance Panel concerning income from other crops and off-farm income, the United States launches into a lengthy discussion of farm bankruptcy.[221] The United States response misses the point of the compliance Panel's question.

139. Contrary to the U.S. response, Brazil does not assert that the major issue before this compliance Panel is whether upland cotton farmers would exit farming altogether *but for* marketing loan and counter-cyclical subsidies. Rather, the relevant question, as stated in question 59, is whether farmers would exit "cotton farming," that is, would they discontinue planting upland cotton. The evidence presented by Brazil demonstrates that a significant percentage of U.S. upland cotton farmers would exit the production of upland cotton. [222]

140. Throughout this proceeding, the United States, understandably, has sidestepped the $12.4 billion gap between upland cotton producers' total costs of production and market returns over the past seven years. U.S. arguments have shifted from highlighting the importance of whole-farm costs[223], to relying on cost and return data in the high price year of MY 2003[224], and finally, to attacking USDA's own cost of production data itself.[225] Yet, none of these arguments individually or collectively explains how an industry that would have lost $12.4 billion without subsidies over the past seven years[226] is economically viable.

(a) Whole Farm Costs Are Irrelevant

141. The U.S. argument that whole-farm costs are relevant to upland cotton production decisions[227] is simply not logical. Why would a farmer cross-subsidize the production of upland cotton – in effect subsidizing foreign purchasers of low-priced/high-cost U.S. upland cotton – with income from other crops or from off-farm income? The United States does not answer that question. Instead, it highlights studies which find that farmers increasingly supplement their income with off-farm work.[228] Brazil does not dispute these studies or this trend. Yet, the fact that U.S. upland cotton farms earn income from growing other crops or in other sectors of the economy is not relevant to these proceedings. As the original panel found, "[w]e are considering costs and market revenues in respect of upland cotton. Our examination is one of the upland cotton industry … We are not looking into the possibility of cross-subsidization or cross-financing of insufficient market revenues for upland cotton that may have come from other United States industries."[229] Moreover, as the studies submitted by the United States point out, the issue of off-farm income is of particular importance for small farms.[230] And as these studies also point out, most U.S. upland cotton production occurs on

[221] U.S. 2 April response to question 59, paras. 137-142.

[222] *See* Brazil's First Written Submission, Section 7.11; Brazil's Rebuttal Submission, Section 2.3.6; Brazil's Opening Statement, Section 2.4; and Brazil's Comments on U.S. Oral Statements, Section 4.

[223] U.S. First Written Submission, paras. 293-297; U.S. Rebuttal Submission, paras. 344-348; and U.S. 2 April response to question 59, paras. 155-157.

[224] U.S. Rebuttal Submission, para. 337; U.S. Opening Statement, paras. 11-13; and U.S. 2 April response to question 59, paras. 144-145.

[225] U.S. 2 April response to question 59, paras. 147-154.

[226] Brazil's Oral Statement, para. 57.

[227] U.S. 2 April response to question 59, paras. 155-157.

[228] The United States repeatedly quotes a portion of one of these studies which finds that "[o[ff-farm work could hypothetically effect exits in two ways" (U.S. Answers to Second Set of Questions, para. 156). As explained above, the question before this compliance Panel is not whether farmers would go bankrupt. It is whether a farmer would stop producing upland cotton. Furthermore, the "hypothetical" effects of off-farm income on farm-exits is no more than a theory. *See* Exhibit US-46 (Hoppe, Robert A. and Korb, Penni. "Understanding U.S. Farm Exits." Economic Research Service Report 21. June 2006, p. 20).

[229] Panel Report, *U.S. – Upland Cotton*, para. 1354, footnote 1470.

[230] U.S. 6 March response to question 31, para. 30.

farms that have very big commercial operations.[231] The U.S. argument is, therefore, not even relevant to the vast majority U.S. upland cotton production.

(b) MY 2003 Cost Data Is Atypical

142. Much of the distorted U.S. analysis of "costs" rests on its reliance on an unusual year – MY 2003.[232] This year was unusual because it was the first – and only time – in the history of the FSRI Act of 2002 (and the first time in eight years) that U.S. farmers actually earned a profit ($65 per acre) based solely on market revenue. The United States understandably focuses its arguments on MY 2003 cost of production data in its Rebuttal Submission and subsequent submissions.[233] In doing so, however, it fails to acknowledge several important points.[234]

143. First, the U.S. MY 2003 cost data is not materially different from what Brazil has used during this entire proceeding. The only difference is that it is broken down into three arbitrary cost groups – low, medium and high.[235] When all cost groups are aggregated, the average acre planted to upland cotton made a profit of $65. Brazil's assertions regarding the seven-year $837 loss on each acre planted to upland cotton is based exclusively on USDA cost data and *includes* the average profit of $65 per acre achieved in MY 2003.[236] Therefore, the United States assertion that "Brazil ask[ed] the Panel to simply ignore this data"[237] is incorrect. Far from ignoring the data, Brazil used *the same USDA data* in its First Written Submission, Rebuttal Submission and Oral Statement.[238]

144. Second, the United States failed to acknowledge that MY 2003 is the only year in the past eight in which the U.S. producers covered their total costs of production only with market revenue. In its response to this question, the United States has finally acknowledged that "prices in MY 2003 were high."[239] However, the United States now argues that that most producers nevertheless would have covered their total costs in MY 2004 and 2005 because of, *inter alia*, increasing yields.[240] USDA data squarely contradicts this statement: the data clearly show that the average acre planted to upland cotton lost $18 in MY 2004 and $88 dollars in MY 2005.[241]

145. Third, U.S. producers' costs are increasing significantly in MY 2006. National average yields are estimated to be 668 pounds per planted acre in MY 2006, far lower than yields of 806 pounds per

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[231] U.S. 6 March response to question 31, para. 30.
[232] U.S. 2 April response to question 59, paras. 144-146.
[233] U.S. Rebuttal Submission, para. 337; U.S. Opening Statement, paras. 11-13; and U.S. 2 April response to question 59, paras. 144-145.
[234] U.S. Opening Statement, paras. 11-12; U.S. 6 March Response to Question 29, para. 20; and U.S. 2 April response to question 59, paras. 144-146.
[235] Brazil notes that the U.S. also adjusts the data to exclude costs and returns associated with cottonseed.
[236] *See* Exhibit Bra-477 (U.S. Upland Cotton Costs and Returns); *see also* Exhibit Bra-475 (U.S. Cotton Producers Costs and Returns Per Planted Acre, Excluding Government Payments, Economic Research Service, USDA, accessed October 2006 at http://www.ers.usda.gov/data/costsandreturns/testpick.htm).
[237] U.S. 2 April response to question 59, para. 145.
[238] *See*, *e.g.*, Brazil's First Written Submission, paras. 156-164.
[239] U.S. 2 April response to question 59, para. 145.
[240] U.S. 2 April response to question 59, para. 145.
[241] Exhibit Bra-477 (U.S. Upland Cotton Costs and Returns); *see also* Exhibit Bra-475 (U.S. Cotton Producers Costs and Returns Per Planted Acre, Excluding Government Payments, Economic Research Service, USDA, accessed October 2006 at http://www.ers.usda.gov/data/costsandreturns/testpick.htm). Brazil notes that USDA's use of harvest period prices underestimates losses in MY 2004. The harvest period (Oct-Nov) farm price of upland cotton was 51 cents per pound (Exhibit Bra-477), while the marketing year average farm price was just 42 cents per pound (Exhibit Bra-448 (Cotton and Wool Situation Outlook and Yearbook, USDA, November 2005, p. 38, accessed October 2006 at http://usda.mannlib.cornell.edu/usda/current/CWS-yearbook/CWS-yearbook-11-25-2005.pdf)).

planted acre in MY 2004 and 799 pounds per acre in MY 2005.[242] Further, U.S. producers are faced with significantly higher seed, fertilizer, and fuel costs in MY 2006 than in MY 2003-2005.[243] Total costs in MY 2006 are forecasted to be 10 percent higher than their MY 2003-2005 average.[244] With market prices remaining low throughout the first eight months of MY 2006[245], the loss based on market revenue is expected to significantly widen in MY 2006 compared to MY 2003-2005.[246]

146. Fourth, the United States makes the remarkable assertion that "there is no basis to assume that the [MY 2003] results would have been substantially different in later years"[247] However, unlike MY 2003, when the average U.S. farm price was $0.62 per pound[248], the average farm price was $0.416 per pound in MY 2004 and $0.477 per pound in MY 2005.[249] The current average farm price for MY 2006, as of April 2007, is $0.472 per pound.[250] Thus, there is no way that the average "mid-cost" producer, with total costs of $0.57 per pound, covered his or her total costs of production in those years. Nor will those costs be covered in MY 2007.[251]

147. In any event, breaking upland cotton farms into arbitrary cost groups is neither necessary nor particularly relevant. It is far more appropriate for this compliance Panel, like the original panel, to examine national average cost of production data to get a complete picture of the U.S. upland cotton industry. Indeed, the Appellate Body in *Canada Dairy (21.5 II)* found that

> [i]t, therefore, seems to us that the benchmark should be a single, industry-wide cost of production figure, rather than an indefinite number of cost of production figures for each individual producer. The industry-wide figure enables cost of production data for producers, as a whole, to be aggregated into a single, national standard that can be used to assess Canada's compliance with its international obligations.[252]

148. Using national average data certainly does not "obscure" cost of production data as the United States suggests.[253] Brazil, the United States and the compliance Panel are all aware that upland cotton farmers have different cost structures. In any given year, about half of the acres planted to upland cotton have costs that are higher than the national average, while the other half has costs that are less than the national average. This is nothing more than basic statistics. It follows, therefore, that in years when the average acre planted to upland cotton lost money (six of the past seven years) more than half of the acreage planted to upland cotton suffered a loss. In this context, it is import to recall that Professor Sumner's analysis suggests that 17-19 percent of U.S. production of upland

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[242] For yields in MY 2004 and 2005, *see* Exhibit Bra-562 (Cotton and Wool Situation Outlook and Yearbook, USDA, November 2006, Table 2, available at http://usda.mannlib.cornell.edu/usda/current/CWS-yearbook/CWS-yearbook-11-21-2006.pdf). For yields in MY 2006, *see* Table 1 from the April 2007 Cotton and Wool Outlook, accessed April 2007 at http://www.ers.usda.gov/Briefing/Cotton/Data/COTTONTABLE1.xls.

[243] *Compare* seed, fertilizer and fuel costs in Exhibit Bra-475 (U.S. Cotton Producers Costs and Returns Per Planted Acre, Excluding Government Payments, Economic Research Service, USDA, accessed October 2006 at http://www.ers.usda.gov/data/costsandreturns/testpick.htm) and Exhibit Bra-575 ("Cost-of-production forecasts for U.S. major field crops, 2006-2008F," Economic Research Service, USDA, accessed January 2007 at http://www.ers.usda.gov/data/costsandreturns/data/Forecast/cop_forecast.xls).

[244] Exhibit Bra-634 (Analysis of Planting Decisions Based on Expected Returns).

[245] *See* Brazil's Comments to Question 82 below.

[246] Based on partial year USDA and FAPRI data, the loss is expected to be $116 per acre, *see* Exhibit Bra-648 (Actual Costs and Returns Analysis).

[247] U.S. 2 April response to question 59, para. 145.

[248] U.S. 2 April response to question 59, para. 145.

[249] Exhibit Bra-562 (Cotton and Wool Situation Outlook and Yearbook, USDA, November 2006, p. 36, available at http://usda.mannlib.cornell.edu/usda/current/CWS-yearbook/CWS-yearbook-11-21-2006.pdf)

[250] *See* Table 1 from the April 2007 Cotton and Wool Outlook, accessed at http://www.ers.usda.gov/Briefing/Cotton/Data/COTTONTABLE1.xls.

[251] *See* Brazil's comments on the U.S. response to question 82, below.

[252] Appellate Body Report, *Canada – Dairy (21.5 II)*, para. 96.

[253] U.S. 2 April response to question 59, para. 144.

cotton would cease without marketing loan and counter-cyclical subsidies.[254] This is consistent with the notion that only higher-cost U.S. producers would exit upland cotton production without these subsidies.

149. Thus, the various U.S. cost-related arguments based on MY 2003 data are entirely misplaced. The reference period of MY 2005 demonstrates significant losses by the average acre of upland cotton of $88 per acre. These losses are set to increase to an estimated $116 per acre in MY 2006.[255] These are significant losses and above the average $65 per acre loss per year over the lifetime of the FSRI Act of 2002.[256]

(c) USDA's Total Cost of Production Data is Relevant and Appropriate

150. For the first time in *this* proceeding, the United States attacks the total cost of production data itself, arguing that it "provides a stylized, abstract view"[257] and is used by Brazil in a way in which "it was never intended."[258] These criticisms echo similar arguments made by the United States in the original proceeding.[259] These old U.S. arguments attacking its own USDA cost data were properly rejected by the original panel.[260] The renewed arguments should again be rejected by this compliance Panel.

151. The United States criticism of USDA's own total cost data is two-fold.[261] First, the U.S. criticizes the method by which USDA values non-cash costs, such as imputed farm labor and land ownership costs.[262] Second, the United States argues that USDA's total cost data is not an appropriate indicator of the financial viability of upland cotton farming because it includes non-cash costs.[263] Both criticisms of USDA's cost data are without merit.

152. The United States challenge to USDA's analysis of non-cash costs squarely contradict basic economic and accounting principles. Non-cash costs, such as ownership costs and opportunity costs, are real, not imaginary, costs, as the U.S. suggests. Indeed, USDA explains that:

> [c]ommodity costs and returns include estimates of both cash expenditures and noncash costs. Cash expenditures are incurred when factors of production are purchased or rented. Noncash costs occur when factors are owned. For example, if a farmer fully owns the land used to produce corn, he/she would have no expenditure for land rental or for loans to pay for the purchase of land. *Yet, an economic cost arises. By owning the land and using it to grow corn, the farmer foregoes income from other uses of the land, such as renting it to another producer. These costs come about because production resources are limited and have alternative uses.* If a farmer uses savings to pay for operating inputs, such as seed, fertilizer, chemicals, and fuel, and thus pays no interest on operating loans, the farmer still incurs an economic cost because the savings could have earned a return in another use. Likewise, the farmer has an opportunity cost of his/her labor used in the production of

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[254] Brazil's First Written Submission, para. 167.

[255] Market returns minus total costs was reduced by the product of 5 percent and total costs, *see* Exhibit Bra-648 (Actual Costs and Returns Analysis).

[256] Exhibit Bra-477 (U.S Upland Cotton Costs and Returns).

[257] U.S. 2 April response to question 59, para. 147.

[258] U.S. 2 April response to question 59, para. 143.

[259] *See e.g.*, Section F of U.S. Further Rebuttal Submission from the original proceeding, 18 November 2003**.**

[260] Panel Report, U.S. – Upland Cotton, paras. 7.1353-7.1354.

[261] U.S. 2 April answer to question 54, para. 119.

[262] U.S. 2 April answer to question 54 and 59, paras. 119, 147-151.

[263] U.S. 2 April answer to question 54 and 59, paras. 119, 152-154.

the commodity because it could have been used on another farm or in off-farm employment.[264]

153. The need to cover total costs of production, including both cash and non-cash costs, is an economic reality facing all farmers. No farmer would or could repeatedly plant his fields with a chronically loss-making crop. There is no basis for the U.S. assumption that farmers do not take into account non-cash "opportunity" costs when making production decisions. This assumption is directly contradicted by USDA economists who include both cash and non-cash costs in their cost and returns estimates.

154. The need for producers to cover total costs of production was recently highlighted by the Appellate Body in *EC – Sugar*. The Appellate Body found that

> in the ordinary course of business, an economic operator makes a decision to produce and sell a product expecting to recover the total cost of production and to make profits. Clearly, sales below total cost of production cannot be sustained in the long term, unless they are financed from *some other sources*.[265]

155. The "some other sources" in this case that cover total costs of production are marketing loan and counter-cyclical subsidies. Without such subsidies, average seven-year losses totalled $837 per acre. With these two subsidies, the average acre showed a seven-year profit of $104 per acre.[266]

156. As noted by the Appellate Body, not only is an economic operator expected to cover his or her total costs of production, but he or she is also expected to make a profit. Brazil notes that USDA also recognizes the need for farmers to make a profit. USDA defines "residual return to management and risk" as follows:

> *[r]esidual returns to management and risk* is the difference between the gross value of production and total economic costs. The return to management and risk indicates the extent to which longrun production costs are covered by production valued at average harvest-month prices.[267]

157. The Appellate Body's findings in *EC – Sugar* and USDA's definition of residual returns to management and risk demonstrate the importance of not only covering costs, but also of generating profits from farming. The ability of upland cotton farmers to cover their variable costs, let alone total costs, is not sufficient to show that marketing loan and counter-cyclical subsidies do not impact production.

158. Brazil's cost of production analysis has not previously factored in the obvious need to make profits on the farmers' investments. This is because the huge losses based only on market revenue readily demonstrate the decisive role played by marketing loans and counter-cyclical subsidies in sustaining revenue and large amounts of upland cotton production. But if the compliance Panel were to consider the need for farmers to generate some reasonable profit, the gap between market returns and such a profit margin obviously would be even greater. For example, assuming even a fairly low profit margin of only 5 percent, the *average* gap between market revenue and the five percent profit would increase to $1,017 per acre in the seven year period of MY 1999-2005. For MY 2005 alone,

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[264] *See* Commodity Costs and Returns: Methods, Economic Research Service, USDA, accessed April 2007 available at http://www.ers.usda.gov/Data/CostsAndReturns/methods.htm (emphasis added).

[265] Appellate Body Report, *EC – Sugar*, para. 266 (emphasis added).

[266] Exhibit Bra-477 (Upland Cotton Costs and Returns).

[267] *See* Definition of Residual Returns to Management and Risk, Economic Research Service, USDA, accessed April 2007 available at http://www.ers.usda.gov/data/CostsAndReturns/Glossary/def_resr.htm).

the gap would be $115 per acre – not the $88 per acre based on a break-even methodology.[268] The projected gap in MY 2006 would be $144 per acre, based on a five percent profit margin.[269]

159. Next, the new U.S. criticism of USDA's valuation methodologies ignores the fact that they were conceived by the American Agricultural Economics Association and implemented by USDA.[270] The data are based off of surveys that are generated in the ordinary course of USDA business.[271] The methods and data used to generate cost of production data are objective and appropriate. USDA explains that four approaches are used to estimate commodity costs, including (1) direct costing, (2) valuing input quantities, (3) indirect costing and (4) allocating whole-farm expenses.[272] The United States singles out only the fourth element for its criticism – not the other three.

160. Brazil notes that "allocating whole-farm expenses"[273] is only used by USDA to determine "general farm overhead" and "taxes and insurance."[274] These costs account for about 5 percent of upland cotton producers' total costs of production.[275] The other valuation methodologies used by the USDA cost survey are also properly used to address the question before this compliance Panel. USDA explains that "[u]npaid labor hours are valued using an estimate of the wages earned off-farm by farm operators"[276] and that "[l]and is valued according to the average cash rental rate for land producing the commodity in the particular area." [277] These relatively straightforward methodologies in no way distort or undermine an assessment of the financially viability of upland cotton farming using total costs of production.

161. Finally, the United States criticizes Brazil's use of USDA total costs of production data by highlighting the fact that the total cost of production was greater than market returns for nearly all U.S. field crops in MY 2005. Based on this fact, the U.S. argues that Brazil's planting decision analysis is "absurd"[278] and "fundamentally erroneous."[279] Neither Brazil nor the U.S. Congressional Research Service ("CRS"), an agency of the U.S. Government, would agree with this latest U.S. assertion. In fact, CRS confirms that "it is only with the aid of subsidies that a substantial portion of

[268] Annual market returns minus total costs were reduced by the product of 5 percent and total costs, *see* Exhibit Bra-477 (Upland Cotton Costs and Returns).

[269] Market returns minus total costs was reduced by the product of 5 percent and total costs, *see* Exhibit Bra-648 (Actual Costs and Returns Analysis).

[270] *See* Commodity Costs and Returns: Methods, Economic Research Service, USDA, accessed April 2007, available at http://www.ers.usda.gov/Data/CostsAndReturns/methods.htm.

[271] The data are collected in Agricultural Resource Management Surveys, s*ee* Commodity Costs and Returns: Methods, Economic Research Service, USDA, accessed April 2007 available at http://www.ers.usda.gov/Data/CostsAndReturns/methods.htm.

[272] *See* Commodity Costs and Returns: Methods, Economic Research Service, USDA, accessed April 2007, available at http://www.ers.usda.gov/Data/CostsAndReturns/methods.htm.

[273] U.S. 2 April answer to question 59, paras. 148-150.

[274] *See* Commodity Costs and Returns: Methods, Economic Research Service, USDA, accessed April 2007, available at http://www.ers.usda.gov/Data/CostsAndReturns/methods.htm.

[275] Exhibit Bra-475 (U.S. Cotton Producers Costs and Returns Per Planted Acre, Excluding Government Payments, Economic Research Service, USDA, accessed October 2006 at http://www.ers.usda.gov/data/costsandreturns/testpick.htm). In any event, it is appropriate to allocate costs to different crops based on their contribution to a farm's operating margin. It is the most reliable method of allocating costs that must be accounted for.

[276] *See* Commodity Costs and Returns: Methods, Economic Research Service, USDA, accessed April 2007, available at http://www.ers.usda.gov/Data/CostsAndReturns/methods.htm.

[277] *See* Commodity Costs and Returns: Methods, Economic Research Service, USDA, accessed April 2007, available at http://www.ers.usda.gov/Data/CostsAndReturns/methods.htm.

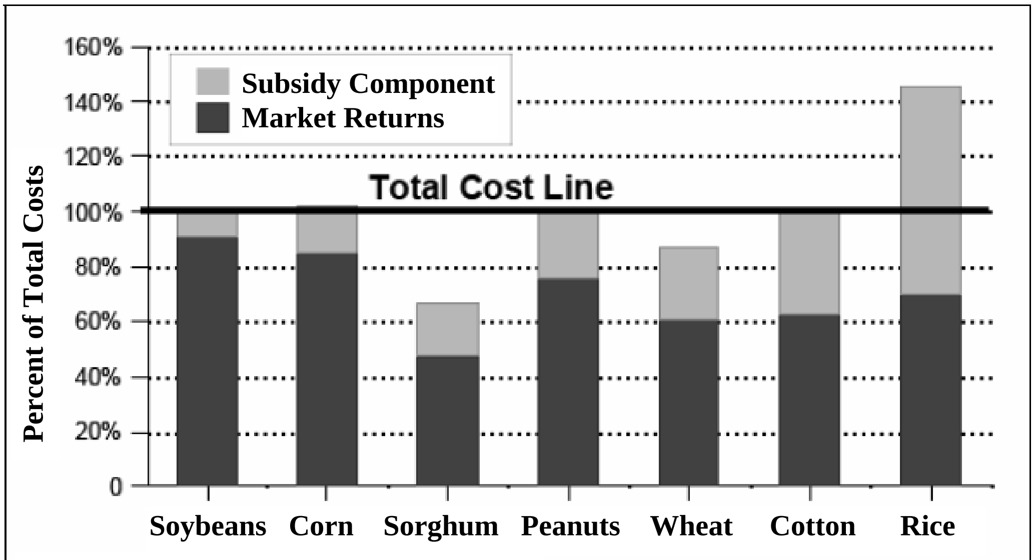
[278] U.S. 2 April response to question 59, para. 143.

[279] U.S. 2 April response to question 53(c), para. 102.

U.S. production [of all crops] is made economically viable."[280] CRS's analysis relied upon a graph of total costs versus market returns in selected periods[281] with and without subsidies as set out below:

Figure 5 – Excerpt from CRS Report to Congress[282]

Figure 1. U.S. Revenue Components as Share of Total Costs, Selected Program Commodities



Source: Calculated by CRS from USDA data.

162. Based on this chart calculated from USDA data, CRS concluded that "the substantial contribution of subsidies toward covering otherwise unmet production costs implies a high chance for adverse rulings for any of the major covered commodities."[283]

163. Indeed, data on farm income from USDA's Economic Research Service ("ERS") shows that, in MY 2005 as well as in previous years, the U.S. farm sector as a whole, *i.e.*, including crop and livestock production, has been viable based on an assessment of costs, farm-related revenues and government subsidies.[284] As the ERS Agricultural Income and Finance Outlook of November 2006

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[280] Exhibit Bra-577 (Schnepf, Randy, Potential Challenges to U.S. Farm Subsidies in the WTO, Congressional Research Service Report for Congress, 25 October 2006, p. 23).

[281] The periods vary across commodities based on the consistency of program operations and the availability of data. Corn and sorghum are for the period 1996-2004, soybeans and cotton are for the period 1997-2004, wheat is for the period 1998-2004, rice is for the period 2000-2004, and peanuts are for the period 2002-2004. *See* Exhibit Bra-577 (Schnepf, Randy, Potential Challenges to U.S. Farm Subsidies in the WTO, Congressional Research Service Report for Congress, 25 October 2006, p. 25).

[282] Exhibit Bra-577 (Schnepf, Randy, Potential Challenges to U.S. Farm Subsidies in the WTO, Congressional Research Service Report for Congress, 25 October 2006, p. 23).

[283] Exhibit Bra-577 (Schnepf, Randy, Potential Challenges to U.S. Farm Subsidies in the WTO, Congressional Research Service Report for Congress, 25 October 2006, p. 23). Brazil notes that consistent with the analysis conducted by CRS, both sorghum and wheat acreage has declined. Sorghum planted acreage declined by about 50 percent from MY 1996 to MY 2005. *See* USDA's Feedgrains database, available at www.ers.usda.gov/data/feedgrains.

[284] For detailed income data for 2003-2007, see www.ers.usda.gov/briefing/farmincome/data/nf_t2.htm, accessed April 2007.

points out, this is the case primarily due to record subsidy payments of $24.3 billion in MY 2005, with a significant portion of these payments received from "ad hoc and emergency programs".[285]

164. USDA data shows a profit of $222 million in MY 2005 from the production of soybeans, corn, sorghum, peanuts, wheat, upland cotton and rice – taking into account total costs, market returns and revenue from the marketing loan, counter-cyclical and direct payment program as well as crop insurance subsidies.[286] Production of certain crops in MY 2005, including upland cotton, resulted in losses based on market revenue alone.[287] Citing low prices in MY 2005, the United States government provided additional very high emergency payments amounting to $3.2 billion.[288] These additional subsidies are not accounted for in the above assessment of the overall financial viability of these seven crops.

165. Thus, the United States is incorrect when asserting that "U.S. farmers would have lost money *across the board* from producing *any* of these crops".[289]

166. To allow a more comprehensive assessment of the role of U.S. subsidies in ensuring the financial viability of U.S. program crop production, Brazil also provides the compliance Panel with data for the other years under the FSRI Act of 2002. Between MY 2002 and 2005, the gap between total costs and market returns for soybeans, corn, sorghum, peanuts, wheat, upland cotton and rice was $43 billion.[290] Marketing loan, counter-cyclical, direct and crop insurance subsidies to the same crops amounted to $53 billion, providing a $10 billion offset to shortfalls in revenue.[291] In addition, U.S. farmers received large emergency and disaster payments in totaled $8.5 billion over the MY 2002-2005 period.[292] This evidence demonstrates that large portions of U.S. program crop production, including upland cotton, are profitable *only* due to large U.S. subsidies.

167. In sum, in view of tens of billions in various forms of subsidies provided to program crops under the FSRI Act of 2002, CRS's and Brazil's conclusion reached based on USDA's cost and returns data are neither absurd nor unexpected. The United States' claim that Brazil's and CRS's methodology of assessing USDA's cost and return data would lead to the conclusion that all of U.S. agriculture is not viable even with subsidies is simply wrong. The USDA data discussed above shows that certain sectors of U.S. agriculture are not viable but for U.S. government subsidies. It also confirms Brazil's analysis[293] and the findings of the original panel[294] with respect to the profitability of growing upland cotton in the United States.

60. In its Rebuttal Submission, the United States argues that Prof. Sumner's description of the model that appeared in a recent CATO publication is not "appropriate" for use in a WTO dispute involving claims of serious prejudice. Professor Sumner has since introduced "more empirical and institutional detail" to the model used in this dispute. These changes are described in paragraphs 111-117 of Brazil's Opening Statement. Does the United States view these changes as being sufficient to make the model appropriate for use in a WTO dispute involving claims of serious

[285] *See* ERS Agricultural Income and Finance Outlook of November 2006, p. 4-5 accessible at http://usda.mannlib.cornell.edu/usda/current/AIS/AIS-11-30-2006.pdf, accessed April 2007.
[286] Exhibit Bra-690 (Crop Losses and Profits 2002-2005).
[287] *See* Exhibit Bra-690 (Crop Losses and Profits 2002-2005).
[288] *See* ERS Data on Direct Government Payments 2002-2007 at www.ers.usda.gov/Briefing/FarmIncome/Data/Government%20payments0207.xls, accessed April 2007.
[289] U.S. 2 April response to question 53, para. 101.
[290] *See* Exhibit Bra-690 (Crop Losses and Profits 2002-2005).
[291] *See* Exhibit Bra-690 (Crop Losses and Profits 2002-2005).
[292] *See* ERS Data on Direct Government Payments 2002-2007 at www.ers.usda.gov/Briefing/FarmIncome/Data/Government%20payments0207.xls, accessed April 2007.
[293] *See* Brazil's First Written Submission, Section 7.11; Brazil's Rebuttal Submission, Section 2.3.6; Brazil's Opening Statement, Section 2.4; and Brazil's Comments on U.S. Oral Statements, Section 4.
[294] Panel Report, *U.S. – Upland Cotton*, para. 7.1353.

prejudice? If not, what modifications does the United States think should have been made to the model?

168. Brazil also notes that, in response to this question, the United States once again repeats its summary and general criticism of Professor Sumner's simulation model. However, the United States does not even attempt to rebut any of the specific arguments, explanations and rebuttals submitted by Brazil and Professor Sumner in the many submissions since the beginning of this proceeding.[295]

2. Increase in world market share - Article 6.3(d) of the *SCM Agreement*

Questions to the United States

75. Could the United States explain further the textual basis of its argument that "Article 6.3(d) is not concerned with absolute market share and whether or not in any given year a member's market share would have been lower if subsidies were removed"? (Rebuttal Submission of the United States, para. 401)

169. The U.S. response provides no clear guidance with respect to the textual basis for its argument regarding the first element of Article 6.3(d), *i.e.*, whether there has been an increase in the world market share for the year in question compared to the previous three-year average. Nor does the United States elaborate, either in this response or in any of its other submissions, on what it believes to be the required proof with respect to the first element of Article 6.3(d). Rather, the United States vaguely asserts that "what is at issue is movement, not something static like the absolute level of market share in a particular year."[296] The United States then concludes that "the upward movement [] itself [must be] proven to be 'the effect' of a challenged subsidy."[297]

170. It is difficult to respond to such vague arguments. Yet, using the terminology in the U.S. response, Brazil has demonstrated that the "movement" (*i.e.*, the increase in MY 2005 compared to the previous three year average of MY 2002-MY 2004) was the effect of marketing loan and counter-cyclical subsidies. Brazil proved this by showing that *but for* the marketing loan and counter-cyclical subsidies, the U.S. world market share in MY 2005 would not have increased, but would have *decreased* compared to the MY 2002-MY 2004 three-year average.[298] This is not a "static" analysis, as asserted by the United States.[299] Rather, this assessment constitutes a dynamic comparison between two time periods demonstrating that it was the effect of the two challenged subsidies that led to the increase in the U.S. world market share in MY 2005 compared to its previous three-year average.[300]

171. Finally, Brazil refers the compliance Panel to its response to question 76, in which it addresses in detail the absence of any textual basis for the U.S. argument regarding the *second* element of Article 6.3(d) – the consistent trend. The U.S. response to question 75 provides no additional textual basis or argument to support its new and erroneous interpretation of the "consistent trend."

[295] *See*, *e.g*., Brazil's Comments on U.S. Oral Statements, paras. 35-56.
[296] U.S. 2 April response to question 75, para. 175.
[297] U.S. 2 April response to question 75, para. 175.
[298] Brazil's Rebuttal Submission, paras 348-349; Brazil's First Written Submission, paras. 214-226; 230-236.
[299] U.S. 2 April response to question 75, para. 175.
[300] Brazil's Rebuttal Submission, paras 348-349; Brazil's First Written Submission, paras. 214-226; 230-236.

C. CLAIM OF BRAZIL REGARDING THREAT OF SERIOUS PREJUDICE

Questions to both parties

78. Could both parties comment on the statements of Canada that "(a)t issue is whether these programmes....threaten to cause serious prejudice simply by virtue of their existence" and that "(c)ertain subsidy programs, by their very nature, give rise to a constant likelihood of support that results in a permanent threat of serious prejudice"? (Third Party Submission of Canada, paras. 9-10)

172. As set out in Brazil's answer to this question, Brazil is not asserting that the existence of the marketing loan and counter-cyclical subsidy programs, in and of themselves, causes a threat of serious prejudice.

173. Brazil notes the U.S. assertion in its response that a challenge to the very "existence" of such programs would be "extraordinary" and "remarkable." In effect, what the United States asserts is that "per se" challenges – *i.e.*, challenges to the very existence – of subsidy programs under Articles 5 and 6.3 of the *SCM Agreement* are, as a practical matter, simply not viable. Yet, the United States' preliminary ruling arguments in this case seek to require the categorization of Article 6.3 claims in strict "per se" and "as applied" terms. According to the United States, "as applied" claims could only be asserted against the *application* of subsidies, *i.e.*, the payment of subsidies for a specified period of time.[301] And the only implementation obligation regarding such subsidies that cause adverse effects, according to the United States for such subsidies, is to remove the effects of such historical subsidy *payments* (*i.e.*, the "application").[302] On the United States view, a Member can take no action when recurring payments are found to cause adverse effects because the "effects" of past payments are wiped away by new payments that, it contends, cannot be regarded as "measures taken to comply", even though they have an extremely close connection to the DSB's recommendations and rulings regarding past payments. Brazil addresses this issue further in its comments on the United States' response to question 45, above.

174. In its response to question 78, the United States has now confirmed its views of the practical impossibility ("extraordinary" and "remarkable") of establishing a "per se" violation of Articles 5 and 6.3 of the *SCM Agreement*. Yet, in doing so, the United States has also confirmed that its arguments reduce the obligation in Article 7.8 of the *SCM Agreement* to inutility where a Member grants annual recurring payments to support the production of an annual crop. Under its strict segmentation of serious prejudice claims into "per se" and "as applied" categories, this remedy becomes meaningless. Indeed, acceptance of such a strict categorization would prevent Members suffering serious prejudice from securing any prospective relief for the future application/payment of recurring subsidies under such programs. This is because, as the United States has argued, only "per se" challenges can result in any obligation to change the statutory or regulatory provisions mandating subsidies.[303] Members seeking relief by challenging, "as applied", the application of those statutory and regulatory provisions would, in the case of recurring annual payments, have to continually institute new WTO proceedings, but would never have any right to take "countermeasures" because there would never be any compliance measures.[304] As Brazil has demonstrated, such an interpretation is neither justified nor mandated by the text, context, and object and purpose of Articles 5 and 6 of the *SCM Agreement*.[305]

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[301] U.S. Rebuttal Submission, paras. 20-28.

[302] *See* U.S. 2 April response to questions 47 and 48, paras. 53-57; U.S. 27 February response to question 17(b), para. 32.

[303] *See e.g.*, U.S. Rebuttal Submission, paras. 20-28.

[304] *See* Brazil's comments on the U.S. 2 April answer to question 45, above.

[305] Brazil's 27 February response to questions 11 and 12, para. 83-116; Brazil's comments on U.S. 27 February response to question 17, paras. 27-31.

79. Could the parties state their views on the analysis of the ordinary meaning of the term "threat" in paras. 15-28 of the Third Party Submission of Canada?

175. The United States' response reaffirms its attempt to import the "imminent and clearly foreseen" standard of threat in Article 15.7 into Part III of the *SCM Agreement*.[306] Brazil has explained in its response to this question and in its First Written Submission why this is contrary to the text, context, and object and purpose of Articles 5 and 6 of the *SCM Agreement*. In this comment, Brazil addresses briefly a number of points raised by the U.S. response.

176. The United States is incorrect in asserting that footnote 5/Article 6 and Article 15.7 of the *SCM Agreement*, together with Article 4.1 of the *Safeguards Agreement* "serve a similar function."[307] Brazil explained in detail in its response to this question[308] that the "imminent and clearly foreseen" threat standards in Article 15.7 and Article 4.1 serve a distinct function, *i.e.*, regulating unilateral action by investigating authorities of imminent surges of *imports*.[309] By contrast, Part III of the *SCM Agreement* deals with the far broader object of protecting against the *effects of subsidies* in a *multilateral* dispute settlement context. Such effects may or may not involve the imminent shipment of goods. Thus, as Brazil has argued, a threat standard such as "significant likelihood" is consistent with both the slower pace of WTO dispute settlement procedures and its the associated remedies, as well as the time it takes for the effects of certain types of subsidies to materialize.

177. The United States' response distinguishes between a *temporal* ("imminent") and a *probability of occurrence* ("clearly foreseen") component of threat under Article 15.7. The United States asserts that Canada's (and Brazil's) approach ignores the temporal element altogether.[310] This is not correct. Rather, Brazil asserts that the notion of "imminent" is appropriate given the ability of investigating authorities (under Article 17 of the *SCM Agreement*) to take rapid action against subsidized imports. Yet, such a standard is not appropriate in a multilateral proceeding. In effect, the United States is requesting the compliance Panel to adopt a "temporal" standard that will force WTO Members to wait just until subsidies are about to cause serious prejudice before asserting their multilateral rights. Brazil has explained why application of the particular "temporal" element ("imminent") of Part V into Part III of the *SCM Agreement* is inconsistent with rules of treaty interpretation.

178. However, Brazil emphasizes again that it does not suggest that there be *no* temporal element to a threat standard in Part III of the *SCM Agreement*. Rather, Brazil's "significant likelihood" standard incorporates the notion that the threat must be real, not be based on allegation, conjecture or *remote* possibility. In sum, the temporal element should be tailored to the particular object and purpose and remedies and procedures applicable to multilateral disputes settlement proceedings applicable to Part III of the *SCM Agreement*, not blindly imported from the different context in Part V of the *SCM Agreement*.

Questions to the United States

80. How does the United States address the argument of Japan that in view of the different purposes of Parts III and V of the SCM Agreement the standard for determining threat of material

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[306] *See* U.S. Rebuttal Submission, para. 410 ("There is no reason why the *elaboration* of the term "threat" in Article 15.7 of he *SCM Agreement* and Article 4.1(b) should not be used as contextual guidance in interpreting the same term in footnote 13 of the *SCM Agreement*."). The "elaboration" advanced by the United States is the "imminent and clearly foreseen" standard.

[307] U.S. 2 April response to question 79, para. 184.

[308] Brazil's 2 April response to question 86, paras. 172-177.

[309] *See* Article 15.7 ("No one of these factors by itself can necessarily give decisive guidance but the totality of the factors considered must lead to the conclusion that *further subsidized exports are imminent* and that, unless protective action is taken, material injury would occur. ").

[310] U.S. 2 April response to question 79, para. 181.

injury in Article 15.7 of the SCM Agreement is an inappropriate standard for determining the existence of a threat of serious prejudice under Part III of the SCM Agreement? (Third Party Submission of Japan, paras. 8-12.) '

179. Brazil believes that Japan has correctly identified significant differences between Parts III and V of the *SCM Agreement* that demonstrate the inappropriateness of importing the "imminent and clearly foreseen" standard of Article 15.7 into Part III of the *SCM Agreement*. Brazil therefore disagrees with the primary point made by the United States in this response, *i.e.*, that there is no difference between the function, object, and purpose of Article 15.7 and Part III of the *SCM Agreement*.

180. The United States suggests that "there is no basis for understanding the same terms in [Article 5/footnote 13 and Article 15.7] to have different meanings based on the an assumption that national authorities are necessarily prone to 'misusing' their discretion whereas WTO panels are not."[311] This is a false argument. Neither Brazil nor Japan "assumes" that investigating authorities will misuse their discretion. Instead, Brazil emphasizes that there are considerably different "temporal" considerations for such authorities compared to a WTO panel.

181. While the United States champions the "temporal" element of "imminent", the U.S. argument ignores the vastly different *temporal* periods involved in a rapid unilateral provisional remedy based on Part V and years of WTO dispute settlement proceeding under Part III of the *SCM Agreement*.

182. It is entirely appropriate that investigating authorities armed with rapid provisional remedies to control imports be compelled to make a finding that such imports are "imminent." The purpose of the rapid provisional remedies under Articles 17 and 15.7 of the *SCM Agreement* ensure that the domestic industry need not suffer material injury while waiting for remedies to take effect. Those rapid remedies available in the unilateral trade remedy context explain why the drafters used an "imminent" temporal standard of threat.

183. But the situation in a challenge under Part III of the *SCM Agreement* is totally different. Part III is not focused on controlling subsidized *imports* but rather on the adverse effects of any subsidy. Even the expedited dispute settlement procedures potentially available (but seldom used) under Article 7 of the *SCM Agreement* require at least 18 months of litigation time before a ruling and implementation can take place. No provisional "self-help" remedies are available under these rules. If "imminent" threat were the standard, then a WTO panel could be confronted with facts demonstrating that the threat was "clearly foreseen" but was not "imminent" because the effect of the subsidies would not take place for another year or two.[312] (By contrast, a domestic industry could petition investigating authorities only months before major shipments of subsidized goods were scheduled to be shipped and obtain relief under procedures sanctioned by Articles 15.7 and 17 of the *SCM Agreement*.) The complaining WTO Member would, in effect, be left without a remedy for future serious prejudice that was real, but not "imminent."

184. The United States asserts that both Article 15.7 and footnote 13/Article 5 strike a balance between disciplining and permitting subsidization.[313] Yet, if the real balance between disciplining subsidies and permitting their use is to be maintained, the concept of threat must be flexible enough to allow the disciplining of the effects of subsides – in practical terms – *well before* subsidized products are about to hit the market. *Avoiding* real and foreseen future adverse effects in the form of material

[311] U.S. 2 April response to question 80, para. 192.

[312] By contrast, a domestic industry could petition investigating authorities only months before major shipments of subsidized goods were scheduled to be shipped and obtain relief under procedures sanctioned by Articles 15.7 and 17 of the *SCM Agreement*.

[313] U.S. 2 April response to question 81, para 192 (claiming that both Article 15.7 and Part III function to establish a balance between the right to subsidized and the right to discipline subsidies).

injury and serious prejudice is the object of both Article 15.7 and Part III of the *SCM Agreement*. However, the entirely different temporal aspects of these two different remedies and procedures compel the use of different threat standards to maintain that balance. Otherwise, the U.S. interpretation creates far greater an opportunity for subsidizing Members to cause serious prejudice without any effective multilateral relief. This appears to be the main objective of the Japanese arguments and is one that Brazil supports.

81. How does the United States respond to the argument of Australia that "it is beside the point for the United States to argue that the programmes under consideration are due to expire in late 2007"? (Third Participant Oral Statement of Australia, para. 13)

185. The United States' response repeats its erroneous assertions that there is no threat of serious prejudice because the FSRI Act of 2002 will allegedly expire by the end of marketing year 2007, *i.e.*, 31 July 2008.[314]

186. Brazil disagrees that the alleged expiration of the FSRI Act of 2002 in the end of July 2008 is a relevant fact before the compliance Panel.[315] The "matter" before the compliance Panel with respect to Brazil's threat of serious prejudice claim is whether marketing loan and counter-cyclical subsidies for MY 2006 and MY 2007 cause a threat of serious prejudice. MY 2006 is the relevant year to consider whether threat of serious prejudice presently exists. It will not end until 31 July 2007, *i.e.*, after the compliance Panel issues its determination. MY 2007 will not end for another 16 months, *i.e.*, on 31 July 2008. The FSRI Act of 2002 remains in effect until the end of MY 2007.[316] Brazil's threat of serious prejudice claims in this proceeding involve the determination of whether there is a threat of serious prejudice today, not at the end of MY 2007 or beyond.

187. Yet, having asserted (incorrectly) that the expiration of the FSRI Act of 2002 is a relevant fact by suggesting that marketing loans and counter-cyclical subsidies may also completely expire, the United States is in no position to then assert that it is entirely *irrelevant* for the compliance Panel to consider whether the marketing loan and counter-cyclical subsidies will continue, in some form or another, in the *next* U.S. Farm Bill.[317] It is undisputed that there will be *some* new Farm Bill that will be enacted at some time in the future after these proceedings have finished.[318] The marketing loan program for upland cotton has been in existence since 1986 and, since, has been a key component of U.S. farm legislation. The current USDA proposal calls for a continuation of both the marketing loan and the counter-cyclical payment programs with certain changes.[319] Thus, Australia is certainly correct when it states that "there is no guarantee that [the marketing loan and counter-cyclical programs] will not be rolled over or maintained in another form with adverse effect."[320] The compliance Panel cannot, of course, determine the exact scope of the marketing loan and counter-cyclical provisions that will exist in the next U.S. farm bill.

[314] U.S. 2 April response to question 81, para. 195.

[315] U.S. Rebuttal Submission, para. 415.

[316] For counter-cyclical payment provisions, *see* Section 1108 of the 2002 FSRI Act ("This subtitle shall be effective beginning with the 2002 crop year of each covered commodity through the 2007 crop year."). Exhibit Bra-29 (2002 Farm Security and Rural Investment Act). For marketing loan provisions, *see* Section 1207(a)(1) of the 2002 FSRI Act ("During the period beginning on the date of the enactement of this Act through July 31, 2008, the Secretary shall issue marketing certificates or cash payments …"). Exhibit Bra-29 (2002 Farm Security and Rural Investment Act).

[317] U.S. 2 April response to question 81, para. 197.

[318] *See*, *e.g*., CRS Report for Congress, "Farm Bill Proposals and Legislative Action in the 110th Congress," available at http://www.nationalaglawcenter.org/assets/crs/RL33934.pdf, accessed April 2007.

[319] USDA's Farm Bill proposal is available at http://www.usda.gov/documents/07finalfbp.pdf, accessed April 2007.

[320] Oral Statement of Australia, para. 13.

188. Finally, whether the provisions of any new Farm Bill fully remove the serious prejudice caused by the FSRI Act of 2002, or the ongoing threat thereof, cannot be determined at this time. However, the United States is incorrect to suggest that the mere expiration of the FSRI Act of 2002 in the future would represent a "withdrawal" of the subsidy.[321] If the marketing loan program and the counter-cyclical payment programs remain in some form in the new Farm Bill – or are replaced by programs with similar effects – then these subsidies will *not* have been withdrawn, within the meaning of Article 7.8 of the *SCM Agreement*.[322]

82. Could the United States comment on the projections of marketing loan and counter-cyclical payments in Table 26 of Brazil's First Written Submission and on the projections of prices and subsidy payments in Table 27 of Brazil's First Written Submission? Could the United States explain how the data in these Tables support its argument that producers are likely to expect low or no marketing loan payments in MY 2007? (Rebuttal Submission of the United States, para. 418)

189. In its answer to this question, the United States focuses on projections of *prices*[323] to derive projected subsidies and downplays projections of *subsidy outlays* itself (what it terms "aggregate figures"[324]), arguing that it is "difficult to fit these projections"[325] with the projections of prices. This is highly misleading and contrary to basic accounting principals used and espoused by USDA.[326] Projections of prices and subsidy outlays are, in fact, entirely consistent, as explained below.

190. Consider the following simplified example, as articulated by Professor Sumner in Exhibit Bra-659.

> But, let us take the case of a farmer with the following view of the future AWP. He considers that there is a 40% chance of an AWP of 42 cents, a 20% chance of an AWP of 52 cents and a 40% chance of an AWP of 62 cents. The expected value is exactly 52 cents. He expects no marketing loan payout, but the value of the program is 4 cents per pound to him. That is 0.4(52-42) = 4 cents. Only if the farmer was absolutely sure the AWP could not be below the loan rate would the program be of no value.[327]

191. Even if the Adjusted World Price ("AWP") is expected to be $0.52 per pound, or higher, it does not mean that the marketing loan program provides no benefit. As noted by the Appellate Body, even if U.S. upland cotton farmers expected prices to be above the adjusted world price at the time of planting, they "were also aware that if actual prices were ultimately lower, they would be 'insulated' by government support, including not only marketing loan program payments but also counter-cyclical payments, which were based on a target price of $0.724 per pound."[328]

192. The distinction between the prices farmers expect and the marketing loan subsidies they expect is akin to the difference between deterministic and stochastic projections of marketing loan subsidy outlays.[329] Like farmers, USDA also ascribes value to the marketing loan program even when prices are expected to be at or above the loan rate. For example, USDA's *deterministic* projection of

[321] U.S. 2 April response to question 81, para. 196.
[322] *See* Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para 77.
[323] U.S. 2 April response to question 82, para. 202.
[324] U.S. 2 April response to question 82, para. 202.
[325] U.S. 2 April response to question 82, para. 202.
[326] *See* Brazil's 2 April response to question 89, para. 189 ("deterministic projections, by their nature, tend to underestimate outlays").
[327] Exhibit Bra-569 (Statement of Professor Sumner Concerning Various U.S. Argument, para. 55).
[328] Appellate Body Report, *U.S.-Upland Cotton*¸ para. 445 (addressing similar arguments raised by the United States in paras 226-235 of its First Written Submission).
[329] For a detailed explanation of the difference between deterministic and stochastic estimates, *see* Brazil's Opening Statement, para. 82 and Brazil's 2 April answer to question 89, paras. 189-190.

marketing loan subsidies, which is based on price projections, is $0 in MY 2009, while its *stochastic* projection is $468 million.[330]

193. USDA's deterministic projection of marketing loan subsidies in MY 2007 is $238 million, indicating that USDA expects the AWP to be below the loan rate.[331] However, based on the probably that prices will be even lower, USDA's stochastic projection of marketing loan subsidies is $798 million. USDA's latest projection that upland cotton production will be 20.7 million bales in MY 2007[332] suggest per-unit expected marketing loan subsidies of 8 cents per pound[333], not 2 cents per pound, as put forward by the United States.[334]

194. In sum, by relying on expected prices, instead of expected subsidies, the United States is repeating a mistake it has made throughout this proceeding. Only stochastic estimations of marketing loan subsidies capture the likelihood that prices will be lower and payments higher. Relying on the difference between the expected AWP and the loan rate does not capture this effect. As explained by USDA, "deterministic projections, by their nature, tend to underestimate outlays."[335]

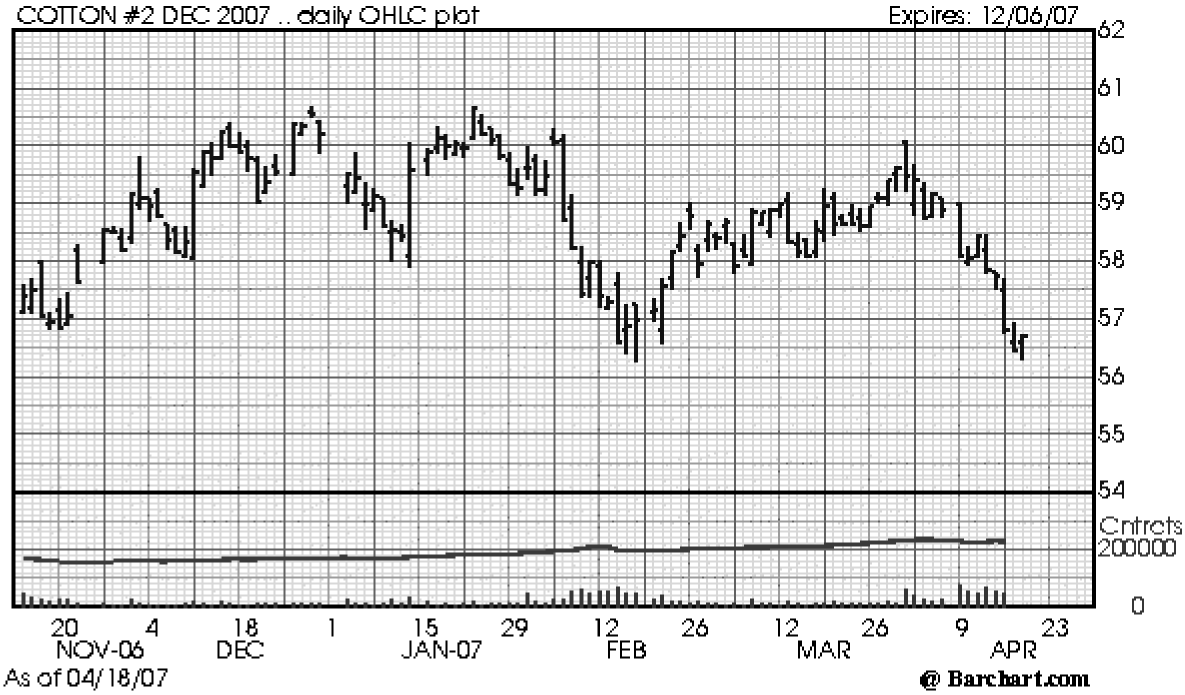
195. Brazil notes that the United States does cite to FAPRI's July 2006 stochastic projections of marketing loan subsidies. However, this projection of marketing loan payments of 1.9 cents per pound[336] is significantly below USDA's own projections of 8 cents per pound. There is a very good reason why USDA estimates are more reliable than the July 2006 FAPRI projections – they are more recent. USDA estimates are found in USDA's Commodity Estimates Book for the FY 2008 President's Budget, which was released in February 2007 – eight months later than the FAPRI baseline that the United States relies on.[337]

196. Furthermore, while the complete 2007 FAPRI baseline has not been released[338], the parts that have been released confirm that FAPRI's projections of upland cotton prices in July 2006 were too high. For example, FAPRI now projects the MY 2007 U.S. farm price for upland cotton to be $0.518 per pound.[339] Last July, it predicted the same price to be $0.534 per pound.[340]

197. Current futures prices also indicate that large marketing loan and counter-cyclical payments can be expected due to expected low prices in MY 2007. The following chart details daily closing prices of the December 2007 contract for upland cotton.

[330] Brazil's 2 April response to question 89, Table 4 at para. 189.
[331] *See* U.S. 2 April response to question 82, para. 203.
[332] Exhibit Bra-635 (2002-2007 USDA Agricultural Baseline Projections).
[333] $798 million / (20.7 million bales * 480 pounds per bale) = $0.0803 per pound.
[334] *See* U.S. 2 April response to question 82, para. 203.
[335] Exhibit Bra-460 (Explanatory Notes for Stochastic Budget Outlay Estimates, Farm Service Agency, accessed October 2006 at http://www.fsa.usda.gov/Internet/FSA_File/msrexplain.doc).
[336] Exhibit Bra-479 (2006 Baseline Update for U.S. Agricultural Markets, FAPRI-UMC Report 12-06, July 2006, p. 6, accessed October 2006 at http://www.fapri.missouri.edu/outreach/publications/2006/FAPRI_UMC_Report_12_06.pdf).
[337] Exhibit Bra-639 (Commodity Estimates Book for FY 2008 President's Budget)
[338] Unfortunately, relevant portions of the latest 2007 FAPRI Agricultural Outlook" has not yet been released, but the FAPRI "World Agricultural Briefing Book" has been released, *see* http://www.fapri.iastate.edu/brfbk07/.
[339] FAPRI World Agricultural Outlook Briefing Book, World Cotton, available at http://www.fapri.iastate.edu/brfbk07/CottonTables2007.pdf.
[340] Exhibit Bra-479 (2006 Baseline Update for U.S. Agricultural Markets, FAPRI-UMC Report 12-06, July 2006, p. 6, accessed October 2006 at http://www.fapri.missouri.edu/outreach/publications/2006/FAPRI_UMC_Report_12_06.pdf).

Figure 6 – Prices for the December 2007 Upland Cotton Futures Contract[341]



198. The average January to March closing price of the December 2007 futures contract was $0.588 per pound.[342] The price of the December 2007 futures contract has since fallen to less than $0.57 per pound. Brazil recalls that marketing loan subsidies are based off of the adjusted world price, which is, on average, 17.3 cents below the average January to March futures price.[343] A simple linear regression of futures prices and actual marketing loan payments indicates that, based on the current futures price of $0.588 per pound for MY 2007, farmers can expect a marketing loan subsidy of 12.3 cents per pound[344], or about $1.2 billion.[345] This would represent 17 percent of the total projected cost of producing a pound of cotton in MY 2007.[346]

199. In the end, it is impossible to know how large marketing loan subsidies will be in MY 2007. Brazil notes that the average futures price of $0.588 per pound during the planting period of MY 2007 is similar to futures prices in the planting period of MY 2001, 2003 and 2006.[347] Actual marketing loan subsidies in these years varied widely, ranging from $2.6 billion in MY 2001, to $757 million (projected) in MY 2006 and to just $184 million in MY 2003.[348] The inability of futures prices to

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[341] *See* http://www2.barchart.com/dfutpage.asp?sym=CT&code=BSTK.

[342] This figures includes complete data through the end of March (*See* Exhibit Bra-691 (Average January to March Price of the December 2007 futures contract)). Despite being asked to provide complete data by the Panel, the United States only provides data through 9 March in Exhibit US-147.

[343] Brazil's Rebuttal Submission, para. 105.

[344] *See* Exhibit Bra-621 (Upland Cotton Expected Marketing Loan Program Payments Based on Futures Prices).

[345] USDA's 2007 baseline projects 20.7 million bales of production in MY 2007. *See* Exhibit Bra-635 (2002-2007 USDA Agricultural Baseline Projections).

[346] Marketing loan payments (12.3 cents per pound) * expected yield per planted acre (806 pounds per acre) / Total costs per acre (593.5 dollars per acre) = 16.7 percent. *See* Exhibit Bra-634 (Analysis of Planting Decisions Based on Expected Returns).

[347] The average January to March closing price of the December contract was 58.07 cents per pound in MY 2001, 59.12 cents per pound in MY 2003 and 59.28 cents per pound in MY 2006. *See* Exhibit Bra-621 (Upland Cotton Expected Marketing Loan Payments Based on Futures Prices.

[348] *See* Brazil's First Written Submission, Table 6 at para. 111. For MY 2006, *see* Brazil's 2 April response to question 89, Table 4 at para. 189.

predict actual subsidies was even more apparent in MY 2004 and 2005. The average futures price in MY 2004 was $0.674 per pound, while in MY 2005 it was $0.529 per pound. Yet, in MY 2004, marketing loan subsidies amounted to $1.8 billion and were 50 percent greater than marketing loan subsidies of $1.2 billion in MY 2005.[349] The following chart shows the progression of nearby futures prices over the past four years:

Figure 7 – Nearby Futures Prices[350]

200. In sum, every farmer knows that expectations based on futures prices, just like USDA and FAPRI projections are just that – projections – and that *actual* prices and *actual* subsidies vary widely. Despite the U.S. focus on "expectations," the underlying reality throughout the life-time of the FSRI Act of 2002 has been self-sustaining low upland cotton prices and enormous price-contingent marketing loan and counter-cyclical subsidies. The evidence in the record fully supports the conclusion that such subsidies and their price suppressing effects will continue throughout the lifetime of the FSRI Act of 2002.

D. EXPORT CREDIT GUARANTEES

1. Outstanding export credit guarantees

Questions to the United States

91. In paragraph 342 of its First Written Submission, Brazil indicates that the total amount of guarantees under the GSM 102, GSM 103 and SCGP programs outstanding on 1 July 2005 amounted to $8.5 billion.

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[349] *See* Brazil's First Written Submission, Table 6 at para. 111, as amended by updated marketing loan subsidy amounts (*see* Brazil's 16 March Comments on U.S. Answer to Question 4, para. 14) and an updated counter-cyclical subsidy amount in MY 2005 (*see* Brazil's Oral Statement, para. 40). *See also* Exhibit Bra-621 (Upland Cotton Expected Marketing Loan Payments Based on Futures Prices.

[350] *See* http://www.agweb.com/, accessed April 2007.

(c) Please indicate what proportion of that amount concerns exports of scheduled products, and in particular rice (please distinguish, in each case, between principal and interest).

201. Although the United States asserts that it does not maintain data concerning outstanding ECGs on a commodity-specific basis, FAS' monthly summaries of GSM 102 program activity is recorded on a commodity-specific basis (at least with respect to select commodities, such as rice).[351]

202. However, if the United States does not maintain data regarding ECGs issued and outstanding on a commodity-specific basis, this fact is telling, and confirms that there is no factual basis for the United States to characterize the measure subject to Brazil's claims of inconsistency with Articles 10.1 and 8 of the *Agreement on Agriculture* as "the pig meat and poultry meat GSM 102 guarantees".[352] Neither the amended GSM 102 program in its totality, nor the individual amendments, set out terms or conditions that differ as between different eligible products.[353] In its response to the compliance Panel's question, the United States insists that it *does not even maintain data* on GSM 102 ECGs issued and outstanding on a product-specific basis.

3. "Benefit" under Articles 1.1 and 3.1(a) of the *SCM* Agreement

Questions to both parties

95. Brazil has taken the position that "different parties to a transaction involving a GSM 102 ECG derive different benefits from the GSM 102 ECG, each of which is potentially subject to assessment under Article 1.1(b) of the SCM Agreement" and has indicated that it is, in this proceeding, "primarily concerned" with the benefit received by the US exporter in the form of below-market fees (para. 404, Brazil's Rebuttal). The United States has challenged Brazil's approach of focusing on fees to the exclusion of other elements of the total cost of the loan. Please explain, referring to the provisions of the SCM Agreement and WTO jurisprudence (if any applicable), your position as to whether: (1) export credit guarantees and other types of subsidies may involve more than one type of benefit and/or recipient; (2) whether it is up to the complaining Member to decide which benefit it chooses to challenge.

203. Contrary to the United States' assertion in its response, Brazil does not ask the compliance Panel to "ignore" Article 14(c) of the *SCM Agreement* in its assessment of the "benefit" flowing from GSM 102 ECGs under the amended GSM 102 fee schedule.[354]

204. Based on Appellate Body jurisprudence, Brazil has noted the Appellate Body's ruling that Article 14 must not be applied "rigidly", even in disputes under Part V of the *SCM Agreement*, to which the provision explicitly applies.[355] The Appellate Body has held that even in disputes under Part V of the Agreement, the provision must be applied flexibly, to account for the "factual circumstances" at hand.[356]

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[351] *See* http://www.fas.usda.gov/excredits/Monthly/ecg.html. This is unfortunately not so for some other commodities, which are grouped into categories (*e.g.*, feed grains) that do not match the commodity categories included in the U.S. Schedule of reduction commitments, making an assessment of circumvention under Article 10.1 of the *SCM Agreement* impossible in some instances. It is for this reason that Brazil asked the Panel to pose question 7 of the list of questions to the United States. Question 7 asks the United States for a correspondence table tying the categories of commodities included in FAS' monthly summaries to the categories of commodities included in the U.S. Schedule.

[352] U.S. Rebuttal Submission, para. 10.

[353] *See* Brazil's 26 February answers to questions, para. 29.

[354] U.S. 2 April answer to question 95, para. 211.

[355] Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 92.

[356] Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 92.

205. Preserving this flexibility is even more important in disputes under Part II of the *SCM Agreement*. In a dispute under Part II, only the existence of *some* "benefit" under Article 1.1(b) must be established, and not the quantity of that benefit. In a passage cited by the United States in these proceedings, the original panel considered that imposing the "quantitative focus and more detailed methodological obligations of Part V" of the *SCM Agreement* on disputes preceding under Part III of the *Agreement* was not appropriate, even where assessing the "magnitude" of the subsidy was required.[357] For a dispute under Part II of the Agreement, where *no* assessment of the "magnitude" of the subsidy is required, much less the calculation of a countervailing duty rate, there is no basis whatsoever to impose the "quantitative focus and more detailed methodological obligations of Part V …. "[358]

206. In its 2 April response to question 100, Brazil demonstrated the proper role for Article 14(c) in these proceedings. The "factual circumstances"[359] in these proceedings under Part II of the *SCM Agreement* are such that a "particularized showing"[360], utilizing data concerning "individual loan costs and fees" or "comparable commercial loans and their terms"[361], is not necessary. Proof of some "benefit" can be established without the type of evidence on which the United States insists.

207. Indeed, in proceedings involving claims against government guarantees under Parts II and V of the *SCM Agreement*, panels have already twice ruled that evidence of the type insisted on by the United States is not necessary to show that a benefit exists.[362] Rather, evidence far short of that produced by Brazil in these proceedings (described in Brazil's 2 April response to question 100[363]) was accepted by these two panels as sufficient to satisfy Article 1.1(b) of the *SCM Agreement*, as informed by Article 14(c). Each of these two panels effectively accepted that, in principle, below-market fees for government guarantees translate into lower costs for commercial credit, and thus a lower total cost of funds – a conclusion rooted in the basic principles of financial economics addressed by Brazil in its 2 April response to question 100.[364]

208. This does not amount to "ignoring" Article 14(c), as the United States asserts.[365] Rather, it amounts to putting Article 14(c), and the evidence required to satisfy it, into the particular context of these proceedings.

96. The parties differ as to whether different types of loans can be compared as long as they have the same "average life." What support (economic literature, etc.) exists for your position on this issue?

209. The United States' position is that two-year bullet loans and three-year amortizing loans are equivalent, as long as one averages out the lives of the two loans.

210. Brazil's position is that two-year bullet loans and three-year non-amortizing loans are not equivalent, and that averaging out the lives of the two loans does not make them so, in light of the varying risks of default.

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[357] U.S. 16 March comments, para. 70. Panel Report, *U.S. – Upland Cotton*, para. 7.1177. *See also Id*., para. 7.1167.

[358] Panel Report, *U.S. – Upland Cotton*, para. 1177. *See also Id*., para. 1167.

[359] Appellate Body Report, *U.S. – Softwood Lumber IV*, para. 92.

[360] U.S. 6 March Response to Question 41, para. 80.

[361] U.S. Rebuttal Submission, para. 137.

[362] Panel Report, *EC – CVDs on DRAMs*, para. 7.189; Panel Report, *Canada – Aircraft Credits and Guarantees*, para. 7.345.

[363] Brazil's 2 April answer to question 100, paras. 232-262.

[364] Brazil's 2 April answer to question 100, paras. 245-253.

[365] U.S. 2 April answer to question 95, para. 211.

211. In its response to question 96, Brazil provided support for its position. Instead of providing support for the U.S. position, the United States instead ascribes to Brazil positions that Brazil has not taken, and argues against those imaginary positions. The United States' response is nothing more than an effort to mislead the compliance Panel, and to deflect attention from the evidence Brazil has offered to prove that bullet and amortizing loans do not have equivalent spreads even if they have the same average lives.

212. With reference to a simplified example addressed at paragraphs 220-222 of Brazil's Oral Statement, the United States argues that Brazil's position requires the compliance Panel to assume that risk "increases over time", such that there is "much higher risk in year 3 of the GSM 102 transaction." The United States admonishes Brazil for providing no basis for this "assumption", which it argues is "not even sound as a theoretical matter."[366]

213. This characterization of Brazil's position is so misleading as to be absurd. Brazil has not asked the compliance Panel to assume this scenario as a matter of fact, but merely to consider it as one hypothetical example. Other examples, involving alternative patterns of default risk, are also considered in paragraphs 31-32 of a statement by Professor Sundaram included as Exhibit Bra-686 to Brazil's 2 April responses. Each of these paragraphs includes two examples; in one example in each paragraph, default risk <u>increases</u> over time, while in the other example in each paragraph, default risk <u>decreases</u> over time. As the examples show, the spread on amortizing loans could be greater or lesser than the spread on bullet loans, depending on the pattern of default risk. That is Brazil's position, and it is mathematically proven by Professor Sundaram in Exhibit Bra-686.

214. In paragraphs 221-222 of its 2 April response, the United States provides a reference that in fact supports Brazil's position. The United States cites a paper finding that for seven-year loans, the likelihood of default "in general" increases over time, rather than decreases.[367] This substantiates Brazil's argument that since default risk is not constant from year to year, bullet and amortizing loans will, in general, have different spreads.[368]

215. Brazil also addresses three other issues raised in the United States' response to question 96: (i) the use of the average life concept in the context of mortgage-backed securities; (ii) the use of the average life concept in pricing swaps in terms of U.S. Treasuries with the same average lives; and, (iii) the use of the average life concept in pricing for an amortizing loan obtained by adding a fixed spread to an index.

<u>Average life in the context of mortgage-backed securities</u>

216. In paragraph 219, the United States suggests that "the concept of average life is commonly used for price comparability of investments and debt-instruments of various terms." The first example in paragraph 219 refers to mortgage-backed securities ("MBS"). Brazil makes two observations about this example.

217. First, and most importantly, the reference does not address, much less establish, the comparability of bullet and amortizing loans with the same average lives, which is the question raised by the Panel. Indeed, in discussing the relevance of the average life concept to MBS, the United States makes no reference at all to pricing. The United States does not, for example, suggest that the price of an MBS is the price of a similar bullet security with the same average life.

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[366] *See* U.S. 2 April answer to question 96, paras. 218, 221, 222.

[367] Exhibit US-152 (Dennis Glennon and Peter Nigro, "Measuring the Default Risk of Small Business Loans: A Survival Analysis Approach," *Journal of Money, Credit, and Banking*, Vol. 37, No. 5 (October 2005), p. 935, 945).

[368] Brazil's 2 April answer to question 96, para. 223. *See also* Exhibit Bra-686 (Statement of Professor Sundaram).

218. Second, the reference to MBS relies on an incorrect understanding of why average life is used for MBS. The biggest risk faced by the holder of an MBS is *pre-payment risk*, or in other words, the risk that some of the individual mortgages underlying the MBS will be pre-paid by the borrowers.[369] Thus, the maturity of the MBS is not, in itself, adequate to describe the instrument. Two MBS may have the same maturity, but if one has higher pre-payment risk than the other (say, because the mortgage coupons underlying it are higher), then the cash flows will last for a shorter period of time. To restore some kind of comparability between different MBS, investors use models that attempt to predict the volume of pre-payments, and calculate an average life accordingly.[370] Such an average life calculation is unnecessary if there is no prepayment risk.

Average life in pricing swaps

219. In paragraph 219 of its response, the United States quotes an article stating that swap dealers "'routinely price the fixed rate side of an interest rate swap as a spread over United States Treasuries of a similar average life.'"[371] This statement does not provide support for (or even address) the United States' assertion that two-year bullet loans and three-year amortizing loans with the same credit quality have identical credit risk whenever they have the same "average lives".

220. The article cited by the United States describes a situation in which an institution holding fixed-rate amortizing mortgage debt funded with the issue of floating rate short-term debt seeks to hedge interest rate risk by using a "swap". A swap is an exchange of cash flows computed at a floating rate of interest, for cash flows computed at a fixed rate of interest. The institution in question looks to receive the floating-rate payment from the swap seller and make the fixed-rate payment to the swap seller so that, taken together with the mortgage that it holds and the floating-rate debt issued to fund that mortgage, the institution's interest-rate exposure is only fixed rate.

221. To identify the fixed rate in a swap, dealers generally add a spread to the Treasury yield on a bond with the same maturity as the swap. However, where the notional principal is amortizing, as in the example offered in the article quoted by the United States, a problem arises – while the notional principal on the mortgage is amortizing, Treasury bonds are bullet bonds. Some adjustment is required to equate the differing maturities of amortizing and non-amortizing debt. This adjustment is addressed in endnote 4 to the article: "[a]verage life is used by swap dealers to equate the maturities of nonamortizing Treasury debt and amortizing mortgage debt."[372]

222. The compliance Panel, however, has asked for support in the literature for the U.S. assertion that non-amortizing and amortizing debt with the same credit quality have identical credit risk whenever they have the same "average lives". This proposition is not even addressed by the example offered in the article quoted by the United States, because the mortgage debt and the Treasury bond in the example have different credit qualities, despite the fact that they have the same "average life".

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[369] *See* http://www.riskglossary.com/link/mortgage_backed_security.htm ("Prepayments introduce uncertainty into the cash flows of a mortgage pass-through. The rate at which fixed-rate mortgagors prepay is influenced by many factors. A significant factor is the level of interest rates. Mortgagors tend to prepay mortgages so they can refinance when mortgage rates drop. By acting in their own best interest, mortgagors act to the detriment of the investors holding the mortgage pass-through. They tend to return principal to investors when reinvestment rates are unattractive, and they tend to not do so when reinvestment rates are attractive"). *See also* http://personal.fidelity.com/products/fixedincome/pombs.shtml. In any event, the vast majority of MBS in the United States have no default risk, since they are guaranteed by federally-sponsored institutions such as Freddie Mac, Fannie Mae, and Ginnie Mae. *See* http://www.sec.gov/answers/mortgagesecurities.htm. *See also* http://www.riskglossary.com/link/mortgage_backed_security.htm.

[370] *See* http://www.riskglossary.com/link/mortgage_backed_security.htm. *See also* http://personal.fidelity.com/products/fixedincome/pombs.shtml.

[371] U.S. 2 April answer to question 96, para. 219, *quoting* Exhibit US-150.

[372] Exhibit US-150, p. 21 (note 4) (emphasis added).

The article cited by the United States does not, as a result, provide support for the U.S. assertion that two-year bullet loans and three-year amortizing loans with the same credit quality have identical credit risk whenever they have the same "average lives".

Average life in pricing an amortizing loan obtained by adding a fixed spread to an index

223. In paragraph 220 of its response, the United States offers another example of the "average life" concept, in this instance suggesting pricing for an amortizing loan obtained by adding a fixed spread to the appropriate index.

224. The example cited by the United States in paragraph 220 and the website cited at Exhibit US-151 do not, as requested by the Panel, offer support for the U.S. position that two-year bullet loans and three-year amortizing loans are equivalent, as long as one averages out the lives of the two loans. Indeed, Exhibit US-151 and the example included in paragraph 220 of the U.S. response do not address the correctness of the U.S. position at all.

225. The U.S. example demonstrates how a single firm in the industry, Bond Street Capital ("BSC"), approaches the pricing of its amortized loans. The example does not involve the use of "average lives" to put bullet loans of a particular maturity and amortizing loans of a different maturity on equivalent footing, therefore enabling a comparison of the prices for the two instruments. The example shows that BSC indexes its loans to average lives of U.S. Treasuries or swaps. It does not suggest that BSC considers an amortizing loan with an average life of *m* years to be equivalent in spread to a bullet loan with a life of *m* years. Indeed, the example does not even mention how BSC would price a bullet loan. Neither the example, nor the material included in Exhibit US-151, exclude that BSC would add different spreads to the index for bullet and amortizing loans.

226. Brazil also notes that the "average lives" of the loans included in the example do not comport to the common understanding of that concept. In paragraph 220 of the U.S. response and Exhibit US-151, BSC asserts that a "15/15" loan has an average life of 9 years. That is simply not accurate. A "15/15" loan has an average life of 8 years. One-fifteenth of the capital is repaid in each of the fifteen years, so the average life is (1/15) * (1+2+ . . . +15), or 8 years. Similarly, BSC asserts that the average life of a "20/20" loan is 12 years, but it is actually 10.5 years ((1/20) * (1+2+ . . . +20) = 10.5). Even if the example served to support the position for which it is offered, it is not reliable, as the average life computation is incorrect.

Questions to the United States

97. Assuming that the Panel accepts the United States' argument that "benefit" is to be assessed on the basis of the "total costs of funds", what do you consider Brazil must establish in order to meet its burden of proof in that respect? Must Brazil prove that a benefit is conferred in all instances (all transactions and all recipients)? In most instances?

227. In its comment on the U.S. response to question 44, Brazil has addressed the United States' professed confusion over whether Brazil is "challenging" the GSM 102 program "as such", or instead "particular guarantees" under the GSM 102 program.[373] As noted in that comment, Brazil has shown that the amended GSM 102 program is an export subsidy. Separately, Brazil has also shown that the GSM 102 program is "applied", *via* individual GSM 102 ECGs for particular products, in a manner that results in circumvention of U.S. export subsidy commitments.

[373] U.S. 2 April answer to question 97, paras. 224-225.

228. In any event, it is not necessary in WTO dispute settlement to prove that a measure violates WTO law in "all" instances. As the panel in *U.S. – Export Restraints* held, it suffices that a measure violates WTO laws in some instances.[374]

98. Does the United States dispute the accuracy of Brazil's comparison of GSM 102 fees with Exim Bank fees? Does the United States agree that ExIm Bank and GSM 102 guarantees are (at least in certain circumstances) similar or comparable?

229. In its First Written Submission, Brazil demonstrated that GSM 102 fees are below the fees charged by the United States' Export-Import Bank ("ExIm Bank") for financial instruments that are in key respects similar to GSM 102 ECGs – ExIm Bank's Letter of Credit Insurance ("LCI") (which serves as a reference point for GSM 102 ECGs issued for tenors of *up to 360 days*), and ExIm Bank's Medium-Term Export Credit Insurance ("MTI") (which serves as a reference point for GSM 102 ECGs issued for tenors *exceeding 360 days*).[375] The results of this comparison between GSM 102 and ExIm Bank fees are tracked in Exhibits Bra-536 (for transactions involving annual repayment of principal) and Bra-537 (for transactions involving semi-annual repayment of principal).

230. The United States argues that GSM 102 ECGs are not similar to ExIm Bank LCI and MTI products, and are therefore not suitable for comparison, for five reasons.

231. Before addressing each of these five reasons, Brazil notes the irony of this situation. Brazil has demonstrated that there is no credit protection product available in the marketplace that is comparable to a GSM 102 ECG.[376] Nonetheless, in addition to that showing, Brazil undertook a comparison between GSM 102 fees and fees for comparable non-market products offered by ExIm Bank. In rebuttal, <u>the United States has not offered a single example of a credit protection product available in the marketplace</u>. Brazil's fundamental position – that GSM 102 ECGs confer "benefits" *per se* because they have no parallel at market – remains unrebutted by the United States with anything that resembles evidence, and indeed echoes the position the United States has taken in other disputes.[377]

232. With that important qualification, Brazil addresses each of the five reasons offered by the United States in support of its argument that ExIm Bank LCI and MTI products are not suitable for comparison with GSM 102 ECGs.

First U.S. criticism:
<u>No ExIm Bank MTI cover for agricultural product transactions</u>

233. **First**, the United States observes that ExIm Bank's MTI is not available for agricultural products, and that it is not therefore comparable to GSM 102.[378]

234. Brazil has already alerted the Panel to this distinction. As Brazil noted in its First Written Submission[379], ExIm Bank cover is indeed not, in normal circumstances, available for agricultural

[374] Panel Report, *U.S. – Export Restraints*, para. 8.78.
[375] Brazil's First Written Submission, paras. 381-406 and Annex IV (Methodology for Comparison of GSM 102 Fees with Fees for ExIm Bank Products).
[376] Brazil's First Written Submission, paras. 377-378. *See also Id*., Annex III (Statement of Professor Rangarajan Sundaram), paras. 8-9.
[377] Panel Report, *Canada – Aircraft Credits and Guarantees*, Annex C-2 (para. 7) ("If the commercial market does not offer a particular borrower the exact terms offered by a government, then the government is providing a benefit to the recipient whenever those terms are more favorable than the terms that are available at market. A government entity 'operating on commercial principles' is still a government entity. It is not the commercial market.").
[378] U.S. 2 April answer to question 98, para. 227.
[379] Brazil's First Written Submission, paras. 389-393.

export transactions with tenors exceeding 180 days or, exceptionally, 360 days.[380] The *minimum* tenor for a transaction to qualify for MTI cover is 360 days. Thus, MTI cover is not available for agricultural products.

235. Brazil fails to see how this criticism aids the United States' defense. All the U.S. observation establishes is that it is not even possible to identify a *non*-market instrument *distorted by government intervention* to serve as a benchmark for GSM 102 ECGs issued for tenors exceeding, at most, 360 days, let alone a *market* instrument. The compliance Panel will recall that in Congressional testimony, the Chairman of CoBank stated that GSM 102's three-year tenor "is critical to the program's success," and that the program "provides for tenors that are typically unavailable in the market and this is a crucial strength of the program."[381]

236. In any event, as Brazil has already explained and the United States has ignored, the fact that a financial instrument does not apply to agricultural products does not undermine the comparability of its fees to GSM 102 fees, and in fact reveals that the ExIm Bank comparison is overly generous to the United States.[382]

237. There is no reason why guarantees for agricultural products should be less risky than credit protection for transactions involving capital goods and products. If anything, making agricultural products subject to ExIm Bank's MTI cover would *increase* MTI fees. In an agricultural export transaction, the value of the product sold holds little value for the guarantor as a security against default by the foreign obligor. Shortly after sale, an agricultural commodity is likely to be (and short of preservation may indeed have to be) consumed; the value of any security interest in the commodity will be short-lived, and usually far less than 360 days. In contrast, an industrial product is generally more durable and lasting, and as such is more susceptible to use as security for performance by the foreign obligor, should the guarantor wish to do so. The availability of this option may lower the risk associated with default faced by the guarantor and, as a consequence, lower the fees necessary to offset that risk. Where this option is not viable, the loss in the event of default is greater, as will be the fees necessary to offset the corresponding risk.

Second U.S. criticism:
<u>No ExIm Bank MTI cover for repayment terms between 360 days and 2 years</u>

238. **Second**, the United States appears to suggest that unlike GSM 102, which applies for repayment terms of up to three years and in "hundreds of … transactions" for less than two years, ExIm Bank's MTI is only available for repayment terms of *more than* two years.[383] While not expressed clearly, the U.S. allegation appears to be that Brazil has not offered a valid comparison for GSM 102 fees for transactions involving repayment terms of between 360 days and two years.

239. To isolate with precision the U.S. criticism, Brazil notes that the criticism does not affect the comparability of GSM 102 fees and ExIm LCI fees for transactions involving repayment terms of 360 days or less. Nor does it affect the comparability of GSM 102 fees and ExIm MTI fees for transactions involving repayment terms of between two and three years.

[380] *See* Exhibit Bra-532 (ExIm Bank, "Standard Repayment Terms," Chart II, accessed October 2006 at www.exim.gov/tools/exposure/ebd-m-26.html). *See also* Exhibit Bra-533 (ExIm Bank export credit insurance product description, accessed October 2006 at http://www.exim.gov/products/insurance/index.cfm).

[381] *See* Exhibit Bra-528 ("GSM Programs Benefit U.S. Agriculture and the Rural Economy", Testimony of Otis Molz, Chairman of the Board of CoBank, to the U.S. Senate Committee on Agriculture, Nutrition and Forestry, 18 July 2000, accessed November 2006 at http://agriculture.senate.gov/Hearings/Hearings_2000/Untitled/00718mol.htm).

[382] Brazil's First Written Submission, para. 443.

[383] U.S. 2 April answer to question 98, para. 227.

240. The United States assertion that MTI cover is not available for repayment terms of between 360 days and two years is, to put it bluntly, untruthful. ExIm Bank documents expressly state that MTI coverage is available for repayment terms of 1-5 years.[384] The ExIm Bank calculator with which Brazil generated the MTI fees tracked in Exhibits Bra-536 and Bra-537 also specifically permits the user to control for repayment periods of between 360 days and two years (and beyond).[385]

241. In any event, the vast majority of GSM 102 ECGs are indeed issued for transactions involving repayment terms in excess of two years – to which the United States acknowledges ExIm Bank's MTI policies apply. The United States notes that "hundreds of GSM-102 transactions, totalling hundreds of millions of dollars are in fact for terms of less than 2 years."[386] When the figures offered by the United States are compared to total GSM 102 ECGs issued in FY 2003-2006 (as well as part-year totals for FY 2007), however, the compliance Panel will note that they compose approximately 8 percent of the nearly $10 billion in GSM 102 ECGs issued in that period.[387] Thus, the vast majority of GSM 102 ECGs – 92 percent – are issued for repayment terms of over two years, which even the United States acknowledges matches the repayment terms for ExIm Bank MTI cover.

242. The United States deliberately withheld its comments on Brazil's ExIm Bank comparison until this late stage of the proceedings, having foregone the opportunity to do so in the 7 submissions it made prior to its 2 April answers and subsequent to Brazil's proffer of the comparison in Brazil's First Written Submission. When it finally offers comment, it misleads the compliance Panel with inaccurate factual statements contradicted by the very U.S. government documents and data on which the United States relies. As well as being tardy, the United States' criticisms of Brazil's ExIm Bank comparison are not credible.

Third U.S. criticism:
Differing interest coverage as between GSM 102 and ExIm Bank products

243. **Third**, the United States argues that Brazil's comparison fails to account for differing levels of interest coverage by GSM 102, on the one hand, and ExIm Bank's LCI and MTI policies, on the other.[388]

244. Once again, had the United States taken the opportunity to raise this concern in the 7 submissions it made prior to its 2 April answers, it could have been resolved in a timely manner. Nonetheless, to answer the United States' concern, Brazil has re-run its ExIm Bank comparison to account for differing levels of interest coverage under GSM 102 and ExIm Bank's LCI and MTI policies. The results show that given the massive gap between GSM 102 fees and ExIm Bank fees, differing interest cover has no material impact on the results of the ExIm Bank comparison tracked in Exhibits Bra-536 and Bra-537.

245. The benchmarking exercise tracked in Exhibits Bra-536 and Bra-537 yields a total of 1071 comparison points between GSM 102 and ExIm Bank fees; in 97.76 percent of those comparisons (1047 of 1071 comparison points), GSM 102 fees fall below ExIm Bank fees.[389] Taking account of the differing interest cover noted by the United States means that GSM 102 fees fall below ExIm

[384] *See* Exhibit Bra-534 ("ExIm Bank Repetitive Sales Bank-to-Bank Export Credit Insurance Policy", Form EIB 99-10, p. 1, accessed November 2006 at http://www.exim.gov/pub/ins/pdf/eib99-10.pdf) ("The policy covers credit sales in which payment terms range between one and five years (exceptionally 7 years).").

[385] *See* http://www.exim.gov/tools/fee_calc.html.

[386] U.S. 2 April answer to question 98, para. 227 (and note 236).

[387] *Compare* figures provided in footnote 236 of U.S. 2 April answer to question 98 *with* GSM 102 totals recorded in end-of-fiscal-year Monthly Summaries of Export Credit Guarantee Program Activity for FY 2003-FY 2006, provided, respectively, in Exhibits Bra-518, Bra-510, Bra-511 and Bra-523. The March 2007 monthly summary is available at http://www.fas.usda.gov/excredits/Monthly/ecg.html.

[388] U.S. 2 April answer to question 98, paras. 229-235.

[389] Brazil's First Written Submission, para. 395.

Bank fees in 97.2 percent of the 1071 comparison points (or 1041 of 1071 comparison points).[390] In other words, what the United States characterizes as "[t]he most significant" difference between GSM 102 ECG cover and ExIm Bank LCI and MTI cover that "Brazil has failed to address" changes the result of Brazil's comparison for a grand total of ***six*** out of 1071 comparison points.[391]

246. Brazil now describes how it has factored the differing interest coverage into the comparison, and explains why even the meagre impact just described is likely exaggerated in the United States' favour.

247. As noted by the United States, in the event of default, GSM 102, on the one hand, and ExIm Bank LCI or MTI coverage, on the other, foresee payment of a share of principal, and a share of interest.

248. As far as principal is concerned, under both GSM 102 and ExIm Bank LCI cover, default results in the guarantor having to pay out 98% of the principal amount that is still outstanding; the ExIm Bank fee calculator allows the user to calculate the applicable MTI fee for 98 percent cover.[392]

249. With respect to interest, there are two questions to assess:

- What is the upper limit for interest coverage under GSM 102, on the one hand, and for ExIm Bank LCI and MTI, on the other?

- Where do the actual interest rates on loans secured with GSM 102 or ExIm Bank LCI/MTI cover fall relative to these caps?

250. These questions are important in determining what level of interest coverage must be taken into account in comparing the GSM 102 and ExIm Bank products. In sum, for the reasons explained below, Brazil has relied on the maximum possible difference in interest rate coverage between GSM 102 and ExIm Bank LCI, to assess the significance of differential interest rate coverage.

251. Concerning the first question, the United States asserts, with supporting data, that GSM 102 interest coverage is capped at approximately 2.8%[393], meaning that in the event of default by a foreign obligor, the CCC will pay the U.S. bank no more than 2.8% for unpaid interest, even if the interest rate on the loan to the foreign obligor exceeds 2.8%.

252. ExIm Bank LCI interest coverage is capped at the prime rate (the interest rate charged by major banks to their most creditworthy customers) minus 50 basis points ("bps"). Data provided by the United States shows that the prime rate less 50 bps is, today, equal to approximately 7.8%.[394] Again, this means that in the event of default, ExIm Bank will pay no more than 7.8% interest cover in case of default, even if the interest rate on the loan subject to LCI cover exceeds 7.8%. ExIm Bank MTI interest coverage is not subject to a cap.[395]

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[390] The few instances in which GSM 102 fees exceed ExIm Bank LCI or MTI fees does not mean that GSM 102 fees do not confer "benefits" relative to the market. *See* Brazil's First Written Submission, paras. 403-406, and Annex III (Statement of Professor Rangarajan Sundaram), paras. 17-24.

[391] U.S. 2 April answer to question 98, paras. 230, 229, 235.

[392] For GSM 102, *see* Exhibit Bra-520 ("Export Credit Guarantee Program," USDA FAS Fact Sheet, March 2006). For ExIm Bank LCI, *see* Exhibit Bra-531 (ExIm Bank Letter of Credit Insurance for Banks, ExIm Bank online). For ExIm Bank MTI, the fee calculator is available at http://www.exim.gov/tools/fee_calc.html.

[393] U.S. 2 April answer to question 98, paras. 231, 233 (and note 243) and Exhibit US-156.

[394] U.S. 2 April answer to question 98, paras. 230, 232 (and note 242) and Exhibit US-154.

[395] U.S. 2 April answer to question 98, para. 230.

253. As noted by the United States, maximum interest coverage is, therefore, higher for the ExIm Bank products than for GSM 102 ECGs. To answer the United States' concern with Brazil's ExIm Bank comparison, Brazil re-ran that comparison to account for differing levels of interest coverage under GSM 102 and ExIm Bank's LCI and MTI policies. In so doing, Brazil applied the maximum interest coverage available under the ExIm Bank LCI cap, and applied the ExIm Bank LCI cap for the purposes of MTI cover – or in other words 7.8%. On the other side of the equation, Brazil similarly applied the maximum interest coverage under the GSM 102 cap – or in other words 2.8%. The details of this comparison, including interest coverage, are explained below.

254. The answer to the second question explains why application of the LCI cap, like Brazil's ExIm Bank comparison overall[396], is extremely conservative and favourable to the United States. In short, under both current and historical economic conditions, actual interest rates by borrowers benefiting from LCI or MTI cover fall significantly below the LCI cap.

255. The United States has provided data in these proceedings concerning the interest rates secured by foreign obligors on GSM 102-guaranteed loans. The highest interest rate tracked by the U.S. data is [[ ]][397], which at current levels corresponds to approximately [[ ]].[398] A USDA FAS publication confirms the U.S. data: "Typically interest rates between U.S. banks and the importer's banks are negotiated at Libor, the London Interbank Offered Rate, <u>plus a fraction of a percent</u>."[399] GSM 102, ExIm Bank LCI and ExIm Bank MTI products all contribute the <u>same</u> U.S. government credit rating to a transaction. Therefore, the rates offered on loans secured with ExIm Bank LCI/MTI cover will be the <u>same</u> as the rates offered on loans secured with GSM 102 cover – LIBOR plus a fraction of a percent or, today, approximately [[ ]].[400]

256. This evidence demonstrates that the rates secured with ExIm Bank LCI or ExIm Bank MTI cover do not reach the ExIm Bank LCI cap of 7.8%. Interest rates on loans subject to ExIm Bank LCI/MTI coverage are considerably lower than the LCI cap. While the United States argues that the absence of an interest cap for ExIm Bank MTI cover means that "one can only infer the disparity between CCC interest cover and [MTI cover] is even greater" than the disparity between CCC interest cover and LCI cover[401], this is not a logical or reasonable inference at all, in light of the fact that actual interest rates fall well below even the LCI cap.

257. Nor have rates secured with ExIm Bank LCI or ExIm Bank MTI cover reached the ExIm Bank LCI cap as an historical matter.

258. Over the 10-year period of 1997-present, the prime rate has ranged between a low of 4.0% from July 2003-June 2004, to a high of 9.5% from June 2000-January 2001.[402] The compliance Panel will recall that according to the United States, the LCI cap is set at the prime rate minus 50 bps.[403]

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[396] Brazil's First Written Submission, Annex IV (Methodology for Comparison of GSM 102 Fees with Fees for ExIm Bank Products), para. 6.

[397] U.S. First Written Submission, paras. 122, 125, 129. *See also* Exhibit US-22 (Letter from [[ ]]).

[398] *See* LIBOR USD rates for the first week of April 2007, available at <u>http://www.bba.org.uk/content/1/c4/86/12/Apr07.xls</u>. Averaging the data for the first week of April across maturities yields approximately 5.3%. This data is posted on the website of the British Bankers' Association ("BBA"), which itself determines the LIBOR rate every day by polling international banks. *See* <u>http://www.bba.org.uk/bba/jsp/polopoly.jsp?d=225&a=1416</u>.

[399] Exhibit Bra-589 (Foreign Agriculture Service Online, *Keys to Successful Trade*, p. 5) (emphasis added).

[400] *See* Brazil's 2 April answer to question 100, para. 251.

[401] U.S. 2 April answer to question 98, para. 234.

[402] *See* <u>http://www.moneycafe.com/library/prime.htm</u>, reproduced in Exhibit Bra-692 (LIBOR and Prime rates, 1997 to the present).

259. As discussed above, actual interest rates secured with LCI or MTI cover are pegged to LIBOR, with the addition of "a fraction of a percent,"[404] or as the United States has shown, around [[ ]] bps.[405] Over the 10-year period of 1997-present, LIBOR has ranged between a low of 1.09% in March 2004 and a high of 6.83% in November 2000.[406]

260. As both current economic conditions and historical conditions demonstrate, whether rates are high or low, LIBOR and the prime rate move roughly in tandem.[407] At no point has the LCI cap of prime minus 50 bps come any where close to falling below LIBOR plus [[ ]], or even LIBOR plus 1 percent (100 bps). The gap between the lower interest rates accessible by borrowers benefiting from LCI or MTI cover, on the one hand, and the higher LCI interest coverage cap, on the other, always exists.

261. Even though actual interest rates accessible by borrowers benefiting from LCI or MTI cover have never reached the LCI interest coverage cap and at present economic conditions fall below the cap by [[ ]] bps (7.8% less [[ ]])[408], Brazil has applied the LCI cap as the amount of interest cover available with LCI and MTI cover. Thus, Brazil's assessment of the impact of interest coverage is extremely conservative and favourable to the United States.

262. Thus, in its revised ExIm Bank comparison, Brazil assumes GSM 102 interest coverage at the cap of 2.8%, and ExIm Bank LCI and MTI interest coverage at the LCI cap of 7.8%.[409]

263. Under these conditions, if default occurs on a GSM 102-guaranteed loan, the CCC will pay 100.8% of the remaining principal – 98% towards principal, and 2.8% towards interest. If default occurs on a loan secured with LCI or MTI cover, ExIm Bank will pay 105.8% of the remaining principal – 98% towards principal, and 7.8% towards interest.

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[403] U.S. 2 April answer to question 98, para. 230.

[404] Exhibit Bra-589 (Foreign Agriculture Service Online, *Keys to Successful Trade*, p. 5).

[405] U.S. First Written Submission, paras. 122, 125, 129. *See also* Exhibit US-22 (Letter from [[ ]]).

[406] *See* http://www.moneycafe.com/library/1mlibor.htm, reproduced in Exhibit Bra-692 (LIBOR and Prime rates, 1997 to the present).

[407] *Compare* the 1997-present chart tracking evolution of the LIBOR rate, at http://www.moneycafe.com/library/1mlibor.htm, *with* the 1997-present chart tracking evolution of the prime rate, at http://www.moneycafe.com/library/prime.htm. These charts are reproduced in Exhibit Bra-692 (LIBOR and Prime rates, 1997 to the present).

[408] Over the 10-year period of 1997-present, actual interest rates on ExIm Bank LCI/MTI cover have fallen below the LCI interest coverage cap by between 113 bps (the low, in November 1999) and 326 bps (the high, in January 2001). *Compare* the 1997-present chart tracking evolution of the LIBOR rate, at http://www.moneycafe.com/library/1mlibor.htm (plus the [[ ]] bps noted by the United States as the spread for loans backed by U.S. government credit protection instruments, *with* the 1997-present chart tracking evolution of the prime rate, at http://www.moneycafe.com/library/prime.htm (less the 50 bps noted by the United States to generate the LCI cap). These charts are reproduced in Exhibit Bra-692 (LIBOR and Prime rates, 1997 to the present). The third and final chart in Exhibit Bra-692 represents the difference, in each month, between the LIBOR and prime rates in force.

[409] This is conservative and favorable to the United States for at least two additional reasons. First, the 5% gap between the 2.8% GSM 102 cap used by Brazil and the 7.8% LCI cap used by Brazil is greater than the 4.91% figure cited by the United States as the average size of the gap between GSM 102 and ExIm Bank LCI interest coverage for the period 2005-2007. U.S. 2 April answer to question 98, para. 233. Second, Brazil assumes that interest payments by the borrower on the loan are due annually. How much interest is owed by the CCC or ExIm Bank at the time of default depends on the contractual frequency of interest payments. If interest is paid annually, then at the time of default, the CCC or ExIm Bank are liable for a fully year's interest. If interest is paid quarterly and default occurs after, for example, the close of the second quarter, then at the time of default, the CCC or ExIm Bank are liable for interest on the third and fourth quarters only. Because a longer interval between interest payments increases the dollar magnitude of the differences in interest coverage highlighted by the United States, Brazil's analysis assumes that interest payments are due annually.

264. Let p_{gsm} be the premium charged per dollar of principal for GSM 102 cover, and let p_{exim} be the premium charged per dollar of principal for ExIm Bank LCI or MTI cover. As noted above, a GSM 102 premium pays 100.8% of the remaining principal in the event of default, while an LCI or MTI premium pays 105.8% of the remaining principal in the event of default. This means that per dollar of coverage, CCC charges $p_{gsm}/100.8$, while ExIm Bank charges $p_{exim}/105.8$.

265. If $p_{gsm} < [p_{exim} \times (100.8/105.8)]$, then GSM 102 fees are cheaper than LCI or MTI fees even after accounting for the differentials in interest coverage. Since (100.8/105.8) is approximately 95.3%, wherever GSM 102 fees are less than 95.3% of LCI or MTI fees, GSM 102 fees are below LCI or MTI fees, even accounting for differing interest coverage.

266. On the basis of the GSM 102 and ExIm Bank LCI and MTI fees listed in Exhibits Bra-536 and Bra-537[410], Exhibits Bra-693 (for GSM 102 transactions involving annual repayment of principal) and Bra-694 (for GSM 102 transactions involving semi-annual repayment of principal) list GSM 102 fees as a percentage of ExIm LCI and MTI fees. In every instance in which GSM 102 fees are less than 95.3% of LCI or MTI fees, GSM 102 fees are below ExIm Bank fees, even accounting for differences in interest cover. As Exhibits Bra-693 and Bra-694 show, this is the case in 97.2 percent of the 1071 comparison points (or 1041 of 1071 comparison points).[411]

267. In conclusion, differing interest cover between GSM 102 and ExIm Bank products does not undermine the validity of Brazil's comparison; nor does adjusting for those differences materially influence the results of that comparison.

Fourth U.S. criticism:
Differing principal coverage as between GSM 102 and ExIm Bank MTI cover

268. **Fourth**, the United States notes that while GSM 102 offers coverage for 98% of principal, ExIm Bank's MTI is available for coverage of up to 100% of principal.[412] In paragraph 390 of its First Written Submission, however, Brazil noted that the fee calculator available at ExIm Bank's website allows a user to reduce the amount of coverage, and to calculate the applicable MTI fee for 98 percent principal cover, or in other words, equivalent principal cover to GSM 102. Brazil did so for the purposes of calculating the ExIm Bank MTI fees tracked in Exhibits Bra-536 and Bra-537. Brazil has fully controlled for the possible difference in principal coverage noted by the United States. Not only has the United States waited nearly 5 months to comment on Brazil's ExIm Bank comparison until this late stage of the proceedings, having foregone the opportunity to do so in the 7 submissions it made prior to its 2 April answers, but it misleads the compliance Panel by raising an element that was controlled for by Brazil, *expressly*, in that comparison.

[410] The Panel will recall that wherever a choice was presented with respect to variables in the ExIm Bank calculator used to generate MTI fees, Brazil adopted the most conservative option available, or in other words the option that would result in a lower ExIm Bank fee. *See* Brazil's First Written Submission, Annex IV (Methodology for Comparison of GSM 102 Fees with Fees for ExIm Bank Products), paras. 7-12.

[411] Instead of in 97.76 percent of those comparisons (1047 of 1071 comparison points), without accounting for differences in interest cover, as was the case in Exhibits Bra-536 and Bra-537. *See* Brazil's First Written Submission, para. 395. The few instances in which GSM 102 fees exceed ExIm Bank LCI or MTI fees does not mean that GSM 102 fees do not confer "benefits" relative to the market. *See* Brazil's First Written Submission, paras. 403-406, and Annex III (Statement of Professor Rangarajan Sundaram), paras. 17-24.

[412] U.S. 2 April answer to question 98, para. 236.

Fifth U.S. criticism:
Differing principal coverage as between GSM 102 and ExIm Bank LCI cover

269. **Fifth**, although not disputing that ExIm Bank's LCI product, like GSM 102, covers 98% of principal for transactions involving agricultural products[413], the United States appears to assert that another feature of the LCI product effectively raises principal coverage to 100%. Specifically, the United States alleges that under an ExIm Bank LCI policy, "'the insured may arrange recourse or 'pass back' to a third party of all or any part of any uninsured amount.'"[414] The United States asserts that "[t]his is not permitted under GSM 102," and that therefore, unlike in the case of a holder of an LCI policy, a GSM 102 holder is, under the GSM 102 regulations, not able to insulate itself from exposure to default on the 2% of principal, and any percentage of interest, not covered by the GSM 102 ECG.[415]

270. The United States' characterization of the GSM 102 regulations is misleading and incorrect. The regulations do not support the U.S. contention that the holder of a GSM 102 ECG "is not permitted" to insure the remaining 2% of principal not covered by the GSM 102 ECG. In fact, the regulations establish exactly the opposite – that a holder of a GSM 102 ECG can insulate itself from exposure to default on the 2% of principal, and any percentage of interest, not covered by the GSM 102 ECG.

271. The United States asserts that under Section 1493.110(b)(4) of the GSM 102 regulations, included as Exhibit US-142, "[u]pon default the claimant must subrogate to CCC the claim to the entire amount in default, not just the guaranteed portion."[416] As noted by the United States, Section 1493.110(b)(4)(iv) states that the holder of a GSM 102 ECG must sign an agreement "subrogating to CCC the respective rights of the exporter and the exporter's assignee, if applicable, to the amount of payment in default under the applicable export sale."[417] The United States further asserts that under Section 1493.130(a) of the GSM 102 regulations, "CCC then has the right to recover from the obligor all moneys in default."[418]

272. In other words, the United States implies that although a GSM 102 ECG only covers 98% of principal, in the event of default and payment by CCC to the holder of the ECG of 98% of principal, the CCC enjoys a claim on 100% of any monies recovered from the foreign obligor.

273. The United States has not been fully forthcoming with the compliance Panel. As the United States is surely aware, Sections 1493.110(b)(4)(iv) and 1493.130(a) are not the end of the story. Indeed, Section 1493.130(c) directly contradicts the United States' argument, and show that a GSM 102 ECG holder, as in the case of an ExIm Bank LCI policyholder, is indeed able to insulate itself from exposure to default on the 2% of principal not covered by the GSM 102 ECG.

274. Section 1493.130(c) provides as follows:

> Recoveries made by CCC from the importer or the foreign bank, and recoveries received by CCC from the exporter, the exporter's assignee, or any other source whatsoever, will be allocated by CCC to the exporter or the exporter's assignee and to CCC on a pro rata basis determined by their respective interests in such recoveries. The respective interest of each party will be determined on a pro rata basis, based on the combined amount of principal and interest in default. <u>Once CCC has paid out a</u>

[413] *See* Exhibit Bra-531 ("ExIm Bank Letter of Credit Insurance for Banks," accessed October 2006 at http://www.exim.gov/products/insurance/loc.html).
[414] U.S. 2 April answer to question 98, para. 236.
[415] U.S. 2 April answer to question 98, para. 236.
[416] U.S. 2 April answer to question 98, para. 236.
[417] 7 CFR Section 1493.110(b)(4)(iv). *See* Exhibit US-142.
[418] U.S. 2 April answer to question 98, para. 236.

particular claim under a GSM-102 or GSM-103 payment guarantee, CCC prorates any collections it receives and shares these collections proportionately with the holder of the guarantee until both CCC and the holder of the guarantee have been reimbursed in full.[419]

275. The underscored sentence is particularly significant. Following default by a foreign obligor on a GSM 102-guaranteed loan from a U.S. bank, the U.S. bank files a claim with the CCC. Upon receipt of the claim, the CCC pays the U.S. bank 98% of principal and any interest up to the GSM 102 cap. Subsequently – "[o]nce CCC has paid out a particular claim"[420] – CCC seeks to collect from anyone it can. If the CCC succeeds in securing collections, the regulations state that it "shares these collections proportionately with the holder of the guarantee until both CCC and the holder of the guarantee have been reimbursed in full."[421]

276. If the United States were correct that the CCC is entitled to 100% of any recoveries it secures from the foreign obligor, why would the U.S. exporter, or more likely the U.S. bank, as the exporter's assignee and the holder of the guarantee, be entitled to a prorated, proportionate share of any collections secured by the CCC? If the United States were correct, once the U.S. bank, as the holder of the guarantee, was paid its claim – 98% of principal and any interest up to the GSM 102 cap – it would be entitled to nothing more. The U.S. bank would at that point "have been reimbursed in full", and any subsequent monies secured by the CCC as part of its collection efforts would be for the CCC to retain.

277. But the United States is not correct. Section 1493.130(c) clarifies that if the CCC's collection efforts are successful, the holder of the guarantee is indeed entitled to more than its claim to 98% of principal and any interest up to the GSM 102 cap. Out of any collections secured by the CCC subsequent to payment of the U.S. bank's claim, the U.S. bank is entitled to its "proportionate[]" share – presumably, up to the remaining 2% of principal, and the portion of interest, not covered by the GSM 102 ECG. The U.S. bank need not wait until CCC has been made whole; rather, CCC's claim on recoveries is ranked *pari passu* with the U.S. bank's claim on recoveries.

278. In other words, the United States has mischaracterized the GSM 102 regulations, asserting a difference between GSM 102 and ExIm Bank's LCI cover that does not exist. As with ExIm Bank's LCI policy, GSM 102 cover allows the holder of a GSM 102 guarantee to recover amounts in excess of 98% of principal and any interest up to the cap.

279. In fact, GSM 102 may well be superior to ExIm Bank's LCI cover in this regard. Section 1493.130(c) of the GSM 102 regulations, quoted at length above, provides that after CCC has paid a claim, it shares recoveries on a pro rata basis with the U.S. bank. This means that CCC's claim on recoveries is ranked *pari passu* with the U.S. bank's claim, rather than senior to the U.S. bank's claim.

280. In contrast, under ExIm Bank's LCI, were the exporter or the U.S. bank to arrange cover with a third party for 2% of the principal and any portion of interest not covered by the ExIm Bank LCI policy, that third party's claim may well rank junior to ExIm Bank's claim. In that case, Section 1493.130(c) of the GSM 102 regulations would mean that GSM 102 provides a superior product from the exporter or the U.S. bank's standpoint. With a GSM 102 ECG, the exporter or the U.S. bank does not stand in line behind the CCC to recover the 2% of principal and any portion of interest not covered by the GSM 102 ECG; rather, out of the first and last dollar of recoveries secured by the CCC, the exporter or the U.S. bank gets its pro rata share. If anything, this means that

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[419] 7 CFR Section 1493.130(c) (emphasis added). *See* Exhibit US-142.
[420] 7 CFR Section 1493.130(c). *See* Exhibit US-142.
[421] 7 CFR Section 1493.130(c). *See* Exhibit US-142.

GSM 102 fees should be even higher than ExIm Bank LCI fees, rather than the reverse, as the United States asserts.

281. Even if this is not the case, however, as Brazil has explained above, Section 1493.130(c) of the GSM 102 regulations means, at the very least, that the difference between GSM 102 and ExIm Bank's LCI cover alleged by the United States does not exist. Having foregone the opportunity to comment on Brazil's ExIm Bank comparison in the 7 submissions it made prior to its 2 April answers and subsequent to Brazil's profer of the comparison, the United States' misleading and inaccurate characterization of its own regulations at this late stage of the proceedings is disappointing and not credible.

99. Please comment on Brazil's argument that the GSM 102 fees are not sufficiently scaled to take into account country risk (i.e. they vary only minimally according with country risk) (see, inter alia, paras. 410-412 Brazil's First Written Submission).

282. The United States argues that there is "no basis in the text" of the *SCM Agreement* for Brazil's assertion that GSM 102 fees are insufficiently scaled to account for risk.[422] The United States notes that it "is not aware of any provision of the *SCM Agreement* that establishes what constitutes 'sufficient' scaling."[423]

283. The United States may be unaware of Article 1.1(b) of the *SCM Agreement*, which has been interpreted by the Appellate Body to require a comparison between the terms offered a recipient for a government financial contribution, and the terms available to the recipient for a comparable instrument secured at market.[424] Brazil has demonstrated that there is no credit protection product available in the marketplace that is comparable to a GSM 102 ECG.[425] Nonetheless, Brazil has additionally undertaken a comparison between GSM 102 fees and fees for comparable non-market products offered by ExIm Bank.

284. That comparison exercise, undertaken methodically on a country-by-country, tenor-by-tenor basis, demonstrates that GSM 102 fees are consistently below ExIm Bank fees. At paragraph 400 of its First Written Submission, Brazil also demonstrated graphically that ExIm Bank fees rise much more sharply than GSM 102 fees in response to increased transaction risks, even if ExIm Bank fees do not represent the market. Consistent with fundamental tenets of corporate finance, as maturity and, in particular, country risk, increases, the *rate* at which ExIm Bank fees rise increases significantly. The same cannot be said of GSM 102 fees, which are barely responsive to increased risks arising from longer maturities and/or increased country risk.

285. In other words, by comparison to other similar instruments, GSM 102 fees are insufficiently scaled to account for transaction risks that even non-market entities take into account. The comparison exercise undertaken by Brazil enjoys a basis in the relevant provisions of the *SCM Agreement* – specifically, Article 1.1(b) of the *Agreement*, as interpreted by the Appellate Body.

4. Item (j) of the Illustrative List

Questions to both parties

102. What, in your view, explains the different results achieved by the two methods advocated, on the one side, by the United States in paragraphs 87-89 of its First Written Submission and by Brazil in

[422] U.S. 2 April answer to question 99, paras. 237, 238.
[423] U.S. 2 April answer to question 99, para. 237.
[424] Appellate Body Report, *Canada – Aircraft*, para. 157.
[425] Brazil's First Written Submission, paras. 377-378. *See also Id.*, Annex III (Statement of Professor Rangarajan Sundaram), paras. 8-9.

Exhibit Bra-613 (other than the United States' criticism that Brazil has not taken recoveries corresponding to pre-1992 guarantees into account in its "cash basis" accounting calculations, of which the Panel is already aware)?

286. The United States suggests that Brazil is backing away from net present value accounting as a reliable way to measure the long-term costs of the GSM 102 program.[426] If it is not already abundantly clear to the United States[427], Brazil agrees that net present value accounting is a reliable way to account for the costs of contingent liabilities.

287. Using a net present value methodology, the CCC has, in every year since the inception of credit reform in 1992 (including in budgets for FY 2006, 2007 and 2008[428], under the amended GSM 102 fee schedule), projected that costs and losses for the "cohort" of ECGs issued in the coming fiscal year would, at closing, exceed projected fees, penalties and recoveries. Using the same net present value methodology, CCC's 2006 audited financial statements state that the CCC does not anticipate covering the costs and losses of the ECG programs across all outstanding cohorts of ECGs issued since 1992.[429]

288. As noted in Brazil's 2 April response to question 105 (at paragraphs 283-307), it is the United States that is backing away from the net present value methodology, while trying to give the impression that it embraces that methodology.

289. First, in these proceedings, the United States consistently derides the net present value methodology required by U.S. law as "unreliable", because it allegedly does not reflect the CCC's particular experience[430] – a proposition with which USDA and FAS disagree, outside the context of WTO litigation.[431]

290. Second, although the projections of long-term losses included in the 2006 CCC financials, and in the U.S. budgets for GSM 102 ECGs issued in fiscal years 2006, 2007 and 2008, are calculated using the net present value methodology mandated by U.S. law, the United States derides these projections as not reflective of "actual" results.[432] The United States' objection that this evidence does not reflect "actual" results most clearly demonstrates its abandonment of the net present value approach. By definition, net present value calculations are projections of future results, discounted back to present value terms. The only way the United States will accept a net present value

[426] U.S. 2 April answer to question 102, paras. 240-242.

[427] Brazil's First Written Submission, paras. 433-437; Brazil's Rebuttal Submission, paras. 483-484, 501-511; Brazil's Oral Statement, paras. 252-254, 257-260.

[428] Exhibit US-71.

[429] Exhibit Bra-585 (Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2005 and 2006, Report No. 06401-21-FM, November 2006, p. 11, 26 of Notes to the Financial Statements) (identifying a USD 220 million "credit guarantee liability", defined as representing "the estimated net cash outflows (loss) of the guarantees on a net present value basis.").

[430] U.S. Rebuttal Submission, paras. 111-125.

[431] Exhibit Bra-588 (Agricultural Export Credit Guarantee Programs Assessment, ExpectMore.gov, Section 3.CR2, accessed January 2007 at http://www.whitehouse.gov/OMB/expectmore/detail.10002020.2005.html) (the "credit models used to calculate the subsidy for the guaranteed credits were revised in FY2001 and FY2003 and currently provides reliable estimates", and identifies the model applied specifically as "[t]he USDA model") (emphasis added); Exhibit Bra-616 (U.S. Department of Agriculture, Office of the Chief Financial Officer, Credit, Travel, and Accounting Division, *Agriculture Financial Standards Manual* (May 2004), p. 121, accessed December 2006 at http://www.ocfo.usda.gov/reports/index.htm) ("In estimating default costs, the following risk factors are considered: (1) loan performance experience ….").

[432] *See* U.S. Rebuttal Submission, para. 88; U.S. 2 April answer to question 108, paras. 276-277.

methodology is if it is converted into a retrospective, cash-basis accounting methodology, by taking account of re-estimates.[433] This amounts to a rejection of the net present value approach.

104. Must a risk-based fee necessarily take into account foreign obligor risk? Please discuss and provide any relevant support for your position. Can foreign obligor risk be treated differently than country risk in this respect, and if so, why?

291. The United States argues that there is "no basis in the text for the obligation" to taken into account foreign obligor risk in setting an ECG fee.[434]

292. The United States may be unaware of item (j) of the Illustrative List, which requires an assessment of "premium rates" for an ECG program, and "long-term operating costs and losses" of the program. As noted by the original panel, item (j), "where a programme does not provide for premium rates that are fully reflective of the risks of a particular transaction, this might be one indicator that the programme was set up in such a way that its long-term operating costs and losses have to be borne, in total or in part, by the government."[435] The United States may also be unaware that Article 1.1(b) of the *SCM Agreement* defines a subsidy as a government financial contribution provided on terms that are better-than-market. Market-based institutions do not provide credit protection instruments without taking account of foreign obligor risk.

293. Brazil has submitted evidence demonstrating that to be "fully reflective of the risks of a particular transaction"[436], ECG fees must be set to take account of foreign obligor risk.[437] The United States has offered no evidence to rebut Brazil's showing that market-based financial institutions (let alone other U.S. government entities providing credit protection instruments similar to GSM 102 ECGs[438]) do not rely on exposure limits alone to adequately manage risk.

106. The parties disagree as to whether Brazil should include recoveries for pre- 1992 guarantees in its cash basis accounting formula (Exhibit Bra-613). Is the Panel correct in understanding that Brazil's formula does not includes amounts for (1) claims paid after 1992 under pre-1992 guarantees; (2) fees paid on pre-1992 guarantees? If so, please explain the relevance or non-relevance of including recoveries under pre-1992 guarantees in light of the non-inclusion of costs and other revenues related to the same guarantees.

294. In paragraph 266 of its 2 April response, the United States addresses CCC's recent, massive write-offs of uncollectible amounts attributed to pre-1992 ECGs, as recorded in the United States' "liquidating account". In Brazil's view, these write-offs offer an additional reason why the liquidating account does not turn a cash-basis assessment of program losses into program profits, as the United States has asserted.[439] Writing off billions of dollars worth of losses does not make a program profitable.[440]

[433] *See*, *e.g*., U.S. First Written Submission, para. 87; U.S. 2 April answer to question 102, para. 244.
[434] U.S. 2 April answer to question 104, para. 251.
[435] Panel Report, *U.S. – Upland Cotton*, para. 7.805.
[436] Panel Report, *U.S. – Upland Cotton*, para. 7.805.
[437] *See* Brazil's Rebuttal Submission, para. 498 and Exhibit Bra-615.
[438] *See* "transaction risk increment" field in the U.S. Export-Import Bank fee calculator, defined at http://www.exim.gov/tools/calchelp.cfm.
[439] U.S. Rebuttal Submission, paras. 97-99.
[440] *See* Brazil's Oral Statement, paras. 261-263.

Questions to the United States

107. What can explain the discrepancy between the "credit guarantee liability" recorded in the CCC's financial statements (which suggest that the program is provided at a net cost to the US government) and the evidence presented by the US in para. 87 of its First Written Submission?

295. Please see Brazil's comment on the U.S. response to question 108.

108. Please explain why the "liability" figure in the CCC's financial statements should not be considered by the panel to provide, if not the amount of actual losses, at least a reliable estimate of the CCC's own perception of the cost to the government of the programmes since their inception. Is the Panel wrong in understanding that a "credit guarantee liability" in this context means that the CCC considers that the programmes will not cover their costs and losses in the long term?

296. The United States misrepresents the significance of the "credit guarantee liability" figure in the 2006 CCC financial statements.

297. The United States' response ignores altogether the definition of "credit guarantee liability" included in the financial statements itself. The definition reads as follows:

> Credit guarantee liabilities represent the estimated **net** cash outflows (loss) of the guarantees on a net present value basis. To this effect, CCC records a liability and an expense to the extent, in management's estimate, CCC will be unable to recover claim payments under the Credit Reform Export Credit Guarantee programs.[441]

298. The bold, underlined word "net" belies the U.S. assertion that the credit guarantee liability figure in the CCC financial statements includes only a "liability for which there is an offsetting balance sheet entry of an asset."[442] By the express terms of this definition, the credit guarantee liability figure in CCC's financials represents "net" cash outflows or losses – meaning that having netted expected cash inflows against expected cash outflows on a net present value basis, the CCC expects that the latter will exceed the former, and that it will therefore experience a "loss" (another term expressly used in the definition).

299. As acknowledged by the United States, the original panel, in its adopted findings, agreed. The United States notes the original panel's finding that "the credit guarantee liability represented a prospective estimate of anticipated experience under the program".[443] This is somewhat of an understatement. Citing the credit guarantee liability figures from the 2002 and 2003 CCC financial statements, the original panel stated as follows:

> [W]e note that the CCC financial statements for the years 2002 and 2003 indicate a "credit guarantee liability" of $411 million and $22 million, respectively. The CCC defines the term "credit guarantee liability" as the estimated cash outflows of the guarantees on a net present value basis. "Liability" is defined as "...a probable future

[441] *See* Exhibit Bra-585 (Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Years 2006 and 2005, Report No. 06401-21-FM, November 2006, p. 11, 26 of Notes to the Financial Statements) (emphasis added). This is virtually identical to the net present value formula called for by the U.S. Federal Credit Reform Act. Exhibit Bra-656 (2 U.S.C. 661a(5)(C)) ("The cost of a loan guarantee shall be the net present value, at the time when the guaranteed loan is disbursed, of the following estimated cash flows: (i) payments by the Government to cover defaults and delinquencies, interest subsidies, or other payments; and (ii) payments to the Government including origination and other fees, penalties and recoveries . . .").

[442] U.S. 2 April answer to question 108, para. 268.

[443] U.S. 2 April answer to question 108, para. 277, *citing* Panel Report, *U.S. – Upland Cotton*, para. 7.855.

> outflow or other sacrifice of resources as a result of past transactions or events." We observe that these amounts are not actual losses. They are but another indicator, used and relied upon by the United States government, to assess the estimated long-term cost to the United States government of export credit guarantees. They are consistently positive, indicating to us that the CCC believes, based upon its own assessment, that it may not, even over the long term, be able to operate the export credit guarantee programmes without some net cost to government.[444]

300. In its response, the United States not only asks the compliance Panel to revisit the original panel's adopted findings regarding what the credit guarantee liability figure represents, but further challenges the reliability of the credit guarantee liability figure as a basis on which to make an item (j) assessment of long-term costs and losses, because it is a future-oriented assessment of long-term losses on a net present value basis rather than an "actual" or "retrospective" loss.[445] The United States made the same arguments during the original proceedings.[446] The original panel and the Appellate Body rejected the U.S. arguments, and accepted a forward-looking approach to the assessment of the ECG programs under item (j).[447]

301. These adopted findings should be followed by the compliance Panel. Prior adopted panel and Appellate Body reports create "legitimate expectations" among WTO Members, and should be taken into account by panels when they are relevant to the resolution of a dispute.[448] Further, where the issues before a panel are the same as those previously examined by the Appellate Body, it is "not only appropriate," but to "be expected," that the panel would follow the Appellate Body's earlier conclusions.[449]

302. With respect to compliance proceedings, in particular, the Appellate Body has stated that "Article 21.5 proceedings do not occur in isolation but are part of a '*continuum of events*.'"[450] The Appellate Body observed that "doubts could arise about the *objective nature* of an Article 21.5 panel's assessment if, on a specific issue, that panel were to *deviate* from the reasoning in the original panel report in the absence of any change in the underlying evidence."[451]

303. Nothing about the way in which the credit guarantee liability figure is defined in the CCC financial statements, or calculated, has changed from the original proceedings.[452] To find now that the

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[444] Panel Report, *U.S. – Upland Cotton*, para. 7.855 (footnotes omitted).

[445] U.S. 2 April answer to question 108, paras. 275-276.

[446] The United States appealed this specific element of the original panel's analysis. U.S. Appellant's Submission in *U.S. – Upland Cotton*, paras. 407 and 410-413 (and note 419), *available at* http://www.ustr.gov/assets/Trade_Agreements/Monitoring_Enforcement/Dispute_Settlement/WTO/Dispute_Settlement_Listings/asset_upload_file938_5598.pdf. For U.S. arguments before the original panel, *see* U.S. 11 July 2003 First Written Submission, paras. 176-178; U.S. 11 August 2003 Answers to Panel Questions, paras. 157, 159, 170 and 173; U.S. 22 August 2003 Rebuttal Submission, paras. 161-162, 167, 171; U.S. 30 September 2003 Further Submission, para. 151; U.S. 18 November 2003 Further Rebuttal Submission, paras. 196-199; U.S. 22 December 2003 Answers to Panel Questions, paras. 86, 90, 91-95, 96-99, 100-101, 103, 117-121 and U.S. 11 February 2004 Answers to Further Panel Questions, para. 21.

[447] Appellate Body Report, *U.S. – Upland Cotton*, paras. 763-764 and Panel Report, *U.S. – Upland Cotton*, paras. 7.842-7.843. *See also Id.*, para. 7.835 ("[T]he item (j) analysis need not be a purely retrospective one ….").

[448] Appellate Body Report, *U.S. – Softwood Lumber V*, para. 111.

[449] Appellate Body Report, *U.S. – OCTG Sunset Reviews*, para. 188.

[450] Appellate Body Report, *U.S. – Softwood Lumber IV (21.5)*, para. 103 (emphasis added) citing Appellate Body Report, *Mexico – Corn Syrup (21.5)*, para. 121. *See* Brazil's First Written Submission, para. 28.

[451] Appellate Body Report, *U.S. – Softwood Lumber VI (21.5)*, para. 103 (emphasis added).

[452] The United States' argument that the credit guarantee liability figure in the CCC financial statements includes only a "liability for which there is an offsetting balance sheet entry of an asset" does *not* represent a *change to the definition or calculation of the credit guarantee liability figure* since the original proceedings.

figure is unreliable would involve a significant departure from the findings in the original proceedings, with no valid basis for that change. It would also involve a violation of the principle of *res judicata*, because the reliability of the estimates has been definitively resolved for purposes of this dispute. As noted by the panel in *U.S. – Gambling (21.5)*, "[a] re-assessment in a compliance proceeding of an issue that had already been ruled upon in an original proceeding in an adopted report, even with better arguments by the respondent but without a change relevant to the underlying facts in the intervening period, would run counter to the prompt settlement of disputes."[453] The United States is not entitled to re-litigate an issue that has been definitively resolved for purposes of this dispute.

Rather, it is simply a new argument by the United States, and one that, as addressed above, is belied by the very definition of "credit guarantee liability" included in CCC's financial statements and relied on by the original panel.

[453] Panel Report, *U.S. – Gambling (21.5)*, para. 6.53.

ANNEX D-15

UNITED STATES' COMMENTS ON THE RESPONSES OF BRAZIL TO THE PANEL'S SECOND SET OF QUESTIONS

(24 April 2007)

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TABLE OF EXHIBITS

Exhibit US-	Title
165	"China: Cotton import quotas of 1.5mn tons to be issued," available at www.fibre2fashion.com (April 24, 2007).
166	U.S. Export Sales for Week Ending 4.12.2007, available at www.fas.usda.gov/export-sales/cottfax.htm
167	U.S. Export Sales Weekly Export Performance Indicator for Week Ending 4.12.2007, available at http://www.fas.usda.gov/esrquery/esrpi.aspx.
168	NASS March 2007 Cotton Ginnings Report
169	N.Y. Futures After Issuance of Planting Intentions Report

1. In its answers to the second set of questions from the Panel, Brazil has reasserted many of the same unfounded arguments presented in its earlier submissions, which the United States has already addressed and rebutted. Many of Brazil's answers to questions also repeat the same information. The United States does not intend to resubmit all of these U.S. arguments in response. Rather, for the convenience of the Panel, the United States first offers one general comment regarding Brazil's answers to each major section of the Panel's questions. The United States then proceeds to address those aspects of Brazil's answers that are either new or call for further comment. Where possible, the United States refers the Panel to its prior submissions where Brazil's arguments have been addressed.

2. To the extent the United States does not address a particular answer or a particular aspect of an answer, this is not intended as – and should not be understood to be – agreement with Brazil's position.

I. GENERAL COMMENTS REGARDING BRAZIL'S ANSWERS

A. BRAZIL HAS NO BASIS TO CHALLENGE MEASURES THAT WERE NEITHER ORIGINAL MEASURES SUBJECT TO ANY FINDING OF WTO-INCONSISTENCY OR DSB RECOMMENDATIONS AND RULINGS NOR MEASURES TAKEN TO COMPLY WITH ANY RECOMMENDATIONS AND RULINGS[1]

3. Brazil repeats in its answers to Questions 44 to 46 the incorrect argument that it is entitled to renew in this "compliance" proceeding under Article 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") claims against measures (a) that were never found to be WTO-inconsistent and were never subject to any DSB recommendations and rulings; and (b) that are not measures taken to comply with any recommendations and rulings.[2] These measures include the GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat. They also include the marketing loan and counter-cyclical payment programs and payments made under the program in years beyond MY 1999-2002. Brazil's arguments continue to be unavailing.

1. <u>Neither GSM 102 guarantees in respect of exports of pig meat and poultry meat nor Brazil's claims with respect to them are within the scope of this proceeding</u>

4. Brazil's assertion of an "entitlement" to make a claim against GSM 102 guarantees in respect of exports of pig meat and poultry meat rests on two untenable grounds. First, Brazil asserts erroneously that *any* changed measure may be challenged in a compliance proceeding regardless of whether it was "taken to comply" with any recommendations and rulings of the DSB.[3] And, second, Brazil asserts that a complaining party may renew in a compliance proceeding any claims that were not "definitively resolved" in the original proceeding.[4] Neither proposition finds support in the DSU.

5. Contrary to Brazil's assertions, the test of whether a measure is properly within the scope of an Article 21.5 compliance proceeding is not simply whether it has changed since the original proceeding. That would effectively write out of Article 21.5 the requirement that the measure be "taken to comply" with the DSB's recommendations and rulings. Rather, under the express terms of Article 21.5, the touchstone of what is and is not a "measure taken to comply with the

[1] The United States does not submit comments regarding Brazil's claims in respect of compliance in past periods as none of Brazil's answers to the second set of questions relate to that issue. For the U.S. arguments in respect of those claims, the United States respectfully refers the Panel to the U.S. First Written Submission, paras. 49-56, U.S. Rebuttal Submission, paras. 64-71, U.S. Answers to Parts A-C of First Set of Panel Questions, paras. 45-46, U.S. Comments on Brazil's Answers to First Set of Panel Questions, paras. 104-111, and U.S. Answers to Second Set of Panel Questions, paras. 54-61.

[2] *See* Brazil Answers to Second Set of Questions, paras. 1-35.

[3] *See e.g.,* Brazil Answers to Second Set of Questions, para. 6, 34.

[4] *See e.g.,* Brazil Answers to Second Set of Questions, para. 7.

recommendations and rulings" of the DSB is – necessarily – the DSB's recommendations and rulings. Where the DSB's recommendations and rulings distinguish between different components of a measure or different measures, that distinction is determinative for purposes of the compliance proceeding as well.

6. Here, the DSB's recommendations and rulings clearly distinguish "export credit guarantees under the GSM 102, GSM 103 and SCGP export credit guarantee programmes . . . *in respect of exports of upland cotton and other unscheduled agricultural products supported under the programmes, and in respect of one scheduled product (rice)*"[5] from other export credit guarantees under those programs. As Brazil's response to Question 44 confirms, this distinction goes to which *measures* were found to be WTO-inconsistent (*i.e.,* which measures the United States was obligated to bring into compliance with its obligations under Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*). The question for this compliance Panel, then, is whether Brazil has demonstrated either that the United States has (a) not brought those measures (export credit guarantees in respect of rice and unscheduled products) into conformity with the DSB's recommendations and rulings or (b) that those measures – as modified – are inconsistent with the provisions of the WTO Agreement cited by Brazil.[6]

7. Brazil has attempted to obscure this distinction by insisting variously that (a) the original panel's findings were made with respect to the GSM program as a whole[7] and that guarantees thereunder are not even "measures" for purposes of WTO dispute settlement[8], (b) that it is Brazil's *claims* and not the measures challenged that are "product specific;"[9] (c) that the United States has made changes across the entire GSM 102 program including with respect to export credit guarantees in respect of exports of pig meat and poultry meat[10], and (d) and that the GSM 102 program applies in

[5] *Upland Cotton (Panel)*, para. 8.1(d) (emphasis added). This is because the original panel found that Brazil had only made its case under Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement* with respect to export credit guarantees provided in respect of exports of rice and unscheduled products.

[6] There can be no presumption that the U.S. measures taken to comply are inconsistent with its WTO obligations; the burden is on Brazil to prove inconsistency.

[7] As the United States has explained, this argument is inconsistent with Brazil's prior arguments and the original panel's resolution of Brazil's claims. *See* U.S. Comments on Brazil's Answers to First Set of Panel Questions, paras. 12-15. This even contradicts Brazil's own clarification in its rebuttal submission that "*Brazil does not assert that the GSM 102 program itself circumvents the United States' export subsidy commitments, within the meaning of Article 10.1 of the Agreement on Agriculture*." Brazil Rebuttal Submission, para. 378 (emphasis added).

[8] *See, e.g.,* Brazil Responses to Panel Section A-C Questions, para. 29. This argument is at odds with Brazil's arguments elsewhere that an *a contrario* reading of item (j) would prevent a Member from challenging specific export credit guarantees (*i.e.,* as opposed to the export credit guarantee *programs* generally). *See* U.S. Comments on Brazil's Answers to First Set of Panel Questions, paras. 10-11. If specific guarantees cannot even constitute "measures," as Brazil now asserts, Brazil's complaints about being able to make claims against specific guarantees would be entirely moot. Brazil's argument is also inconsistent with the clarification by the Appellate Body that a "measure" for purposes of WTO dispute settlement may encompass "[i]n principle, any act or omission attributable to a WTO Member. . . ." *United States – Corrosion-Resistant Steel (AB)*, para. 81.

[9] Calling Brazil's claims "product-specific" does not change the fact that only particular guarantees – those provided in respect to the particular "product" at issue – are the subject of the claims. Where those guarantees were not the subject of any DSB recommendations and rulings and are not measures taken to comply with any DSB recommendations and rulings – as in the case of the GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat – there is no basis for a claim to be considered with respect to them in a DSU Article 21.5 proceeding. See U.S. Comments on Brazil's Answers to First Set of Panel Questions, paras. 16.

[10] *See e.g.,* Brazil Answers to Second Set of Panel Questions, para. 6. As the panel in *EC – Bed Linen (21.5)* recognized the mere fact that improvements have been made to more than just the original measures subject to findings of WTO-inconsistency and DSB recommendations and rulings does not render all changed measures "measures taken to comply." *See* U.S. U.S. Answers to Second Set of Panel Questions, paras. 1-16 (discussing *EC – Bed Linen (21.5) (Panel)*, paras. 6.9-6.22)).

the same way regardless of what products are involved.[11] As the United States has explained[12], however, not only are certain of these assertions wrong, they do not alter the conclusion that GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat are not within the scope of this proceeding.

2. The marketing loan and counter-cyclical payment programs, payments made thereunder after MY 2002, and Brazil's claims in respect of those measures are outside the scope of this proceeding

8. In its response to Question 45, Brazil continues to press the Panel impermissibly to expand the scope of this compliance proceeding to include claims against the marketing loan and counter-cyclical payment programs and payments made thereunder in periods after MY 2002. Brazil's arguments turn on its own pronouncements that the original panel did in fact find the Step 2, marketing loan, and counter-cyclical payment programs to be causing "present" serious prejudice and that it similarly found payments allegedly "mandated" to be made thereunder in MY 2003-2007 to be causing "present" serious prejudice (though, of course, such payments had not even been made as of the time the matter was referred to the original panel). These pronouncements are flatly contradicted by the facts and the express language of the original panel report.

9. Brazil's approach in Question 45 – as it has been throughout this proceeding – consists of cherry-picking individual sentences of the panel report and imposing upon them a strained reading that is neither supported by the context nor consistent with the most basic principles of WTO dispute settlement (e.g., that a panel cannot make the claim for a complaining party, let alone make claims never presented by a complaining party). As the United States has explained, there is no merit to these arguments.[13]

10. In fact, it is remarkable that, in its response to Question 45 from the Panel, Brazil accuses the United States of "mischaracteriz[ing] the original panel's findings from beginning to end."[14] Not only is this untrue, but the irony of the accusation is that Brazil has never even attempted to reconcile its arguments with the "original panel's findings from beginning to end." So, for example, Brazil has never explained what legal basis this Panel has for ignoring the original panel's *actual* conclusion on present serious prejudice:

> In conclusion, in light of all of these considerations, we find that the effect of the mandatory, price contingent United States subsidies at issue – *that is*, marketing loan programme *payments*, user marketing (Step 2) *payments* and MLA *payments* and CCP *payments* – is significant price suppression in the same world market for upland cotton in the period MY 1999-2002 within the meaning of Articles 6.3(c) and 5(c) of the SCM Agreement.[15]

This conclusion *on its face* contradicts Brazil's assertion that "the United States . . . wrongly assumes that 'U.S. subsidies' does not include the legislative and regulatory provisions – the subsidy

[11] *See e.g.*, Brazil Answers to Second Set of Panel Questions, para. 4. Contrary to Brazil's assertions, the U.S. argument is not premised on the assumption "that different ECG measures apply to different products." Brazil Answers to Second Set of Panel Questions, para. 4. As the United States has explained, this is irrelevant to the U.S. arguments.

[12] U.S. First Written Submission, paras.24-30, U.S. Rebuttal Submission, paras. 10-15, U.S. Answers to Parts A-C of First Set of Panel Questions, paras. 17-26, U.S. Comments on Brazil's Answers to First Set of Panel Questions, paras. 8-44, and U.S. Answers to Second Set of Panel Questions, paras. 1-16 and 42-48.

[13] U.S. First Written Submission, paras. 31-48, U.S. Rebuttal Submission, paras. 16-63, U.S. Answers to Parts A-C of First Set of Panel Questions, paras. 27-44, U.S. Comments on Brazil's Answers to First Set of Panel Questions, paras. 45-103, and U.S. Answers to Second Set of Panel Questions, paras. 17-41.

[14] Brazil Answers to Second Set of Panel Questions, para. 12.

[15] *Upland Cotton (Panel)*, para. 7.1416.

programs – mandating the subsidy payments."[16] The language confirms that the United States has not *assumed* – let alone *wrongly* assumed – what the "U.S. subsidies" are, as Brazil charges.

11. To the contrary, as the original panel clearly states, the "United States subsidies at issue" . . . [are] marketing loan programme *payments*, user marketing (Step 2) *payments*, MLA *payments*, and. . . CCP *payments*." There is no other way to understand the language in between the dashes in the conclusion or the fact that the original panel uses the introductory phrase "that is" – a phrase used for clarification of what a term means – to explain that the "subsidies at issue" are marketing loan programme *payments*, user marketing (Step 2) *payments*, MLA *payments*, and counter-cyclical *payments*. Brazil has never reconciled its theory – that the "subsidies at issue" include the programs providing for these payments – with this language or with the scores of other clear indications by the original panel that the subsidies subject to its "present" serious prejudice examination were payments made in MY 1999-2002 under, *inter alia*, the Step 2, marketing loan, and counter-cyclical payment program.

12. Nor has Brazil offered any credible explanation for:

- How the original panel could have made a finding of *present* serious prejudice against either the Step 2, marketing loan, and counter-cyclical payment programs or payments allegedly "mandated" to be made thereunder in MY 2003-2007 when it did not recognize Brazil as even presenting a *claim* of "present" serious prejudice with respect to either group of measures.[17]

- Why the original panel identified only "user marketing (Step 2) *payments* to domestic users and exporters; marketing loan programme *payments*; PFC *payments*; MLA *payments*; DP *payments*; CCP *payments*; crop insurance *payments*; and cottonseed *payments*"[18] as the "challenged measures" that were alleged to be the "subsidies" for purposes of Brazil's "present" serious prejudice claim. The panel only found that those measures constituted subsidies within the meaning of Articles 1 and 2 of the *SCM Agreement*.[19] The panel did not conduct *any* assessment as to whether the statutory/regulatory provisions authorizing these payments were also "subsidies."

- How the original panel could have made findings of WTO-inconsistency with respect to the Step 2, marketing loan, and counter-cyclical payment programs or future payments allegedly "mandated" to be made under the programs without addressing the extensive arguments that the parties made, and without making any of the factual

[16] Brazil Answers to Second Set of Panel Questions, para. 13.

[17] The United States recalls that the panel set out the claims presented by Brazil as follows: (a) claims of "present" serious prejudice with respect to "U.S. subsidies provided during MY 1999-2002"; (b) claims of threat of serious prejudice with respect to "U.S. subsidies mandated to be provided in MY 2003-2007;" and (c) *per se* claims of threat of serious prejudice against "selected provisions of the FSRI Act of 2002 and the ARP Act of 2000" providing for these subsidies, to the extent relevant to upland cotton, and their implementing regulations. *Upland Cotton (Panel)*, para. 3.1(vi) – 3.1(viii). The original panel did *not* identify a "present" serious prejudice claim under Article 5(c) and 6.3(c) of the *SCM Agreement* as one of the claims "concerning selected provisions of the FSRI Act of 2002 and the ARP Act of 2000." Nor did the original panel identify "selected provisions of the FSRI Act of 2002 and the ARP Act of 2000" as part of the measures subject to Brazil's claims of "present" serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*.

[18] *Upland Cotton (Panel)*, para. 7.1120. The original panel ultimately found that these constituted "subsidies" within the meaning of Article 1 of the *SCM Agreement* because they were "financial contributions" (mostly in the form of "grants") conferring a "benefit." *Upland Cotton (Panel)*, paras. 7.1112-7.1120.

[19] *Upland Cotton (Panel)*, para. 7.1112-7.1120.

findings that *Brazil* conceded would be necessary to support an affirmative finding of WTO-inconsistency in respect of those measures.[20]

13. And Brazil has not addressed the other clear textual signals that – consistent with the claims presented to it – the original panel's findings of "present" serious prejudice were made with respect to payments made in MY 1999-2002. This includes:

- The fact that the original panel's prohibited subsidy-related conclusions and recommendations regarding the Step 2 program, *as such*, expressly refer to "section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters of upland cotton"[21] and "section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users of upland cotton."[22] If the conclusions regarding "present" serious prejudice in paragraphs 8.3(d) and 8.1(g)(i) of the original panel report also pertained to the Step 2 program, *as such*, together with the marketing loan program and counter-cyclical payment program, the panel would certainly have included the same specific kind of reference, rather than a reference to "user marketing (Step 2) *payments*.."

- The fact that in Section VII:D of the Panel Report, dealing with the evaluation of domestic support measures under Article 13 of the *Agreement on Agriculture*, the original panel expressly stated that, "[i]n this Section of our report, the Panel will consider the current programmes 'as applied' and 'as such' together. Therefore, references to marketing loan programme, user marketing (step 2), direct, counter-cyclical and crop insurance 'payments' include the legislative and regulatory provisions authorizing those payments unless otherwise indicated."[23] No similar statement can be found in Section VII:G, which is the section including the original panel's analysis of the effects of the subsidies alleged to be causing serious prejudice. In fact, the original panel in Section VII:G clearly distinguishes payments from provisions providing for those payments. Nor is there any similar statement made in connection with the recommendation in paragraph 8.3(d) of the panel report (or paragraph 8.1(g)(i), which contains the conclusion on actionable subsidies to which the recommendation relates).

- The panel's clarification that it was not precluded from considering whether production flexibility contract and market loss assistance *payments* were causing "present" serious prejudice even though the legislative and regulatory provisions authorizing those payments had expired even before Brazil made its request for

[20] For example, Brazil conceded in the original proceeding that "[i]t is established under WTO law that a Member can only challenge measures of another Member *per se* if such measures mandate a violation of the WTO Agreement." Brazil First Submission in Original Panel Proceeding, para. 244 (citing *US – 1916 Act (AB)*, para. 88). Thus, in the case of its claims against the challenged programs, *per se*, Brazil asked the Panel "to find that the mandatory provisions of the 2002 FSRI Act and the 2000 ARP Act together with their implementing regulations, as listed above, *cannot be applied in a WTO consistent manner*." Brazil's 9 September 2003 Further Submission, para. 435-436. Explaining what this would mean in the context of this dispute, Brazil argued "[f]irst, the Panel needs to evaluate whether the U.S. subsidies will *necessarily threaten* to cause serious prejudice at price levels below the trigger prices of the U.S. subsidies. Second, the Panel needs to consider whether the U.S. subsidies threaten to cause serious prejudice *even at price levels at which only crop insurance subsidies and direct payments are made*." Brazil's September 9, 2003 Further Submission, para. 426 (emphasis added). The Panel neither conducted the requested evaluations, nor made any findings along the lines requested by Brazil.

[21] *See Upland Cotton (Panel)*, paras. 8.3(b) and 8.1(e).

[22] *See Upland Cotton (Panel)*, paras. 8.3(c) and 8.1(f).

[23] *Upland Cotton (Panel)*, para. 7.337(ix), n. 466.

consultations.[24] If the original panel's findings with respect to "payments" – and the DSB's recommendations and rulings on the basis thereof – were to be understood to automatically refer also to the programs authorizing those payments, as Brazil urges, the recommendation with respect to "MLA payments" in the panel's "present" serious prejudice conclusion would necessarily be a recommendation also with respect to the "MLA program" as such (an expired measure). This would be inconsistent with the original panel's express clarification that it was not making any findings of WTO-inconsistency or any recommendations and rulings with respect to expired programs, as such[25] as well as with the Appellate Body's subsequent clarification that "there [is] an obvious inconsistency" between a finding that a measure has expired and a "subsequent recommendation that the . . . DSB request the United States to bring the [expired measure] into conformity with its WTO obligations."[26]

14. In short, Brazil has not – and cannot – reconcile its own arguments to the "the original panel's findings from beginning to end."[27] Brazil's does not offer any coherent interpretation of the original panel report that addresses and takes into account all of the facts discussed above and in the prior U.S. submissions. Simply ignoring the facts or making accusations that the United States is "mischaracteriz[ing] them" does not allow Brazil to overcome that fatal deficiency. It remains, therefore, that Brazil's claims against the marketing loan and counter-cyclical payment programs and any payments made under the programs post-MY 2002 are outside the scope of this proceeding.

B. MARKETING LOAN AND COUNTER-CYCLICAL PAYMENT PROGRAMS ARE NOT CAUSING ANY PRESENT "SIGNIFICANT" PRICE SUPPRESSION WITHIN THE MEANING OF ARTICLES 5(C) AND 6.3(C) OF THE *SCM AGREEMENT*

15. For the reasons set out above and in the prior U.S. submissions, Brazil's claims of "present" serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement* against the marketing loan and counter-cyclical payment programs and/or any present payments thereunder are not within the scope of this proceeding. Were they to have been within the scope, they would nonetheless fail because they are bereft of a basis in the facts.

16. Indeed, a substantial part of Brazil's responses to the Panel's Questions 51 and 62-74 are devoted to attempts to explain away this failing. Brazil complains, on the one hand, that it should not be required to provide "direct evidence of what would actually happen to U.S. acreage, production, exports, and world prices"[28] without marketing loan and counter-cyclical payments and it complains, on the other, that the United States has "ignore[d] the hundreds of exhibits and circumstantial evidence presented by Brazil."[29] Both assertions are baseless.

17. Brazil – as the complaining party – bears the burden of proving its claims with evidence and arguments that actually *support the claim for which they are offered*. It has not done so. Further, in observing this, the United States has not "ignored" any argument or exhibit submitted by Brazil. To the contrary, the United States has painstakingly examined and addressed – over the course of two written submission, the presentation before the Panel, three set of responses to questions from the

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

[25] *Upland Cotton (Panel)*, para. 7.111.

[26] *Upland Cotton (AB)*, para. 272 (citing *U.S. – Certain EC Products* (AB), paras. 81-82).

[27] Brazil Answers to Second Set of Panel Questions, para. 12.

[28] Brazil Answers to Second Set of Panel Questions, para. 91.

[29] Brazil Answers to Second Set of Panel Questions, para. 90.

Panel, comments on Brazil's "oral" presentation to the Panel, and now two sets of comments on answers – every argument made by Brazil and demonstrated that these do not, individually or collectively, support Brazil's claims of "significant" price suppression.[30]

18. ***Brazil's assertions about the removal of the Step 2 program are unsubstantiated, internally contradictory, and inconsistent with arguments made by Brazil in the original proceeding:*** Brazil's claims are premised on the assertion that removal of the Step 2 program has not removed the adverse effects of the package of payments found by the original panel to be causing "present" serious prejudice. However, Brazil's assertions about the effects of removing the Step 2 program are unsubstantiated, internally contradictory, inconsistent with arguments made by Brazil in the original proceeding, and contradicted by the empirical evidence.[31]

19. Thus, for example, having proclaimed to the original panel that "it is difficult to imagine how a subsidy could be *more* of an export subsidy than the Step 2 export provisions" and that "[the program] plays an important role in stimulating and maintaining the present record high U.S. upland cotton world export market share,"[32] Brazil has no basis now to allege that "removal of the Step 2 program does [not] result in any significant or long-term reduction of U.S. exports."[33] The United States notes the irony in Brazil's assertion here that a "long-term" assessment of the effects of the removal of the Step 2 program is appropriate while in its analysis of the marketing loan and counter-cyclical payment program it insists that "the assessment is necessarily of a short-term, not a long-term nature."[34] This is yet further evidence that Brazil's positions on such fundamental questions as the appropriate analysis under the *SCM Agreement* shift simply depending on its preferred outcome. Moreover, the United States notes that Brazil's asserted bases for this assertion do not withstand scrutiny.

20. Indeed, while Brazil attempts to assert as evidence a statement by a National Cotton Council ("NCC") representative that in MY 2007, "NCC sees U.S. exports recovering to 16.22 million bales as foreign mill use increases," Brazil fails to quote for the Panel the statement immediately prior to this one in which the same representative notes that:

> the 2006 marketing year is the first of the post-Step 2 era, and the impact on exports has been evident. Through mid-January, export commitments of upland cotton totaled roughly 6 million bales. This time a year ago, total commitments had surpassed 10 million bales.[35]

[30] In fact, if the United States were in fact "ignor[ing]" Brazil's arguments, one can only wonder why Brazil has repeatedly attempted over the course of this proceeding to attempt to cut U.S. opportunities for response: for example, arguing at the start of the proceeding that the United States should be given no more than two weeks to respond to Brazil's nearly 200-page first written submission and; arguing that the United States should not be permitted to address Brazil's contingent "threat" claim in its rebuttal submission; arguing that the United States should be given no opportunity to respond to Brazil's unsolicited third written submission submitted under the guise of an "exhibit" to Brazil's "oral" presentation; and in its latest attempt to obtain an unfair procedural advantage, arguing against the grant of any additional time for submission of these comments.

[31] The full U.S. arguments in this respect are set out at U.S. First Written Submission, paras. 149-195, U.S. Rebuttal Submission, paras. 175-214, and U.S. Oral Statement, paras. 54-59.

[32] Brazil's Rebuttal Submission to the Panel Regarding the "Peace Clause" and Non-Peace Clause Related Claims," para. 128 (22 August 2003) (emphasis in original).

[33] Brazil Answers to Second Set of Panel Questions, para. 90.

[34] Brazil Answers to Second Set of Panel Questions, para. 131.

[35] "US Cotton Industry To Face Challenges In Global Market," 2006 AgWeb.com (Exhibit BRA-679).

The United States recalls Brazil's assertion that in assessing the effects of payments "the views of their recipients constitute particularly relevant evidence."[36] Brazil would presumably attach similar importance to the NCC statement it neglected to cite.

21. In any event, the possibility of an increase in the export volume in MY 2007 in *absolute* terms does not change the analysis regarding the effects of removing the Step 2 program. As the United States explained in its rebuttal submission[37], such factors as China's import needs may have contributed in part to the decline in the level of U.S. exports as of August, 2006. And as there are changes in those factors, there may well be effects in the level of U.S. exports. However, those factors do not account for the entire decline. Thus, for example, primarily in connection with the pending release of import quota by China[38], there have been recent purchases of some 795,800 running bales of U.S. cotton.[39] This represents a marketing-year high. Yet, even with these purchases, total export commitments, both sales and shipments, are 31% and 15% below last year's total and the 5-year average, respectively.[40] The fact that U.S. export volume may recover somewhat in the future, thus, does not suggest that export levels would not have been even higher had the Step 2 program been in effect.

22. In the face of such empirical data at odds with its assertions (for purposes of this proceeding) about the alleged effects of eliminating the Step 2 program, Brazil urges the Panel, in its response to Question 74, to consider MY 2005 – *a year in which Step 2 payments were still in effect* – as the relevant period for purposes of its analysis of the effects of removal of the Step 2 program. Presumably, the Panel would then have to accept Brazil's assertions (for purposes of this proceeding) about what the effects of that program would or would not have been in that year rather than relying on the actual evidence thereof. Neither this suggestion by Brazil nor its unsubstantiated assertions about the effects of removing the Step 2 program may be credited.

23. ***Brazil does not show that marketing loan and counter-cyclical payments cause "present" serious prejudice:*** Citing the original panel, Brazil argues that "an examination of the 'effects'" of the challenged measures "cannot be conducted in the abstract."[41] Yet, in support of its claims, Brazil repeatedly suggests that, even without considering the existing market conditions (or conducting any assessment of what these were likely to be) the original panel somehow found marketing loan and counter-cyclical payments to be causing significant suppression of world market prices today.[42] Similarly, it makes generic assertions about impacts on wealth and risk aversion that – if credited – would effectively preclude *any* payment to farmers no matter what their form and no matter how minimal their impact on planting, production, exports, and prices.[43]

24. Brazil's claim cannot properly rest on these bases. For one, the original panel did not find that marketing loan and counter-cyclical payment *programs* caused significant price suppression in MY 1999-2002. Therefore, Brazil is incorrect to assert – in response to Question 69, for example – that it could prove significant price suppression in this proceeding merely by asserting[44] that payments were made under those programs over the course of the FSRI Act and that "[t]he world market for

[36] Brazil Answers to Second Set of Panel Questions, para. 48.

[37] U.S. Rebuttal Submission, paras. 206-213.

[38] "China: Cotton import quotas of 1.5mn tons to be issued," available at www.fibre2fashion.com (April 24, 2007) (Exhibit US-165).

[39] U.S. Export Sales for Week Ending 4.12.2007, available at www.fas.usda.gov/export-sales/cottfax.htm (Exhibit US-166).

[40] U.S. Export Sales Weekly Export Performance Indicator for Week Ending 4.12.2007, available at http://www.fas.usda.gov/esrquery/esrpi.aspx (Exhibit US-167).

[41] Brazil Answers to Second Set of Panel Questions, para. 10 (citing *Upland Cotton (Panel)*, para. 10).

[42] *See e.g.*, Brazil Answers to Second Set of Panel Questions, paras. 45, 53-55, 94, 99.

[43] *See e.g.*, Brazil Answers to Second Set of Panel Questions, paras. 49, 55, 94.

[44] These are assertions by Brazil, not "undisputed facts," as it has stated. Brazil Answers to Second Set of Panel Questions, para. 95.

upland cotton identified by the original panel still functions on the same basis as found by the original panel."[45] The original panel's finding of "present" serious prejudice related to the effects of an entirely different set of measures (*payments* not only under the marketing loan and counter-cyclical payment programs but also under the Step 2 program) made in a different time period (MY 1999-2002) and under substantially different market conditions. There have been many changes since that time. These include not only the removal of the Step 2 program but many other factors, for example production-related technological changes that have had dramatic effects on the cost structure of U.S. upland cotton farming (as well as farmers in other countries, such as India) and shifts in patterns of world trade in upland cotton – shifts that are so significant that even the basis for Brazil's asserted "world market price" (the A-Index) has had to be changed (from a Northern Europe basket of quotes to a Far Eastern basket of quotes).

25. The original panel did not – and could not – have taken these factors into account in assessing the "present" effects of the different package of measures at issue in the original proceeding. And, in fact, it is precisely because the original panel could *not* predict what these changes might be (for example, if the United States were to modify the statutory and regulatory provisions providing for Step 2, marketing loan, or counter-cyclical payments in order to implement the Panel's findings), or foresee what effect the challenged measures might have under such changed factual circumstances, that it declined to make any "threat" finding against either future payments or the marketing loan and counter-cyclical payment programs as such.

26. In addition, as explained in the U.S. comments regarding Question 62, Brazil's attempts to indict support to agricultural producers simply on the basis it contributes to the "wealth" of producers and may render them less "risk averse" in their production decisions cannot be credited. If Members had agreed that no domestic support could be provided to agricultural producers, the *Agreement on Agriculture* could have been a great deal shorter. The drafters could simply either have inserted one provision either in that agreement or the *SCM Agreement* stating that "no Member shall provide payments to any producer of any commodity" as this, *inevitably*, contributes to the "wealth" of the producer and, as such, may also render him less risk averse. No such provision exists in either agreement because Members have not agreed to such a prohibition.[46]

27. What the United States finds instead is clear recognition in the *Agreement on Agriculture* and *SCM Agreement* that domestic support to producers of a commodity may have effects that lie anywhere in a range from "no or at most minimal, trade-distorting effects" to more substantial effects that may implicate the reduction commitment obligations in the *Agreement on Agriculture* but are not of the type to render the domestic support an "actionable subsidy" under the *SCM Agreement*, to the kinds of serious effects on trade identified under Articles 5 and 6 of the *SCM Agreement*. It is only the latter – "adverse effects" to the interests of another Member – that are disciplined under the *SCM Agreement.* Whether or not a Member may *challenge* a measure under the *SCM Agreement* has no bearing on whether it can establish a breach of Articles 5(c) and 6.3(c). It can only do the latter where it proves that "the effect" of a measure found to be a "subsidy" is "*significant* price suppression" within the meaning of Article 5(c) and 6.3(c) of the *SCM Agreement*.

28. As the United States has demonstrated[47], none of the allegedly "abundant and diverse evidence" that Brazil asserts in its answers to questions or any of its prior submissions proves that this

[45] Brazil Answers to Second Set of Panel Questions, para. 94.

[46] To the contrary, there is one agriculture-specific actionable subsidy provision in the *SCM Agreement* – Article 6.3(d) of the *SCM Agreement* – and that falls far short of a blanket prohibition on any subsidy that increases producer wealth and renders them less risk averse.

[47] U.S. First Written Submission, paras. 203-331 and Annex I; U.S. Rebuttal Submission, paras. 215-404 and Annex I; U.S. Answers to Parts A-C of First Set of Panel Questions, paras. 27-44; U.S. Oral Statement, paras. 50-85 and Statement of Dr. Joseph W. Glauber; U.S. Answers to Parts D-E of First Set of Panel Questions, paras. 14-42; U.S. Comments on Brazil's "Oral" Presentation, paras. 34-91 and Annex I, and U.S. Answers to Second Set of Panel Questions, paras. 1-4, and 62-170.

is "the effect" of the marketing loan and counter-cyclical payments. What the substantial evidence shows, instead, is that any effects of marketing loan and counter-cyclical payments on U.S. planting, production, exports or world market prices of upland cotton are minimal and not subject to discipline under Articles 5 and 6 of the *SCM Agreement*.

C. THE EFFECT OF THE MARKETING LOAN AND COUNTER-CYCLICAL PAYMENT PROGRAMS IS NOT ANY "PRESENT" INCREASE IN THE U.S. SHARE OF THE WORLD MARKET FOR UPLAND COTTON WITHIN THE MEANING OF ARTICLES 5(C) AND 6.3(D) OF THE *SCM AGREEMENT*

29. Even though Brazil has admitted that "U.S. *share* of world production . . . stayed relatively stable" over the entire period that the FSRI Act has been in effect (*i.e.,* MY 2002-2005), Brazil has attempted in this proceeding to assert a breach of Articles 5(c) and 6.3(d) of the *SCM Agreement* on the basis of a slight (0.46 percent) up-tick in the U.S. share of the world market in MY 2005 over the average for MY 2002-2004.[48] The evidence on the record shows clearly that this increase in MY 2005 is part of the ordinary fluctuations in U.S. share of world supply[49] and is directly attributable to such factors as a sudden shift in acreage from soybeans in certain regions of the United States due to concerns about an outbreak of Asian soybean rust at the end of MY 2004.[50] Thus, Brazil's claim fails – at the outset – because Brazil cannot establish any causal connection between the challenged measures and the slight increase in U.S. world market share in MY 2005 (*i.e.,* it cannot prove the first of the two elements under Article 6.3(d), that "the effect" of the U.S. marketing loan and counter-cyclical payment programs "is an increase in the world market share" of the United States "as compared to the average share it had during the previous period of three years.")

30. But Brazil's claim also fails on a second basis – namely, Brazil's failure to establish that "this increase" – *i.e.,* the "increase in the world market share of the subsidizing Member . . . as compared to the average share it had during the previous period of three years" – "follows a consistent trend over a period when subsidies have been granted." This safeguard precludes complaining parties from establishing a breach under precisely the kind of factual circumstances before this Panel – where an increase in one year is clearly part of the normal fluctuation of world market share and attributable to any number of factors other than subsidies. As the United States showed in its first written submission and again in its rebuttal submission[51], the slight increase in U.S. market share above the previous three-year average has *not* followed a "consistent trend over a period when subsidies have been granted." To the contrary, over the entire period that the FSRI Act of 2002 has been in effect there were only *one* year in which this happened – MY 2005.[52]

31. To try to escape this key flaw in its claim, Brazil urges the Panel to adopt an end-point to end-point comparison using, as the starting point, MY 1998, a year before the entry into force of the

[48] Brazil First Written Submission, paras. 222 and 224. This is the figure if one looks at U.S. share of world production plus beginning stocks. If one looks at U.S. share of world production, there was a similarly small increase (of 1.53 percent) over the average for MY 2002-2004.

[49] *See* U.S. First Written Submission, paras 332-343.

[50] *See* U.S. Comments on Brazil's "Oral" Presentation, paras. 70-72.

[51] The United States notes in this regard that Brazil devotes much effort in its answers to Questions 76-77 to attempting to characterize the U.S. interpretation of Article 6.3(d) as a "new" interpretation not previously presented. This is inexplicable given that in the U.S. first written submission, the United States clearly examined whether the U.S. world market share was higher than the average share of the previous 3-year period for each year in the periods MY 1996-2006, MY 1980-2006, and 1960-1996. This is the exact same examination conducted by the United States in its rebuttal submission. Indeed, Brazil appears to be confusing two separate issues – (a) the question of normal fluctuations in market share, which relates to the question of causation and whether in any particular year it is the challenged measures that are "causing" an increase over the previous three-year average and (b) the question of a "consistent trend" under the second element of Article 6.3(d).

[52] This is true if one looks at world production. If one looks at world production plus beginning stocks, U.S. share of world supply would have been higher than the previous three-year average also in MY 2002.

FSRI Act of 2002 and one in which counter-cyclical payments were not even in existence. The reasons for Brazil approach are patently obvious – MY 1998 was a disastrous year for U.S. production, in which, as a result of severe drought U.S. abandonment rates skyrocketed and harvested area fell more than 2,000,000 acres compared to the previous year. U.S. production that marketing year was the lowest in almost a decade, by more than 1,500,000 bales, and lower than any marketing year *since* by more than 3,000,000 bales. By contrast, growers in the rest of the world, unaffected by the drought, increased harvested area about 100,000 acres. As a result, U.S. share of the world market was at an extremely low point in MY 1998. By selecting this year as the starting point of its "representative period,"[53] and drawing a line from this to the U.S. share of production in MY 2005 – one which would *inevitably* slant upwards – Brazil asserts that it has met its burden of showing that "this increase follows a consistent trend over a period when subsidies have been granted" under Article 6.3(d) of the *SCM Agreement*. Brazil is wrong. As the United States explains in its comments regarding Question 76, Brazil's argument is premised on a fundamentally flawed interpretation of Article 6.3(d) of the *SCM Agreement*. That interpretation would – if adopted – effectively write out of Article 6.3(d) of the *SCM Agreement* both the reference to "this" increase and to a "consistent" trend. As Brazil fails to establish either of the two elements required under Article 6.3(d), it fails to make any *prima facie* of breach of that provision.

D. NEITHER THE MARKETING LOAN AND COUNTER-CYCLICAL PAYMENT PROGRAMS – NOR ANY PAYMENTS THEREUNDER – ARE CAUSING A "THREAT" SIGNIFICANT PRICE SUPPRESSION UNDER ARTICLES 5(C) AND 6.3(C) OF THE *SCM AGREEMENT*

32. There are two fundamental flaws in Brazil's claims of "threat of" significant price suppression under Articles 5(c) and 6.3(c) of the *SCM Agreement*. The first is that Brazil's claim is premised upon a legally incorrect interpretation of "threat of" significant price suppression. The second is that Brazil has not established as a factual matter that there is a "threat of" significant price suppression as a result of either the marketing loan and counter-cyclical payments programs or any payments under the programs. Brazil's answers to the Panel's questions regarding "threat" focus mostly on the first issue.

33. In its response to Questions 86-88, Brazil urges the Panel to replace the term "threat" in footnote 13 of the *SCM Agreement* with "significant likelihood," a standard that Brazil admits is "not found in the *SCM Agreement* or any other WTO Agreement."[54] Indeed, the only basis that Brazil has ever asserted for grafting a "significant likelihood" standard that drafters did *not* agree upon into footnote 13 is that "the precedent interpreting the terms 'threat' and 'threaten' suggests that the appropriate standard of threat in Part III [of the *SCM Agreement*] is one in which there is a significant likelihood, based on the nature of subsidies and particular conditions of competition, that serious prejudice will occur in the future."[55] As the United States pointed out in its rebuttal submission, however, even leaving aside that there is no basis to attempt to interpret a treaty in accordance with "precedent" rather than "in accordance with customary rules of interpretation of public international law,"[56] Brazil cannot even identify any "precedent" that "suggests" that the appropriate standard for "threat" of serious prejudice is "a significant likelihood."[57]

34. Brazil's proposed "significant likelihood" standard injects an entirely new term into the text that (a) is not used by the drafters either in Article 5(c) of the *SCM Agreement* or elsewhere to define "threat," (b) ignores entirely a critical aspect of the ordinary meaning of the "threat," (proximity in time) and (c) itself requires interpretation (e.g., what is a "significant" likelihood of serious prejudice). Brazil has provided no basis whatsoever for writing "significant likelihood" into footnote 13 of the *SCM Agreement*. And, indeed, to do so would contravene the express provisions of Article 3.2 of the

[53] Brazil First Written Submission, para. 227.
[54] Brazil Answers to Second Set of Panel Questions, para. 182.
[55] Brazil First Submission, para. 253.
[56] DSU Article 3.2.
[57] U.S. Rebuttal Submission, para. 413.

DSU, which provides that "[the dispute settlement system of the WTO] serves . . . to clarify the *existing provisions of those agreements in accordance with customary rules of interpretation of public international law*."

35. Brazil has also failed to establish an empirical basis for a finding of "threat" of serious prejudice. To the contrary, Brazil is asking the Panel to find that there is such a "threat" even though the evidence shows:

- an expected decline in U.S. planted acreage of more than 20 percent in MY 2007[58];
- an expected decline of 11 percent in U.S. production[59] in MY 2006 from year-before levels that is expected to continue on into MY 2007[60]
- an expected decline in U.S. *share* of world production in MY 2007[61];
- a 31 percent decline in U.S. exports going into the end of MY 2006 (compared to MY 2005 levels)[62];
- that U.S. producers are likely to cover their variable, or operating, costs as well as a large share of their total costs in MY 2007 (even looking at the inflated "total costs" that Brazil has attempted to use repeatedly in this proceeding).[63]
- that marketing loan payments are likely to be small (at most 2 cents/lb) in MY 2007 and counter-cyclical payments – which are paid regardless of what is planted – are likely to remain at effectively "fixed" levels[64]; and
- the FSRI Act of 2002 is scheduled to expire in October of 2007 meaning that there will be no further payments thereunder as of MY 2008.

There is no basis for a finding of "threat" of serious prejudice under these circumstances.

E. THE UNITED STATES IS PROVIDING GSM 102 GUARANTEES IN RESPECT OF EXPORTS OF RICE AND UNSCHEDULED PRODUCTS CONSISTENTLY WITH ARTICLES 10.1 AND 8 OF THE *AGREEMENT ON AGRICULTURE* AND 3.1 AND 3.2 OF THE *SCM AGREEMENT*

36. In its responses to the Panel's questions – including Questions 92, 95, 100 – Brazil continues to urge the Panel to ignore the provisions of the *SCM Agreement* expressly setting out the conditions under which export credit guarantees may be found to be export subsidies and to make a finding that the provision of GSM 102 guarantees is prohibited simply because the fees under that program are allegedly lower than those charged by Ex-Im Bank for it Letter of Credit Insurance for Banks ("LCI")

[58] *See* U.S. Answers to Second Set of Panel Questions, paras. 1-4 (discussing NASS Prospective Plantings Report (March 30, 2007) (Exhibit US-140)).

[59] Indeed, just last month, USDA lowered expected production levels for MY 2007 even further. According to NASS, the MY 2007 U.S. upland cotton crop is now forecast at 20.8 million bales – down from the 21.3 million bales forecast in December 2006 – and approximately 11 percent below MY 2005 levels. NASS March 2007 Cotton Ginnings Report (Exhibit US-168).

[60] U.S. Export Sales Weekly Export Performance Indicator for Week Ending 4.12.2007, available at http://www.fas.usda.gov/esrquery/esrpi.aspx (Exhibit US-167).

[61] Cotton This Month, ICAC, p. 4 (February 1, 2007) (Exhibit US-107).

[62] U.S. Export Sales Weekly Export Performance Indicator for Week Ending 4.12.2007, available at http://www.fas.usda.gov/esrquery/esrpi.aspx (Exhibit US-167).

[63] U.S. Rebuttal Submission, paras. 422-425.

[64] *See* U.S. Answers to Second Set of Panel Questions, paras. 196-199 (showing that both FAPRI and CBO project at most a 2 cents/lb marketing loan payment for MY 2007.

and Medium-Term Export Credit Insurance ("MTI") products. There is no support in the text or in logic for such a conclusion.

37. As the United States has explained, the drafters expressly set out in item (j) of the Illustrative List the conditions under which export credit guarantees may be found to be export subsidies. Brazil has not shown – and cannot show – that GSM 102 guarantees are provided "at premium rates which are inadequate to cover the long-term operating costs and losses of the" program. The data show that – to the contrary – for cohorts 1992-2002, examined by the original panel, the negative subsidy net of reestimates (*i.e.*, profit) is now $926,331,216. For all cohorts 1992-2006, the negative subsidy net of reestimates (*i.e.*, profit) is $403,714,701.[65] These are the figures under the U.S. government's credit reform accounting, which Brazil championed in the original proceeding as:

> an ideal basis on which to determine whether the CCC's export credit loan guarantee programs are offered at premium rates that are inadequate to cover the long-term operating costs and losses of the programs, within the meaning of item (j) of the Illustrative List of Export Subsidies. It functions as a more sophisticated alternative to constructed cost formulas, and thoroughly accounts for all of the premium and operating cost and loss elements required by item (j). Moreover, it has the virtue of serving as the actual, real-world calculation used by the U.S. Congress, the President of the United States, and federal agencies like the CCC to "measure more accurately the costs of Federal credit programs."[66]

38. Brazil has no basis for its arguments now – including in response to Question 114 – that the Panel should disregard this actual data and should use instead, Brazil constructed cost formula. The "the actual, real-world calculation used by the U.S. Congress, the President of the United States, and federal agencies like the CCC to 'measure more accurately the costs of Federal credit programs'"[67] confirms that export credit guarantees under the GSM 102 program are being provided at premiums that are *well* above those that would be required simply to "cover" long-term operating costs and losses. Under the text of the *SCM Agreement*, the analysis begins and ends there. There is no "separate" standard under Articles 1.1 and 3.1(a) for when export credit guarantees constitute an "export subsidy."

39. But even if item (j) did not exist, asserting that Ex-Im Bank charges higher fees for export credit guarantees than CCC does under the GSM 102 program would not establish any breach of Articles 1.1 and 3.1(a) of the *SCM Agreement*. As Article 14(c) of the *SCM Agreement* makes clear[68], a loan guarantee provides a "benefit" recognized under Article 1.1 of the *SCM Agreement* only where it affects the underlying transaction – *i.e.*, where it results in there being a "difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee." This makes perfect sense. Export credit guarantees have no value in and of themselves; they simply modify and relate to the underlying loan transaction. It is only when they cause the underlying loan to be more attractive than loans otherwise available on the market that there is a possibility of trade distortion (*i.e.,* making a particular purchase of U.S. goods more attractive than it would have been absent the guarantee). The fee charged for a guarantee is passed through by the U.S. exporter to the foreign purchaser and becomes part of the overall cost of the financing. And it is only through the comparison of the total cost of loans guaranteed by GSM 102 guarantees and comparable commercial

[65] *See* U.S. Answers to Second Set of Panel Questions, paras. 277-278.

[66] Statement of Brazil - First (Original) Panel Meeting, para. 129 (22 July 2003).

[67] Statement of Brazil - First (Original) Panel Meeting, para. 129 (22 July 2003).

[68] Because it interprets and applies the definition of "benefit" set out in Article 1.1, Article 14 has been relied upon by the Appellate Body as important contextual guidance in interpreting "benefit." *Canada – Aircraft (AB)*, para. 155.

loans not guaranteed by GSM 102 guarantees that one can assess whether the GSM 102 guarantee actually rendered particular transactions more attractive than they otherwise would have been.

40. Brazil has not even attempted to make the kind of particularized showing contemplated under Article 14(c) of the *SCM Agreement*; it has not shown that the overall cost, including fees, of each of the loans guaranteed by the government is less than overall cost of a comparable commercial loan that could be obtained without a government guarantee. Instead, Brazil relies on sweeping and erroneous assertions that obligors on loans guaranteed under the GSM-102 program can *never* obtain any other financing of any kind and that the United States could *never* provide an export credit guarantee without also providing an export subsidy. These arguments simply do not square with the evidence submitted by the United States showing that such obligors are in fact able to obtain financing even without GSM 102 guarantees and on terms better than those available *with* GSM 102 guarantees. The declining level of use of the GSM 102 program in recent years is even further evidence of this.

41. Brazil's attempts to declare GSM 102 guarantees export subsidies merely on a comparison to fees charged by Ex-Im Bank are contrary to the text and logic of Articles 1.1(a), 14(c), and item (j) of the *SCM Agreement*. As the United States has explained, Brazil has not established that the LCI and MTI products are even comparable to the GSM 102 guarantees provided by CCC.[69] But, regardless of this, the reasoning underlying Brazil's comparison of these products is unavailing.

42. Brazil is effectively asking the Panel to assume that the LCI and MTI products are themselves provided at "below market" rates even though Brazil has conducted no actual comparison vis-a-vis any other comparable product available on the market. Following from this assumption, Brazil would have the Panel accept that, if the CCC charges lower fees than Ex-Im Bank, the fees for the GSM 102 guarantees must also be "below market." Brazil's approach is based on unfounded factual assumptions and on logic that is not found anywhere in the *SCM Agreement*. Member did *not* agree that export credit guarantees could be found to be export subsidies simply if one government entity charges fees that are different or lower than another government entity. Brazil's efforts to establish a breach of Articles 1.1(a) and 3.1(a) of the *SCM Agreement* on that basis are unavailing.

II. SPECIFIC COMMENTS REGARDING BRAZIL'S ANSWERS

A. SCOPE OF THIS PROCEEDING

Questions to both parties

44. The European Communities argues in respect of the preliminary objection raised by the United States regarding the claims of Brazil relating to export credit guarantees for pig meat and poultry meat under the GSM 102 programme that "the important issue is the nexus or the degree of interrelatedness or interdependence between different elements of the measure." (Oral Statement of the European Communities, para. 6) The European Communities submits in this regard that:

> ***"the Panel should examine the original measure at issue and the 'measures taken to comply,' and, with particular reference to the 'elements of the measure' that the United States argues are outside the Panel's terms of reference, enquire into the extent to which these are interrelated or interdependent with measures or 'elements of measures' that the United States accepts are within the Panel's terms of reference." (Oral Statement of the European Communities, para. 11)***

[69] Brazil First Written Submission, para. 381.

Do the parties agree with the approach suggested by the European Communities and with the considerations in paragraph 13 of the Oral Statement of the European Communities?

43. The United States respectfully refers the Panel to its general comments above regarding Brazil's claims in respect of exports of pig meat and poultry meat as well as to its own response to this question.[70]

45. Could the parties comment on the observations made by the European Communities in paras. 15-24 of its Oral Statement on the issue of whether the marketing loan and counter-cyclical payment programmes are within the scope of the Panel's proceeding?

44. The United States respectfully refers the Panel to its general comments above regarding Brazil's claims in respect of the marketing loan and counter-cyclical payment programs as well as to its own response to this question.[71] The United States also submits one additional brief observation regarding Brazil's answer to this question.

45. The United States disagrees with Brazil's assertion that a claim about a measure "as such" is "typically understood to involve an examination of a general rule or norm in the abstract."[72] An "as such" claim relates to whether the application of a measure in *all* present and future circumstances results in a breach of a covered agreement. This is not an inquiry "in the abstract" but the exact opposite, an inquiry across *all* of the possible factual circumstances that have and are expected to arise. Indeed, the Appellate Body underscored exactly this aspect of "as such" claims in *United States – Sunset Reviews on OCTG from Argentina*, where it explained that:

> *By definition*, an "as such" claim challenges laws, regulations, or other instruments of a Member that have general and prospective application, asserting that a Member's conduct – *not only in a particular instance that has occurred, but in future situations as well* – will necessarily be inconsistent with that Member's WTO obligations.[73]

The Appellate Body explained that "as such" claims were to be considered to be "serious challenges" because "[i]n essence, complaining parties bringing 'as such' challenges seek to prevent Members *ex ante* from engaging in certain conduct."[74]

46. Despite this clarification from the Appellate Body about the caution to be exercised with "as such" challenges – and Brazil's own acknowledgment, in response to this question, that a finding regarding the *effects* of a subsidy under Articles 5 and 6 of the *SCM Agreement requires* an examination of market conditions and the operation of the alleged subsidy within those conditions – Brazil would have the Panel believe that the original panel made a serious prejudice finding against the statutory and regulatory provisions authorizing Step 2, marketing loan, and counter-cyclical payment *programs* without so much as addressing the market conditions likely to prevail in the future. Rather, Brazil urges the Panel to ignore Brazil's own express explanation to the original panel that the MY 1999-2002 period was "*both the period of time covering the measures challenged by Brazil* as well as the period of investigation to examine present serious prejudice caused by the U.S. subsidies under Articles 5(c) and 6.3 of the SCM Agreement" and its arguments in this proceeding that the MY 1999-2002 period presented an unusually "dynamic" situation for world market prices and U.S.

[70] *See* U.S. Answers to Second Set of Panel Questions, paras. 1-16.
[71] *See* U.S. Answers to Second Set of Panel Questions, paras. 17-41.
[72] Brazil Answers to Second Set of Questions, para. 10.
[73] *United States – Argentina OCTG Sunset Reviews (AB)*, paras. 172.
[74] *United States – Argentina OCTG Sunset Reviews (AB)*, paras. 172.

exports.[75] Instead, Brazil would now have the Panel believe that the original panel simply used MY 1999-2002 as a reference period for the entire period of effectiveness of the FSRI Act of 2002. The facts simply do not support Brazil's argument.

> ***46. In its Oral Statement, the European Communities characterizes Brazil's and the United States' respective approaches as the "measure model" and the "element of the measure model" (Oral Statement of the European Communities, para. 7). Please discuss whether you agree with this characterization and whether, in your view, the application of a measure alleged to be a subsidy to different agricultural products relates to a "measure" (or elements thereof) or if, rather it relates to a "claim". Would it be permissible for a compliance panel to examine a "claim" that relates to subsidies (granted as part of measures taken to comply) provided to agricultural products to which the "initial measure" did not apply?***

47. The United States respectfully refers the Panel to its general comments above regarding Brazil's claims in respect of exports of pig meat and poultry meat, its comments regarding Brazil's answer to Question 44 above, as well as to its own response to this question.[76]

<u>Questions to the United States</u>

> ***47. The United States has raised a preliminary objection regarding Brazil's claims of (threat of) serious prejudice in respect of the marketing loan and counter-cyclical payment programmes. Is the Panel's understanding correct that, apart from this preliminary objection regarding programmes, the United States also considers that the issue of whether payments made under the marketing loan and counter-cyclical payment programme after 21 September 2005 cause serious prejudice to the interests of Brazil is not properly within the scope of this proceeding?***

> ***48. How does the United States address the argument of Brazil that "[i]f the United States were to prevail on its view that subsequent mandatory and price-contingent marketing loan and CCP payments are not properly before this Panel, the grant of annual recurring subsidies becomes 'a moving target that escape from [the WTO subsidy] disciplines'"? (Closing Statement of Brazil, para. 4)***

> ***49. Could the United States comment on the argument of the European Communities that the text of Article 21.5 of the DSU does not limit the temporal scope of that provision in the manner suggested by the United States? (para. 29 of the Oral Statement of the European Communities)***

<u>Question to Brazil</u>

> ***50. Does Brazil maintain its claims with respect to the three unscheduled products (lyocell, lysine, wood products) identified by the United States as falling outside the scope of the Agreement on Agriculture? (see paragraph 83 of the United States' Rebuttal)***

48. In its response, Brazil appears to acknowledge that lyocell, lysine, and wood products fall outside the scope of the *Agreement on Agriculture*. By definition, therefore, the provision of GSM 102 export credit guarantees in respect of lyocell, lysine, and wood products cannot circumvent U.S. agricultural export subsidy commitments under that agreement.[77] In its request for establishment of a

[75] Brazil Rebuttal Submission, para. 236.
[76] *See* U.S. Answers to Second Set of Panel Questions, paras. 1-16.
[77] U.S. Rebuttal Submission, paras. 81-83

panel, Brazil presented claims under Articles 3.1 and 3.2 of the *SCM Agreement* "as a result and to the extent of [the alleged] violation of Article 10.1 (and, as a consequence, Article 8) of the *Agreement on Agriculture*."[78] As there can be no "violation of Article 10.1 (and, as a consequence, Article 8) of the *Agreement on Agriculture*,"[79] there can be no claim under the *SCM Agreement* with respect to the GSM 102 export credit guarantees in respect of lyocell, lysine, and wood products under the express terms of Brazil's request for panel establishment. Where a claim is not set out in the request for panel establishment – as here – it is not part of the matter referred to the panel and falls outside the scope of a panel proceeding.

B. CLAIMS OF BRAZIL REGARDING PRESENT SERIOUS PREJUDICE

1. Significant price suppression - Article 6.3(c) of the *SCM Agreement*

Questions to both parties

51. The parties disagree on whether or not the marketing loan and counter-cyclical payments have more than minimal effects on production of upland cotton. Could each party explain how its approach to the analysis of the impact of these payments on production of upland cotton is supported by the provisions of Articles 5 and 6 of the SCM Agreement and by any other relevant WTO provisions?

49. The United States notes that, although the Panel's question asks each party to "explain how its approach to the analysis of the impact of [marketing loan and counter-cyclical] payments on production of upland cotton is supported by the provisions of Articles 5 and 6 of the *SCM Agreement* and by any other relevant WTO provisions," Brazil does not appear to actually answer this question. Rather, Brazil devotes almost all of its response to explaining why even green box measures can be subject to challenge under the *SCM Agreement*. This is inexplicable because Brazil then asserts that (a) the marketing loan and counter-cyclical payment programs are properly viewed as so-called "amber box" measures and (b) in the very next question, concedes that the fact that measures are classified in the "amber box" does not mean that they cause adverse effects within the meaning of Articles 5 and 6 of the *SCM Agreement*. It is difficult to understand, therefore, what – if anything – Brazil's answer has to do with explaining whether Brazil's approach is consistent with Articles 5 and 6 of the *SCM Agreement*.

50. Instead, Brazil's discussion seems to be aimed at suggesting that U.S. marketing loan and counter-cyclical payments should be found in breach of Articles 5 and 6 of the *SCM Agreement* no matter how minimal the effects thereof. Any such suggestion would be flatly wrong under the terms of those provisions. Only "subsidies" the effect of which is "significant" price suppression are subject to discipline by virtue of Articles 5(c) and 6.3(c) of the *SCM Agreement*. Whether any measures – whether green, blue, amber, or something else – may be *challenged* does not change the fact that the complaining party bears the burden of *proving* through evidence and argument that the challenged measures are causing adverse effects within the meaning of Articles 5 and 6 of the *SCM Agreement* (in the present case, "significant" price suppression under Article 6.3(c)). Where – as here – a complaining party fails to do so, its claim cannot succeed.

52. In its Third Party Submission New Zealand observes:

> ***"Marketing loan payments are amber box measures, the category in which are included the non-prohibited measures with the most trade distorting effect on production and trade." (para. 5.19)***

[78] Brazil Request for Panel Establishment, para. 28.
[79] Brazil Request for Panel Establishment, para. 28.

Do the parties consider that the fact that under the Agreement on Agriculture a subsidy is included in the 'amber box' is relevant to the analysis of the subsidy's consistency with Articles 5 and 6 of the SCM Agreement?

51. The United States respectfully refers the Panel to the U.S. comments regarding Brazil's response to Question 51 above.

Questions to the United States

53. The United States argues that Brazil has not provided evidence of 'actual production inducing' effects of marketing loan and counter-cyclical payments and that Brazil 'purports to demonstrate indirect production effects through its claim that the US planting, production, and exports are not responsive to prices.' (Opening Statement of the United States at the meeting of the Panel with the parties, paras. 62 and 69, emphasis in original)

(a) Could the United States explain further the distinction between what it terms "actual production inducing effects "and "indirect production effects"? Could the United States also elaborate on how this distinction is legally relevant in the context of Articles 5 and 6 of the SCM Agreement?

(b) What is the response of the United States to the argument that the fact that "U.S. upland cotton producers know that their overall revenue will always be protected by marketing loans and counter-cyclical payments ... plays a major role in their planting decisions"? (Rebuttal of Brazil, para. 185; see also Third Party Submission of New Zealand, paras 5.20-5.21)

(c) In its Opening Statement at the meeting of the Panel with the Parties, Brazil observed:

> ***"...we have demonstrated that these subsidies stabilized cotton producers' revenue despite wildly fluctuating market prices, thereby insulating and numbing acreage response to market price signals. These subsidies also cover the huge long-term gaps between market returns and total costs of production. Both effects are closely interrelated." (para.55)***

Is the United States only arguing that Brazil has not empirically substantiated that these two "effects" have actually occurred or is it also the position of the United States that these effects are in any event legally irrelevant to an analysis of whether a subsidy causes significant price suppression within the meaning of Article 6.3 (c) of the SCM Agreement?

54. Could the United States explain whether, and, if so, why, it is of the view that this Panel should not rely on the findings and analysis by the original Panel regarding the effects of marketing loan and counter-cyclical payments on production and exports? Please comment in particular on paras. 7.1291, 7.1295, 7.1302, 7.1349, 7.1353 of the Panel Report.

55. Can the United States confirm that the figures "$868 million" and "$838 million" Brazil cited in para. 40 of its Opening Statement are correct figures if one uses the "Brazil's methodology" and the "Cotton-to-Cotton methodology"? (Please note that the Panel is not asking whether the US agrees with these methodologies.)

56. The United States has cited new empirical research on the production effects of counter-cyclical payments. How does the United States address Brazil's criticism that none of this research has dealt specifically with the effects of countercyclical payments under the FSRI Act of 2002 on upland cotton? (Rebuttal Submission of Brazil, para. 120)

57. The United States has offered the Lin and Dismukes (Exhibit US-34) and Westcott (US-35) studies as examples of new empirical research on the production effects of counter-cyclical payments.

(a) Is it not more accurate to characterize the Lin and Dismukes study as a simulation of the possible effect of countercyclical payments on production rather than a study on the actual impact of the payments since it does not statistically estimate the effect of the actual payments (which began only in 2002) on crop production? (Please refer to pages 9-12 of the paper which describe the data, covering the period 1991-2001, used for the study).

(b) How does the United States deal with Brazil's characterization of the Westcott study as offering no new empirical evidence, and instead, being a qualitative discussion, much like that presented to the original panel (see para 128 of Brazil's rebuttal)?

58. The Unites States stated that the key consideration in assessing a farmer's decision to grow upland cotton is whether the farmer has been covering his variable costs of production. In this connection, it presented upland cotton costs and returns estimates for marketing years 1999-2005 (Exhibit US-47). Brazil has disputed the absence of certain items – land, labour and capital recovery costs - in the US calculations of variable costs. In response, the United States has referred to the Commodity Costs and Returns Estimation Handbook (Exhibit US-88) prepared by a Task Force of the American Agricultural Economics Association as the basis for leaving out these items in its calculations. However, the Task Force which authored the Handbook does not use the categories "fixed" or "variable" costs and in fact recommends that the microeconomic concepts of fixed and variable costs not be used in preparing and reporting cost and return estimates. Page 2-67 of the Handbook states:

> *The Task Force therefore recommends that costs should be categorized only as to whether they are associated with expendable factors or the services of capital assets. The division of costs into categories such as fixed and variable should generally be avoided in preparing CAR estimates. For the purpose of preparing CAR estimates for specific enterprises, the Task Force recommends that all the costs of all expendables be allocated to the generic group OPERATING COSTS and that all other costs be allocated to the group ALLOCATED OVERHEAD.*

Would the United States clarify whether the categories "operating costs" and "allocated overhead" correspond to the economic concepts of fixed and variable costs? In particular, are "operating costs" variable costs or not? Would the United States please indicate whether, and if so, where, the Handbook makes these clarifications or distinctions.

59. In discussing the impact of long-term costs of production (and hence long-term profitability) of upland cotton production on farmers' decisions to exit cotton *farming, the United States argues that income from other crops and off-farm income must be into account. Why does the United States consider these issues relevant given the original Panel's decision that "off farm income" is not a legally relevant consideration. (Panel Report, para. 7.1354, footnote 1470) Please respond to Brazil's arguments on this matter in paragraphs 249-253 of its Rebuttal Submission.*

60. In its Rebuttal Submission, the United States argues that Prof. Sumner's description of the model that appeared in a recent CATO publication is not "appropriate" for use in a WTO dispute involving claims of serious prejudice. Professor Sumner has since introduced "more empirical and institutional detail" to the model used in this dispute. These changes are described in paragraphs 111-117 of Brazil's Opening Statement. Does the United States view these changes as being sufficient to make the model appropriate for use in a WTO dispute involving claims of serious prejudice? If not, what modifications does the United States think should have been made to the model?

61. With respect to marketing year 2006, the United States has provided some data on upland cotton exports (Exhibit US-113), planted and harvested area and cotton production (Exhibit US-114), as well as a copy of the National Cotton Council's survey of planting intensions (Exhibit US-115). The data, all of which have been collected through the first half of marketing year 2006, are variously qualified as "estimates" or "projections" or "projected."

(a) Please clarify, as completely as possible, what these various terms mean as they apply to US upland cotton exports, acreage and production.

(b) Would the United States be able to provide the Panel with some information, based on the average of the past six marketing years or so, of how final marketing year data on these variables, would differ from preliminary estimates, projections and the like, taken at the end of February of the relevant marketing year?

(c) Finally, would the United States be able to update that part of Exhibit US-83 dealing with futures prices so as to provide the panel with as complete as possible average January to March 2007 New York futures prices for upland cotton?

Questions to Brazil

62. How does Brazil rebut the argument of the United States that the fact that marketing loan and counter-cyclical payment programmes provide income support when prices are low is not the key question before this Panel and that while, like any other payments to producers, marketing loan and counter-cyclical payments could affect production, Brazil has not provided any evidence of actual production-inducing effects? (Rebuttal Submission of the United States, paras. 222, 287-291; Opening Statement of the United States at the meeting of the Panel with the parties, paras. 62-75; Comments of the United States on Brazil's 'Oral' Presentation in the meeting with the Panel, paras. 42-57)

52. Brazil's response to the first part of this question highlights that fact that Brazil is attempting to have the Panel find income support to agricultural producers to effectively be a prohibited measure under the *SCM Agreement*.

53. Indeed, Brazil asserts as "one of the fundamental facts supporting Brazil's adverse effects claims"[80] the mere *fact* that marketing loan and counter-cyclical payment programs provide income support to U.S. producers at times of low prices. Similarly, Brazil argues that it is evidence of price suppression under Articles 5(c) and 6.3(c) of the *SCM Agreement* that U.S. farmers "know" that if prices fall below certain levels, they may receive payments under the marketing loan and counter-cyclical payment programs. As the United States explained in its response to Question 53(b), however, *any* eligible recipient of income support "knows" that he or she will receive some income protection due to those payments. That is the very nature and intent of income support programs – to ensure that producers receive some income that they would not otherwise get on the market.

54. In fact, U.S. farmers are even more secure in their "knowledge" that they will receive such payments where payments are fixed, as in the case of direct payments (*i.e.*, as compared to payments under the marketing loan and counter-cyclical payment program, which depend on U.S. and world market prices that are not within the control of individual farmers and cannot even be known until many months after the decision is made whether or not to plant cotton). Yet, as the original panel recognized in the case of direct payments[81], the fact that farmers have such "knowledge" does not necessarily result in any "adverse effects" within the meaning of Articles 5 and 6 of the *SCM Agreement*.

55. As the United States has noted before, most economists agree that direct payments, like marketing loan payments, counter-cyclical payments, payments supporting elderly or low-income recipients or, for that matter, *any* type of payment to a producer of agricultural products will have some effect on risk and wealth and that this may, in turn, have some effect on production. The question under Articles 5(c) and 6.3(c) is whether Brazil has shown that – taking into account the particular structure and design of the programs and the way they operate under the market conditions prevailing at present – payments under the programs are having actual effects on production that are so substantial that they are resulting in "present" *significant* price suppression. It is significant price suppression that is precluded under the SCM Agreement, not any *possible* effect on production or any *actual* effect on production that does not ultimately result in significant price suppression in the market identified by the complaining party.

56. Brazil's response to the second part of the Panel's question – asking Brazil to respond the U.S. observation about the lack of an empirical basis for Brazil's claims of "present" serious prejudice – confirms that Brazil has not established such actual "present" effects. Thus, for example, Brazil cites as "evidence" findings made by the original panel and the Appellate body about the collective effects of a different set of measures (Step 2, marketing loan and market loss assistance or counter-cyclical payments) in a different period of time (MY 1999-2002) and under different market conditions.[82] These findings are not directly relevant here. Moreover, as the United States explained in its response

[80] Brazil Answers to Second Set of Questions, para. 44.

[81] Brazil's assertions about the alleged "key role" that direct payments allegedly play in "allowing many upland cotton farmers to achieve a healthy 'profit' from growing upland cotton" – even though direct payments are not at issue in the present proceeding – is further evidence of Brazil's efforts to render income support a prohibited measure under the *SCM Agreement*. Brazil Answers to Second Set of Questions, para. 56. According to Brazil, "such profits play an important role in maintaining upland cotton production over the longer term by increasing the 'wealth' of producers." Brazil Answers to Second Set of Questions, para. 56. What Brazil asserts is true of any payment to any agricultural producer; any such payment would "increas[e] the 'wealth' of producers." This does not mean that all payments to producers are causing "significant" price suppression.

[82] As Brazil confirmed in the first (resumed) meeting with the original Panel, "[t]he four-year period in which these subsidies [the "subsidies provided for the production, export and use of U.S. upland cotton during the period MY 1999-2002"] were provided is both the period of time covering the measures challenged by Brazil as well as the period of investigation to examine present serious prejudice caused by the U.S. subsidies under Articles 5(c) and 6.3 of the SCM Agreement." Brazil's 7 October 2003 Second Statement at First Panel Meeting, para. 3 (emphasis added)

to Question 54[83], the factual observations that the original panel made regarding marketing loan and counter-cyclical payments in reaching its conclusion about the collective effects of the Step 2, marketing loan and counter-cyclical payments made in MY 1999-2002 do not support a finding that marketing loan and counter-cyclical payments are causing "significant" price suppression at present under the existing market conditions.

57. Brazil then asserts that a "strong link" "has been recognized" by various entities between the programs and payments challenged by Brazil in this proceeding and upland cotton acreage, production, exports, and prices.[84] However, *not a single one of the sources* Brazil cites actually looks to the collective effects of the marketing loan and counter-cyclical payments on world market prices, let alone looks at whether these effects amount to significant price suppression under the market conditions existing in the "present" (*i.e.,* MY 2006). Indeed, Brazil even goes as far as to cite as "evidence" a U.N. Food and Agricultural Organization ("FAO") report that observes that "all of the recent studies unambiguously demonstrate that *the removal of domestic subsidies in industrialized countries* reduces cotton production in and exports from these countries."[85] There is no basis whatsoever to find that U.S. marketing loan and counter-cyclical payments are causing "present" significant price suppression within the meaning of Articles 5(c) and 6.3(c) of the *SCM Agreement* simply on the basis that they are "domestic subsidies in [an] industrialized countr[y]."

58. Moreover, contrary to Brazil's assertions, the FAO report does *not* suggest that there is a "strong link" between the marketing loan and counter-cyclical payments and upland cotton acreage, production, exports or prices.[86] The FAO report simply reviews a number of different studies examining the removal of various domestic support measures and/or tariffs from the cotton sector in a number of countries (some even looking at removal of such measures world-wide). As Brazil has acknowledged, the original panel reviewed similar studies during the course of its analysis and "recognized that many of the parameters including magnitude, and time period of the subsidies, elasticities, measures, and selection of baselines did not address exactly the time period or legal issues before the original panel."[87] Accordingly, the *only* conclusion that the original panel considered appropriate to draw from these widely divergent, inapposite studies – according to Brazil – was that "subsidies bestowed by Member governments have the *potential* to distort production and trade."[88] This does not equate to the recognition of any "strong link."

59. Brazil also points to statements by a U.S. trade association made before enactment of the 2002 farm bill purporting to show that U.S. farmers would be "bankrupt" without marketing loan and counter-cyclical payments. Again, not one of these statements pertain to marketing loan or counter-cyclical payments. Rather, they were made about emergency relief provided under the FAIR Act of 1996 in the period MY 1999-2001. These statements – quoted out of context – about an entirely different set of measures (including disaster payments), offers no insight regarding the role of marketing loan and counter-cyclical payments in production decisions or about U.S. farmers' costs and revenues today. Certainly it does nothing to detract from the actual data regarding "present" costs and revenue, which, as discussed in the prior U.S. submissions, flatly contradict Brazil's claims that

[83] U.S. Answers to Second Set of Panel Questions, paras. 101-106.
[84] Brazil Answers to Second Set of Questions, para. 45.
[85] Brazil Answers to Second Set of Questions, para. 45.
[86] Brazil Answers to Second Set of Questions, para. 45.
[87] Brazil Rebuttal Submission, para. 309.
[88] Brazil Rebuttal Submission, para. 309. Indeed, the FAO itself concludes that any potential distortion may be minimal. The FAO estimates price effects of *only* 3.1 to 5 percent and it does so for "*complete elimination of domestic subsidies as notified to the WTO* <u>*and*</u> *tariffs*;" in other words, *every domestic support* and *every tariff* for *every* country in the world that notifies either to the WTO. Poonyth, Daneswar, *et al.*, "The Impact of Domestic and Trade Policies on the World Cotton Market," FAO Commodity and Trade Policy Research Working Paper No. 8, April 2004, p. *i* (Exhibit US-55). Any possible effect of *U.S.* domestic supports – let payments under only *two* of the U.S. programs – would necessarily be substantially less. This is hardly evidence of a "strong link."

U.S. upland cotton farmers would be bankrupt without the marketing loan and counter-cyclical payment programs.

60. What is conspicuous in its almost complete absence from Brazil's listing of the evidentiary basis for its claims is evidence of any present production-inducing effects of the marketing loan and counter-cyclical payments under the market conditions prevailing at present and without the Step 2 program in place. Indeed, the *only* argument that Brazil makes about the effects of marketing loan and counter-cyclical payments under the current market conditions is that, according to a U.S. "market expert," current U.S. stocks will allegedly "keep a heavy lid on the market" and, in term of prospective plantings, that "any total acreage number below 12.5 million acres will be bullish. The lower the intended plantings, the higher the price rally."[89]

61. Brazil's assertion that this is "evidence" of significant price suppression is misleading. The question under Articles 5(c) and 6.3(c) is whether U.S. marketing loan and counter-cyclical payments significantly suppress world market prices for upland cotton. Whether or not increased U.S. stocks may have some effects on prices does not answer that question. Any effects on prices could only be attributed to U.S. marketing loan and counter-cyclical payments to the extent that Brazil proves that it was marketing loan and counter-cyclical payments that *cause*d all of the production that is placed in inventory. Brazil clearly has not done so.[90]

62. Absent specific evidence regarding the effects that marketing loan and counter-cyclical payments are having at present under the prevailing market conditions, Brazil has no basis for its claims of "present" serious prejudice under Articles 5(c) and 6.3(c).

63. Could Brazil explain whether or not it considers that whether marketing loan and counter-cyclical payments increase acreage is not relevant to the inquiry of whether these payments cause significant price suppression within the meaning of Article 6.3 (c) of the SCM Agreement? (para. 56 of the Opening Statement of Brazil) Could Brazil comment on the points made by the United States in footnote 72 of the Comments of the United States on Brazil's "Oral" Presentation in the meeting with the Panel?

63. The United States notes that the bulk of Brazil's answer to this question addresses arguments that have never been made by the United States. The United States has never suggested that "Article 6.3 of the *SCM Agreement* . . . compel[s] a complaining Member to produce evidence that the challenged subsidies result in a steady *increase* in production or acreage."[91] Therefore, it is inexplicable why Brazil devotes nearly four pages of argument in an attempt to rebut such an assertion.

[89] Brazil Answers to Second Set of Questions, para. 51.

[90] The market analysis submitted by Brazil actually *confirms* that – contrary to Brazil's assertions – U.S. production and exports/stocks are not primarily responsible for the upland cotton market trends that are currently being observed. Specifically, the actual planting intentions figures for MY 2007 were far lower than those predicted by the "market expert" cited by Brazil – the report forecasted U.S. upland plantings to be only 11.86 million acres. NASS Prospective Plantings Report (March 30, 2007) (Exhibit US-140). This is 20.7 percent lower than MY2006 acreage and over 600,000 acres below the point at which the "market expert" predicted there would be a "bullish" impact on prices. Yet, both the May and December futures contracts for upland cotton, as quoted by the New York Board of Trade, *declined*, on average, since the report was issued. N.Y. Futures After Issuance of Planting Intentions Report (Exhibit US-169). This is hardly the "bullish" response predicted and confirms that other factors – such as China's upland cotton trade balance – are very much responsible for the world market price phenomenon that experts are trying to understand. As discussed in response to Question 74 below, Brazil has never properly accounted for these other factors in its assessment of "present" serious prejudice.

[91] Brazil Answers to Second Set of Questions, para. 59.

64. Rather, as the Panel's question itself reflects in its reference to footnote 72 of the Comments of the United States on Brazil's "Oral" Presentation in the meeting with the Panel, the United States has taken issue with Brazil's inexplicable arguments in its unsolicited third written submission – BRA-659 – that the Panel should disregard a number of the studies submitted by the United States because they do "not examine whether CCPs are decoupled from production. Rather, [they] examine whether CCPs increase acreage."[92]

65. The United States appreciates Brazil's acknowledgment now, in response to this question, that its focus on "coupling" in the language cited by the United States was misplaced: "the notion of "coupled" and "decoupled" support in the Agreement on Agriculture . . . is not relevant for the assessment of the effects of subsidies under Articles 5 and 6 of the SCM Agreement."[93] Rather, as Brazil now concedes the salient question is whether marketing loan and counter-cyclical payments cause such substantial shifts in planted acreage that oversupply, export, and ultimately "significant" price suppression within the meaning of Articles 5(c) and 6.3(c) of the *SCM Agreement* result.[94] As discussed in the prior U.S. submissions[95] and above in the general comments of the United States regarding Brazil's claims under Articles 5(c) and 6.3(d) of the *SCM Agreement*, the evidence before the Panel does *not* support Brazil's arguments that the marketing loan and counter-cyclical payments are causing any such significantly suppressed world market prices.

64. Given that Brazil has criticized the new empirical research cited by the United States because it does not deal specifically with the effects of countercyclical payments on upland cotton production, why does Brazil consider that the McIntosh, Shogren & Dohlam study (Rebuttal Submission of Brazil, para. 140) is particularly relevant to this case? Could Brazil comment on the arguments of the United States in paragraphs 248-249 of the Rebuttal Submission of the United States?

66. Brazil fails to establish why the McIntosh, Shogren & Dohlam study – a study that does not address upland cotton specifically and that is premised on highly restrictive assumptions about the operation of the counter-cyclical program – is "more applicable to the assessment that the compliance Panel is tasked with"[96] than the many studies submitted by the United States.

67. Indeed, it is important to note that – because the McIntosh, Shogren & Dohlman study is not limited to upland cotton production – its results are presumably supposed to be valid even for predicting effects on wheat, corn, and soybean acreage. However, it comes to *directly* inconsistent conclusions about the effects of counter-cyclical payments on wheat, corn, and soybean acreage than the studies submitted by the United States (for example, the Lin & Dismukes study finding that "[t]he effect of CCPs on producers' planting decisions . . . appears to be *very negligible* – an increase in the acreage of major field crops of less than 1% . . . .")[97] Although Brazil has argued that the Panel should ignore those other studies because they are not specific to upland cotton, Brazil has never explained

[92] Supplementary Statement of Daniel Sumner, para. 21.

[93] Brazil Answers to Second Set of Questions, para. 65. Brazil's attempts to attribute the focus on "coupling" to the United States in its response is, however, patently unfounded, as the U.S. discussion in footnote 72 (reflected above) clearly shows.

[94] Brazil Answers to Second Set of Questions, para. 66.

[95] U.S. First Written Submission, paras. 203-331 and Annex I; U.S. Rebuttal Submission, paras. 215-404 and Annex I; U.S. Answers to Parts A-C of First Set of Panel Questions, paras. 27-44; U.S. Oral Statement, paras. 50-85 and Statement of Dr. Joseph W. Glauber; U.S. Answers to Parts D-E of First Set of Panel Questions, paras. 14-42; U.S. Comments on Brazil's "Oral" Presentation, paras. 34-91 and Annex I, and U.S. Answers to Second Set of Panel Questions, paras. 1-4, and 62-170.

[96] Brazil Answers to Second Set of Questions, para. 67.

[97] Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter-cyclical Payments' Production Impacts,*" Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 83 (Exhibit US-85) (emphasis added).

why the McIntosh, Shogren & Dohlman study should be viewed as reliable when it comes to such different conclusions about the effects of counter-cyclical payments even with respect to the other crops. Indeed, the divergence in the results for wheat, corn, and soybean acreage simply confirm what the United States has argued and the authors of the McIntosh, Shogren & Dohlman study themselves acknowledge[98] – that this study overstates any effects of counter-cyclical payments on acreage.

68. The authors themselves identify some of the reasons why that particular study overstates any effects of counter-cyclical payments on acreage. Namely:

> Our design did not address two features of the 2002 Act which could affect the interpretation of our results. First, there are no adjustments made in our bonuses for the fact that direct and counter-cyclical payments are made only on a percentage (85 percent) of base acres. If these adjustments were incorporated, the lump sum bonuses would have been lower, implying our results could overstate the effects of CCPs. Second, we excluded the marketing loan program to focus on the basic CCP structure—target price, market price, and direct rate. Adding the marketing loan program into our design would temper the basic effects of CCPs by providing an additional price support mechanism.[99]

69. There are other reasons as well that have to do with the kind of laboratory experiments upon which the McIntosh, Shogren & Dohlman study is premised. The use of a laboratory experiment may allow the researchers to focus on a particular set of problems or issues but necessarily abstracts away from other highly relevant factors that also affect a producer's planting decision. Thus, for example, Brazil cites the authors of the McIntosh, Shogren & Dohlman study as noting that "farmers have other risk management tools at their disposal; large and less risk-averse farms tend to dominate production of program crops; and other programs such as marketing loan provisions already offer price protection."[100] The McIntosh, Shogren & Dohlman study excludes these factors in assessing the effects of counter-cyclical payments. Yet, as Paul Westcott *et. al.* explained[101], it is precisely these kinds of factors that mitigate and temper any *actual* effects of counter-cyclical payments.[102] To

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[98] McIntosh, Christopher R, Jason F. Shogren and Erik Dohlman,"Supply Response to Counter-Cyclical Payments and Base Updating under Uncertainty: An Experimental Study,: forthcoming paper in the *American Journal of Agricultural Economics*, November 2006, page 18 (Exhibit BRA-565). The United States notes that this citation is in error since the article did not appear in the November 2006 issue of the *American Journal of Agricultural Economics*.

[99] McIntosh, Christopher R, Jason F. Shogren and Erik Dohlman,"Supply Response to Counter-Cyclical Payments and Base Updating under Uncertainty: An Experimental Study,: forthcoming paper in the *American Journal of Agricultural Economics*, November 2006, page 18 (Exhibit BRA-565). The United States notes that this citation is in error since the article did not appear in the November 2006 issue of the *American Journal of Agricultural Economics*.

[100] *See* Brazil Answers to Second Set of Questions, para. 68, n. 63 (citing McIntosh, Christopher R., Jason F. Shogren and Erik Dohlman, "Supply Response to Counter-Cyclical Payments and Base Acre Updating under Uncertainty: An Experimental Study," Forthcoming paper in the American Journal of Agricultural Economics, November 2006, p. 16-17 (See Exhibit BRA-565)).

[101] The original panel found an earlier version of Westcott's analysis to be persuasive as to the effects of counter-cyclical payments.

[102] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 203-205 (Exhibit US-35). Westcott notes in this regard that: (a) where prices are expected to be above maximum threshold – counter-cyclical payments behave just like the fixed direct payments; (b) "cross-commodity effect[s] suggest[] that CCPs may provide a general reduction in revenue risks rather than a crop-specific effect. Net returns among alternative crops would remain the primary consideration underlying production choices;" (c) "while a number of studies indicate that farmers are risk averse (Chavas and Holt, 1990, 1996, for example), other risk reduction instruments already exist to manage risks. Thus, with revenue risk reduction now provided by CCPs as part of farm programs, farmers may adjust their use of these other farm and nonfarm risk management strategies;" and (d) "a large portion of output in the U.S. agricultural

ignore these factors is to improperly attribute to counter-cyclical payments effects that they do not *actually* have in the real world but only have in some artificial vacuum created for purposes of a laboratory experiment. It says little about whether counter-cyclical payments are *actually* having the kind of production effects alleged by Brazil and whether those effects are *actually* lead to the kind of price suppressive effects with which Article 6.3(c) is concerned.

70. What Brazil presents – in short – is a highly abstract study with limited conclusions.[103] The laboratory experiment upon which the study is based does not reflect the economic conditions of actual upland cotton producers.[104] Rather, the experiment "mimicked" certain stylized scenarios to attempt to isolate and measure the impact risk aversion and uncertainty might have on production decisions.[105] In doing so, however, the authors removed from consideration some of the most critical factors that affect the degree to which farmers are, in fact, risk averse, such as the size of the enterprise and the availability of other price hedging mechanisms. Moreover, they exclude important factors other than risk that affect a farmer's planting decisions. When *all* factors are taken into account – as reflected in the empirical data used by some of the other studies submitted by the United States – a much more realistic picture emerges of the effects of counter-cyclical payments.

71. Brazil also claims that the McIntosh, Shogren & Dohlman study is more relevant because it is not confined to the geographic regions of other studies.[106] That is a curious argument given that Brazil at once asserts that geographical factors may have some effect on the effects of counter-cyclical payments and asserts that a study that takes *none* of these factors into account is somehow the most reliable measure of the effects of counter-cyclical payments. In any event, Brazil's criticism that the Lin & Dismukes and Goodwin & Mishra studies on corn, soybeans, and wheat are less relevant to upland cotton because supply elasticities for these crops are much smaller than for upland cotton is only valid if one ascribes to the inflated supply elasticity used by Brazil in its Sumner II (CATO) model. For the reasons explained in the prior U.S. submissions, it is not appropriate to do so.[107]

72. Finally, the United States notes that Brazil misstates the U.S. arguments. The United States has not criticized the field of behavioral or experimental economics, nor has the United States

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sector is produced by a small share of large producers. . . . Evidence that risk aversion decreases as income rises (Chavas and Holt, 1990, 1996) suggests that risk aversion may also tend to decline as the size of farms increases. Thus, with larger farms that account for most production being less averse to facing risk, this lowers potential production effects of CCPs due to risk reduction. And while smaller farms may be more risk averse in their farm enterprise, off-farm income may reduce the overall level of household income risk." Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 203-205 (Exhibit US-35). On the basis of these and other factors, Westcott concludes that "there are several mitigating factors which suggest that overall production effects of CCPs through revenue risk reduction are likely to be limited." Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 205 (Exhibit US-35). The other studies submitted by the United States examining the empirical evidence of production effects – for example, including the Lin & Dismukes study finding that "[t]he effect of CCPs on producers' planting decisions . . . appears to be *very negligible* – an increase in the acreage of major field crops of less than 1% . . . ." – confirm that the effects of the counter-cyclical payments are, in fact, very limited. Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter- cyclical Payments' Production Impacts," *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 83 (Exhibit US-85) (emphasis added).

[103] Brazil Answers to Second Set of Questions, para. 68.

[104] Brazil Answers to Second Set of Questions, para. 69.

[105] McIntosh, Christopher R., Jason F. Shogren and Erik Dohlman, "Supply Response to Counter-Cyclical Payments and Base Acre Updating under Uncertainty: An Experimental Study," Forthcoming paper in the *American Journal of Agricultural Economics*, November 2006, p. 5) (Exhibit Bra-565).

[106] Brazil Answers to Second Set of Questions, para. 69.

[107] *See e.g.*, U.S. First Written Submission, paras. 319-328 and Annex I; U.S. Rebuttal Submission, paras. 349-386 and Annex I; U.S. Oral Statement, paras. 76-81 and Statement of Dr. Joseph W. Glauber; U.S. Comments on Answers to Parts D-E of First Set of Panel Questions, paras. 30-42; and U.S. Comments on Brazil's "Oral" Presentation, paras. 79-91.

suggested that the McIntosh, Shogren & Dohlman is invalid merely because it is based on controlled experiments, as Brazil claims.[108] Rather, the United States has identified the numerous factors that limit the utility of the McIntosh, Shogren & Dohlman study in assessing the question at hand, including those expressly acknowledged by its authors. Moreover, the United States has noted the irony in Brazil's criticisms leveled at the studies submitted by the United States (*i.e.*, that they are not unique to upland cotton production), when Brazil itself submits studies that do not even examine the behavior of actual farmers but, rather, the responses of University of Wisconsin economics students to some highly stylized scenarios. To claim that this highly abstract experimental study "analyzes more closely the effects of counter-cyclical payments on the production decisions of U.S. upland cotton farmers than results of empirical studies"[109] – as Brazil does – is simply not supported by a review of the study and its conclusions.

65. The United States has cited new empirical research on the production effects of counter-cyclical payments. Could Brazil explain why the fact that these studies do not deal specifically with upland cotton should preclude the Panel from considering the studies as being highly probative?

73. Brazil's answer to this question fundamentally contradicts its answer to Panel question 64. Brazil asserts that the studies submitted by the United States are not probative "due to their failure to address the specific effect of upland cotton counter-cyclical subsidies on upland cotton production."[110] Yet, as Brazil admits in Question 64 there are no studies that "address the specific effect of upland cotton counter-cyclical subsidies on upland cotton production."[111] and in fact that studies upon which it relies itself – including the McIntosh, Shogren & Dohlman study – do not even do so. Brazil's complaint on this basis is, thus, patently absurd.

74. Equally unavailing are the four bases that Brazil asserts for why the effects of counter-cyclical payments made to a holder of upland cotton base acreage that produces upland cotton should be understood to be fundamentally different from those observed by Lin & Dismukes for counter-cyclical payments made in respect of corn, wheat, and soybeans and Goodwin & Mishra for marketing loss assistance payments in respect of the same crops. For example, Brazil does not explain what its assertions about "maximum per-acre counter-cyclical payments" have to do with effects on production. In fact, if it were true – as Brazil alleges – that the costs of production for upland cotton are higher than for other crops, one would expect rational farmers to produce other crops while still collecting the allegedly very high maximum upland cotton counter-cyclical payment. Thus, Brazil's reasoning actually supports exactly the opposite conclusion than the one it asserts.

75. Brazil's assertions about the "frequency of payment" similarly lack merit. Differences in what Brazil calls the "fill rate" did not preclude Brazil's preferred study – the McIntosh, Shogren & Dohlam study – from presenting one single assessment across all counter-cyclical payments. This supports the conclusion that any alleged differences in the "frequency of payment" do not preclude the Lin & Dismukes and Goodwin & Mishra from being highly probative of the likely effects of counter-cyclical payments made in respect of upland cotton base acres.

76. Brazil's third asserted basis – its allegation that "one would expect low supply elasticities in these regions for these crops"[112] – is similarly without merit. As noted in response to Question 64, this appears to be premised on Brazil's own assertions of grossly inflated supply elasticities for upland cotton.

[108] Brazil Answers to Second Set of Questions, para. 71.
[109] Brazil Answers to Second Set of Questions, para. 73.
[110] Brazil Answers to Second Set of Questions, 75.
[111] Brazil Answers to Second Set of Questions, 75.
[112] Brazil Answers to Second Set of Questions, para. 80.

77. Finally, as noted above, there is no basis for Brazil's attempts to invoke certain statements by the NCC carefully selected to give the impression that U.S. upland cotton farmers would simply be "bankrupt" without counter-cyclical payments. As Brazil admits, these statements were not even made with respect to counter-cyclical payments under the FSRI Act of 2002 but rather were made in February 2001 – before the FSRI Act of 2002 even came into effect – about certain emergency relief that had been provided under the FAIR Act of 1996 including production flexibility contract payments, marketing loss assistance payments, and disaster payments. These statements offer no insight regarding the role of counter-cyclical payments in production decisions or about U.S. farmers' costs and revenues today. And they certainly do nothing to detract from the actual data regarding "present" costs and revenue, which flatly contradict Brazil's claims that U.S. upland cotton farmers would be bankrupt without counter-cyclical payments.

78. In sum, Brazil has offered no valid reason why the Panel should not consider the studies submitted by the United States to be highly probative on the question of the effects of the counter-cyclical payments on acreage and production decisions. The United States submits that these studies continue to provide important insight into the effects of those payments and confirm the U.S. arguments that these effects are not the "significant" production and price effects that Brazil has alleged.

66. Can Brazil explain the differences between the figures for the amount of counter-cyclical payments allocated to upland cotton provided by Brazil at the meeting of the Panel with the parties (Opening Statement of Brazil, para. 40 and Exhibit Bra 625) and the figures in Table 5 of Brazil's Rebuttal Submission?

67. Please confirm whether or not the Panel's understanding is correct:
"Table 6" in Brazil's First Written Submission was produced using the so-called "Brazil's method" using USDA data.
"Table 5" in Brazil's Rebuttal Submission was produced using the so-called "cotton-to-cotton" methodology using USDA data.
The figures cited in para. 40 of Brazil's opening statement (i.e. "$868 million and $838 million) are produced with the "Brazil's method" as well as the "cotton-to-cotton" methodology, using the data provided by the United States in exhibit US-64.

68. Please comment on the following statement by the US:

> ***"The United States understands that Brazil intends the counter-cyclical payment figures shown in 'Table 5' of Brazil's rebuttal submission to supersede the counter-cyclical payment figures shown in 'Table 6' of its first written submission." (US response to question 4 at para. 15)***

69. How does Brazil address the argument of the United States that "the only evidence that Brazil has submitted purporting to examine the price effects of marketing loan and counter-cyclical payments specifically are the results of the modelling exercise that it has conducted for purposes of this proceeding"? (Opening Statement of the United States, para. 76)

79. In the cited portion of the U.S. oral presentation, the United States observed that:

> regarding the *degree* of any possible effects on world market prices, the United States notes that the *only* evidence that Brazil has submitted purporting to examine the price

effects of marketing loan and counter-cyclical payments specifically are the results of the modeling exercise that it has conducted for purposes of this proceeding.[113]

80. Brazil accuses the United States of "ignor[ing] the hundreds of exhibit and the circumstantial evidence presented by Brazil in the original proceeding and in this compliance proceeding,"[114] and then expounds for 10 pages about the "abundant and diverse evidence" it has allegedly presented.[115] However, not a single piece of the allegedly "abundant and diverse evidence" does what the United States noted – examines the degree of any possible effects on world market prices of the marketing loan and counter-cyclical payment programs. The United States therefore understands Brazil's response to confirm the U.S. observation.

81. As to Brazil's assertion that its allegedly "abundant and diverse evidence" nonetheless supports a finding that "the effect" of marketing loan and counter-cyclical payments is "present" significant price suppression, Brazil is wrong. The United States has addressed each of Brazil's arguments in its prior submissions[116], in the general U.S. comment above regarding Brazil's claims under Articles 5(c) and 6.3(c), and in the U.S. comments regarding Brazil's responses to Questions 62-65 and 70. As shown therein, none of the "evidence" asserted by Brazil withstands scrutiny.

70. How does Brazil respond to the United States' rebuttal that Brazil has not even established a temporal correlation between payment of subsidies and significantly suppressed prices during the life of the FSRI, that is from marketing year 2002 to 2005? More specifically, please address the United States' claim of the stability of US plantings, US share of world production, US share of world exports and the world price of cotton during this period.

82. The United States notes that Brazil chooses not to respond to the Panel's question. The Panel asks Brazil to "respond to the United States' rebuttal that Brazil has not even established a temporal correlation between payment of subsidies and *significantly suppressed prices during the life of the FSRI, that is from marketing year 2002 to 2005*." Instead of responding, however, Brazil attempts to sidestep the issue by attributing to the United States – inexplicably – the "assertion" that "there were not 'coincidences' between (a) *increased U.S. production and exports* and (b) large U.S. marketing loan and counter-cyclical subsidies" and then proceeding to attempt to rebut that alleged "assertion."[117] The United States has never suggested that this is the appropriate analysis, let alone made the kind of "assertions" that Brazil attempts to attribute to the United States. Nor did the original panel conclude that an increase in absolute levels of production and exports would equate to a "temporal coincidence" between allegedly *significantly suppressed world market prices* and payments under the marketing loan and counter-cyclical payment program.

83. Rather, the original panel considered a number of factors *every single one* of which the United States examined in its first written submission and its rebuttal submission.[118] As the United States showed therein, none of the factors considered by the panel in the original proceeding in reaching its conclusion of a "discernible temporal coincidence" between U.S. subsidies and significant

[113] U.S. Oral Statement, para. 76.

[114] Brazil Answers to Second Set of Questions, para. 90.

[115] Brazil Answers to Second Set of Questions, para. 101.

[116] U.S. First Written Submission, paras. 203-331 and Annex I; U.S. Rebuttal Submission, paras. 215-404 and Annex I; U.S. Answers to Parts A-C of First Set of Panel Questions, paras. 27-44; U.S. Oral Statement, paras. 50-85 and Statement of Dr. Joseph W. Glauber; U.S. Answers to Parts D-E of First Set of Panel Questions, paras. 14-42; U.S. Comments on Brazil's "Oral" Presentation, paras. 34-91 and Annex I, and U.S. Answers to Second Set of Panel Questions, paras. 1-4, and 62-170.

[117] Brazil Answers to Second Set of Questions, para. 108.

[118] U.S. First Written Submission, paras. 277-291; U.S. Rebuttal Submission. paras. 314-320.

price suppression support such a finding with respect to the marketing loan and counter-cyclical payments now. Brazil has never rebutted the U.S. arguments in this regard; and does not do so now even despite the direct request by the Panel to do so. This confirms that Brazil has not – and cannot – prove any "discernible temporal coincidence" between significantly suppressed world market prices and marketing loan and counter-cyclical payments. Indeed, as discussed below, Brazil has not even proven the factual predicates therefor, including significantly suppressed prices.

84. Rather than offering any proof of "discernible temporal coincidence" between significantly suppressed world market prices and marketing loan and counter-cyclical payments, Brazil relies on reasoning that is entirely untenable. Consider, for example, Brazil assertion that the increase in the absolute level of U.S. production and exports alone over the life of the FSRI Act of 2002 should be understood "in isolation" to "suggest a relationship" between the marketing loan and counter-cyclical subsidies and allegedly suppressed world market prices.[119] As evidenced by the fact that U.S. share of world production and exports has remained relatively stable over the course of the entire FSRI Act, however, it is a fact that there is *precisely* the same "temporal coincidence" between increased foreign production and exports and the U.S. marketing loan and counter-cyclical payments. Does this – "in isolation" – support the same conclusion in respect of *foreign* production and exports? Should the U.S. marketing loan and counter-cyclical payments be understood to have *caused* the increase in the absolute level of *foreign* production and exports? Surely not. Surely any rational analysis would look more closely at how the marketing loan and counter-cyclical payments interact with the production decisions (*i.e.*, the decision on what to plant).

85. When one looks at planted acreage, one finds that the *increase* of absolute levels of U.S. production is solely attributable to an increase in yields. In fact, in MY 2005, U.S. producers actually planted *fewer* acres than in either MY 2001 or MY 1999 (13.9 compared to 15.4 and 14.5 million acres, respectively), the years that Brazil has urged the Panel to look at as comparison years before the FSRI Act came into effect. Moreover, had the yields in MY 2005 been what they were in those earlier years, U.S. production in MY 2005 would have been far lower.[120] Thus, contrary to Brazil's assertions, the increased production in these years is not evidence of any causal link between the marketing loan and counter-cyclical payments and production. It is evidence of dramatic improvements in yields.

86. In an apparent effort to avoid this flaw in its argument, Brazil then argues that "but for" the U.S. marketing loan and counter-cyclical payments, U.S. planted acreage would have been lower over the life of the FSRI Act.[121] As the United States has shown – examining the planting decisions made by U.S. farmers in MY 2006, MY 2005 and, in fact, every year under the FSRI Act of 2002 – the facts do not support Brazil's assertion.[122] Thus, Brazil's answer only confirms that, notwithstanding its assertions, Brazil does not – and, in fact, cannot – "reinforce the original panel's finding, at paragraph 7.1351 of its report, of a discernable temporal coincidence of suppressed world market prices and the price-contingent U.S. subsidies."[123]

87. Nor does Brazil respond fully to the second of the Panel's questions. As the Panel's question reflects, the United States identified a key flaw in Brazil theory at the very start of this proceeding.[124]

[119] Brazil Answers to Second Set of Questions, para. 109.

[120] If yields were at the levels that prevailed in MY 2001, U.S. production would have been almost 30 percent lower in MY 2005. If yields were at MY 1999 levels, U.S. production would have been almost 40 percent lower. *See* U.S. First Written Submission, paras. 279-282.

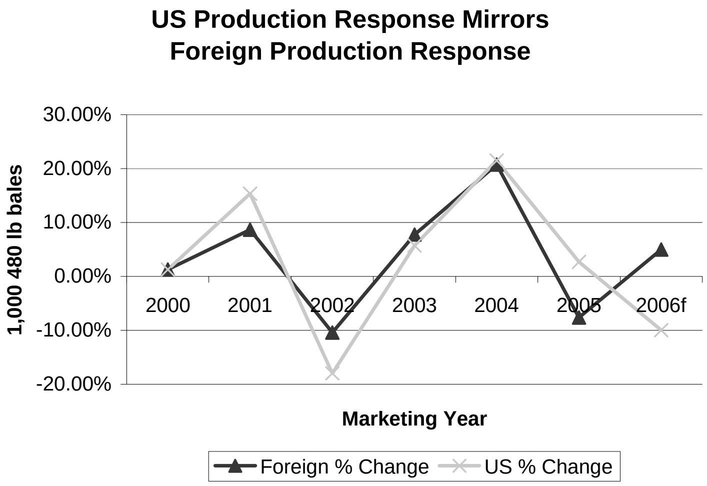
[121] Brazil Answers to Second Set of Questions, para. 108.

[122] *See e.g.,* U.S. Comments on Brazil's "Oral" Presentation, paras. 58-78.

[123] Brazil First Written Submission, para. 152. The United States notes that, while Brazil asserts in its first written submission that it will isolate the effects of the marketing loan and counter-cyclical payment programs, it does not do in its assessment of "temporal coincidence."

[124] U.S. First Written Submission, paras. 243-252.

Namely, if, as Brazil alleges, U.S. producers were cut off from market signals, why does U.S. production response mirror foreign production response (see chart below)? Why does one not find U.S. share of world production and exports increasing over the life of the FSRI Act as U.S. producers allegedly ignore the same market signals received by their foreign counterparts?



88. Brazil has never been able to rebut this evidence; its only response has been to assert that the stable share of world production and exports is somehow itself evidence that U.S. producers are insulated from market signals. However, as the United States explained in its first written submission, in making this assertion, Brazil is improperly assuming its own conclusion – *i.e.*, "stable U.S. share of world production and export proves that U.S. support payments cause price suppression because without the price suppression caused by U.S. support payments U.S. share of world production and exports would not be stable."[125] Brazil's circular reasoning is not improved by its reassertion in Brazil's response to this question.

89. In its response, Brazil also argues at length about the alleged "United States [*sic*] claims that the stability of U.S. acreage demonstrates the lack of any 'temporal coincidence' (and hence causation)."[126] Brazil's arguments in this regard are baffling because the United States has not "claimed" any such thing. What the United States has noted is (a) the original panel's analysis that "United States production of upland cotton increased from MY 1998 to MY 2001 and, while production dropped in MY 2002, there was still an overall increase in MY 2002 compared to MY 1998;"[127] and (b) ***Brazil's*** arguments that in its discussion of production and "temporal coincidence" in the panel report, "[t]he [original] Panel simply referred to "production" as shorthand for planting decisions by producers, which even in agricultural economics literature is not uncommon."[128] According to Brazil's argument, then, the original panel found an "overall increase" in the U.S. upland cotton planted acreage in MY 1999-2002 and considered this as one factor in its finding of a "discernible temporal coincidence". The United States has shown that there is no similar "overall increase" in the U.S. upland cotton planted acreage over the life of the FSRI Act. To the contrary, planted acreage declined from MY 2002 levels in MY 2003 and MY 2004, picked up

[125] U.S. First Written Submission, para. 251.
[126] Brazil Answers to Second Set of Panel Questions, paras. 112-115.
[127] *Upland Cotton (Panel)*, para. 7.1351.
[128] Brazil Appellee Submission, para. 686. Brazil argued that "ultimate production" is not an appropriate basis for assessing production *decisions* as "producers do not decide on production, but on plantings. Ultimate production is affected by weather and other factors affecting yields." Brazil Appellee Submission, para. 706, n. 995. As a result, Brazil asserted that the original panel's discussion of an "overall increase in production" was actually a discussion regarding planting, not actually production.

slightly in MY 2005 and more so in MY 2006 but is projected to fall dramatically in MY 2007 to levels lower than they have been in almost a decade.[129]

90. There is similarly no merit to the other arguments made by Brazil regarding U.S. planted acreage.[130] Brazil continues to make arguments on the fundamentally flawed assumption that U.S. planted acreage should change year-to-year based on changes in the futures price for upland cotton alone. Thus, for example, Brazil even claims as "one of the most important 'temporal coincidences' in the record" – the fact that U.S. planted acreage increased slightly in MY 2005 even though futures prices for cotton in that year were lower than the year before.[131] But Brazil's own assertions about the proper analysis of planted acreage in another year – MY 2007 – demonstrate the fallacy in Brazil's arguments about planted acreage shifts in MY 2005. If U.S. planted acreage must move in synch solely with upland cotton prices, why does Brazil argue that U.S. upland cotton acreage should be *decline* dramatically in MY 2007[132] even though the expected harvest time price for upland cotton in this year (*i.e.,* the average January-March 2007 New York futures price for the December contract) is 59 cents/lb, more than 6 cents/lb *higher* than for MY 2005 and almost the same level as in MY 2006. The reason why Brazil argues that there should be a decline is because the prices for *corn* – a competing crop – make that a more attractive option in MY 2007.[133] The same kind of considerations of competing crops, weather, pests and other such factors – not some narrow assessment of changes in the futures price for upland cotton price alone – explain the acreage shifts also in MY 2005 (and indeed in each of the other years that the FSRI Act has been in effect).[134]

91. Finally, the United States notes that although the Panel asks Brazil specifically to respond to the U.S. arguments regarding world market prices, Brazil does not do so. Rather, Brazil simply asserts that prices over the life of the FSRI Act are below those that prevailed in MY 1980-1998.[135] As the United States explained in its first written submission, however, Brazil's claim in this proceeding is of significant price *suppression*, not price *depression*. A *decline* in prices does not demonstrate price *suppression*.[136] The question is whether prices are being prevented from *rising* by

[129] *See* U.S. First Written Submission, para. 280 and U.S. Answers to Second Set of Panel Questions, paras. 1-4.

[130] As the United States explained in its rebuttal submission, Brazil's attempts to compare changes in U.S. *planted acreage*, changes in foreign *harvested* acreage, and *changes* in the futures prices is fundamentally flawed both because of its apples-to-oranges comparison and also because it seeks to explain changes in U.S. upland cotton acreage *solely* by reference to upland *cotton* futures, in disregard of the basic fact that acreage decisions are made in consideration of prices and other factors not only for cotton but for competing crops. U.S. Rebuttal Submission, paras. 305-306. In fact, what Brazil's flawed analysis shows – when conducted on the same harvested-acreage basis for both the United States and the rest of the world – is that *neither* U.S. nor foreign harvested acreage moves closely in line with futures prices of cotton alone. U.S. Rebuttal Submission, para. 305-307. Nonetheless, even if the comparison were valid (and it is not), it would show that, where changes in U.S. and foreign area diverge, U.S. harvested acreage tends to react more *conservatively* than foreign acreage to increasing prices (as in MY 2003 and 2006). U.S. Rebuttal Submission, paras. 305-307. This would undermine – rather than support – Brazil's assertions of alleged "subsidy-fueled overproduction."

[131] *See* U.S. Comments on Brazil's "Oral" Presentation, para. 70.

[132] Oral Statement of Brazil, para. 73.

[133] *See* Brazil Oral Statement of Brazil, para. 73 (arguing that "[i]f marketing loan and CCP subsidies did not exist, and if U.S. cotton farmers would have to react to market price signals, far more than 14 percent of cotton acreage predicted by the NCC [for MY 2007] would switch to substitute crops."); *see also* U.S. Comments on Brazil's "Oral" Presentation, paras. 1-4 (rebutting Brazil's argument).

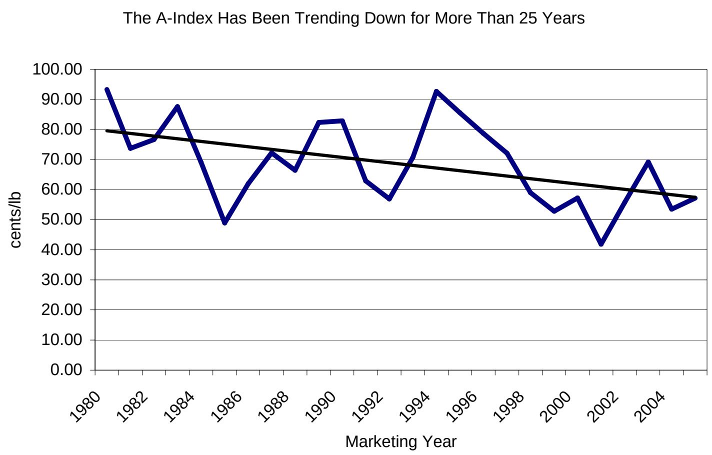
[134] *See* U.S. Comments on Brazil's "Oral" Presentation, para. 70. For example, the data show a perfect correlation between a shift away from soybean acreage in MY 2005 due to concerns about an outbreak of Asian soybean rust in the Delta and Southeast regions of the United States and an increase in the competing crop – cotton – in the exact same areas.

[135] Brazil Answers to Second Set of Questions, para. 113.

[136] Interpreting "suppression" in accordance with its ordinary meaning of "[p]revent or inhibit (an action or phenomenon)," the panel in the original proceeding defined "price suppression" as "the situation where 'prices' – in terms of the 'amount of money set for sale of upland cotton' or the 'value or worth' of upland cotton

something (in this case, the marketing loan and counter-cyclical payment programs). Brazil provides no empirical evidence showing such "suppression" as a result of marketing loan and counter-cyclical payments.

92. Rather, the fact that the A-Index has trended downwards for more than 25 years now – well before the FSRI Act came into effect – and the fact that the A-Index has gone *up* from the levels that prevailed *before* the FSRI Act came into effect as of MY 2002 would tend to suggest that, to the extent there is any price *suppression*, it is not "the effect" of the marketing loan and counter-cyclical payment programs.



Source: USDA, Agriculture Marketing Service Reports[137]

93. Brazil has never rebutted this evidence nor established that there is a "discernible temporal coincidence" of U.S. marketing loan and counter-cyclical payments and allegedly suppressed world market prices.

71. In the original case, the Panel concluded that the analysis covering "the six-year period from 1997-2002 ... lends itself to an assessment of the medium- to longer-term examination of developments in the United States upland cotton industry" (see para. 7.1354 of the original panel report). Thus, total costs of production were the costs considered appropriate by the Panel. Would total costs of production continue to be relevant should the compliance Panel decide to use only marketing year 2005 as the reference period for analysis? Or would variable costs of upland cotton farming in marketing year 2005 now be the relevant information to consider?

94. The United States offers a number of observations regarding Brazil's answer to this question. First, Brazil asserts that there have been no fundamental changes in the conditions of competition or any other relevant factors that would compel the compliance Panel to reject the findings of the original panel's causation analysis relating to "total cost of production."[138] Brazil is incorrect.

– either are prevented or inhibited from rising (*i.e.* they do not increase when they otherwise would have) or they do actually increase, but the increase is less than it otherwise would have been." *Upland Cotton (Panel),* paras. 7.1276-7.1277. The Appellate Body agreed that this was an appropriate interpretation of "price suppression." *Upland Cotton (AB),* para. 424.

[137] Compiled Statistics – Prices (Exhibit US-25).

[138] Brazil Answers to Second Set of Questions, paras. 117 and 118.

95. As the United States explained as early as September 2003, the 1997 ERS/USDA survey data on cost of production used by both Brazil and the United States in the original panel proceeding likely overstated certain costs because of technological and other changes.[139] The U.S. arguments were borne out when ERS released new cost of production data based on a 2003 survey. As a result of changes in technology – widespread adoption of biotech cottonseed, and other improvements in production practices, such as boll weevil eradication programs – upland cotton yields have exhibited a structural increase and per unit input costs have fallen.[140] This dramatic shift in the cost and yield structure for upland cotton certainly represents a fundamental shift in the conditions of competition, contrary to Brazil's assertions. As the United States explained in earlier submissions, the data show clearly that upland cotton producers covered not only their operating (variable) costs but also a substantial portion of their total costs between 2002-2005.[141]

96. Second, Brazil continues to assert that total costs of production, including non-cash or economic costs, are determinative of a producer's planting decision, without offering any basis in the economic literature or even in fact to support that assertion. The United States has reviewed this issue thoroughly in its prior submissions and, rather than repeating this here, refers to the Panel to the earlier discussion.[142] For the reasons explained by the United States, if the Panel were to examine effects on planting/production in a single year – MY 2005 – the relevant consideration is operating costs, not "total" costs.[143]

97. Third, while Brazil is correct in its observation that a farmer has two different cost concerns – one a year-to-year planting decision and another long-term decisions about the economic viability of his farm – Brazil analysis of these decisions is flawed. As the United States has explained the "total costs" that Brazil uses is not an appropriate consideration with respect to either decision.[144] To the extent a producer has planting options for various crops, based on agronomic conditions, the first decision is an assessment of net returns per crop; that is, what is relative market revenue minus operating costs (net revenue per crop).[145] In addition, over time, a producer must also cover all cash costs, including such items as mortgage costs and equipment. The United States agrees with Brazil that "without generating sufficient funds to meet this second set of costs, there would be no facilities or equipment to grow upland cotton in the first place."[146] However, as the United States has shown, U.S. farmers assess the economic viability of a farm *based on the total costs and revenue for the farm*.[147] It is on the basis of those considerations – not some artificially segmented crop-by-crop "total cost" analysis – that the farmer makes decisions such as whether to declare bankruptcy.

98. It is a significant flaw in Brazil's analysis, therefore, that Brazil disregards off-farm income and income from other crops, both of which are an important part of the total revenue of a farm. It is similarly incorrect for Brazil to attempt to include in its "total cost" analysis such factors as imputed opportunity costs that have been calculated by USDA to attribute some value to unpaid labor and owned land but that are not necessarily costs that must be paid off in order for farmers to avoid having to "close down [their] business[es]."[148] As a result of these flaws, the picture that emerges of the

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[139] U.S. Further Submission in the original panel proceeding, paras. 46-54 (September 30, 2003). U.S. Further Rebuttal Submission in the original panel proceeding, para. 123-133 (November 18, 2003).

[140] U.S. First Written Submission, December 15, 2006, para. 302.

[141] U.S. First Written Submission, December 15, 2006, para. 300.

[142] For the most recent review, see U.S. Comments on Brazil's "Oral" Presentation, paras. 62-65.

[143] Any such analysis would also have to look at the other factors besides expected operating costs affect the planting decision – MY 2005 being a good example of other confounding factors. In that year, a major unanticipated factor was the emergence of soybean rust in key cotton producing states, which encouraged producers to switch from soybeans to cotton. U.S. Comments on Brazil's "Oral" Presentation, para. 70.

[144] *See* U.S. Answers to Second Set of Panel Questions, paras. 96-100, 113-116, 133-154.

[145] *See e.g.,* U.S. Comments on Brazil's "Oral" Presentation, paras. 66-67.

[146] Brazil Answers to Second Set of Questions, para. , para. 121.

[147] *See e.g.,* U.S. Answers to Second Set of Panel Questions, paras. 133-154.

[148] *Upland Cotton (Panel)*, para. 7.1353.

financial viability of U.S. farmers is completely and thoroughly distorted. It results in the attribution to marketing loan and counter-cyclical payment "effects" that they are not in fact having.

99. When one considers instead, the total cash costs that most farmers do in fact have to meet over the long term, the data show that U.S. farmers have in fact generated sufficient funds to cover their total cash costs over the long term. The cost data for the period 2000-2005 show that, instead of the cumulative $663 *deficit* per acre erroneously asserted by Brazil, the cumulative returns over the same period were a *positive* return of $161 per acre. Moreover, for MY 2000-2006, instead of the $837 *deficit* per acre alleged by Brazil, the cumulative net returns were a positive $133 per acre.[149]

100. The FAPRI baseline projections from July 2006, which Brazil used in an earlier submission, confirm the same facts. Comparing gross market revenue for upland cotton per acre to variable expenses per acre shows that upland cotton revenue would more than cover variable expenses and would cover a large share of other cash expenses. For the period 2004/05-2010/11, cumulative net returns per acre were projected to be $620.34.[150]

101. It is important to remember that these results look *only* to total costs and revenue for upland cotton production. When whole-farm costs and revenue from all sources is taken into consideration an even more robust picture of economic viability would likely emerge.

72. Brazil has argued that the adjustment in cotton stocks should not be included in the simulation of a large and permanent reduction in subsidies to cotton. Please respond to the following argument:

> ***If the simulation were a comparative static analysis in which a baseline is compared to a counterfactual outcome in some long-run state, modelling such adjustments would be unnecessary. But such adjustments should be taken into account given that the model is used to simulate the average impact on the world price of cotton (among other variables) on specific periods of time (MY 2002-05 or MY 2006-08) and not in the long run.***

102. In its response to this question, Brazil continues to suggest incorrectly that stock responses are incorporated into the demand elasticities used in Brazil's new model. This is simply untrue.

103. Brazil also attempts to minimize the importance of stock adjustments to overall market price movements. However, stock-holding activity is an important component of any storable commodity market. Market participants hold stocks for a variety of reasons to accommodate a number of possible factors. The adjustment of stocks is an important determinant in overall price movement. The United States has shown that by ignoring the importance of stocks in a short-run analysis, Brazil's analysis overstates the price impacts.[151]

104. The United States agrees that stock adjustments are not necessary to an analysis of long-term demand and price adjustments. However, in a long-term analysis, the elasticities that are used must fully reflect long-term adjustments in supply and demand. Based on such elasticities documented by FAO, the United States demonstrated that – even using Brazil's own econometric model, which suffers from certain fundamental structural flaws that tend to overstate the results – any price impacts due to the removal of U.S. programs are only in the range of 1 to 1.5 percent, not the grossly exaggerated results that Brazil attempts to show.

[149] U.S. Comments on Brazil's "Oral" Presentation, paras. 76-77.
[150] Brazil's First Written Submission, para. 286. *See also* Exhibit Bra-479, page 6.
[151] *See e.g.,* U.S. Comments on Brazil's "Oral" Presentation, para. 86.

73. ***How does Brazil respond to the argument made by the United States in paragraph 79 of its Opening Statement that:***

> ***"to the extent a counterfactual assessment is undertaken, it is only to assess what the price equilibrium would be at present if marketing loan and counter-cyclical payments had been lower, different or did not exist. Article 6.3(c) does not ask what prices will look like in the short-run adjustment period if the marketing loan and counter-cyclical payments are suddenly eliminated... Brazil's argument that it is necessary to look at the short-run effects of total elimination of the programs cannot be accurate as a textual matter."***

More specifically:

(a) ***Why did Brazil not consider it appropriate to include simulations that involve reductions rather than elimination of the subsidy programmes?***

105. The United States offers two observations in respect of Brazil's answer. First, Brazil's response to this question appears to make little sense. Brazil asserts that it has not modeled reductions of the U.S. marketing loan and counter-cyclical payment programs because the United States has not made changes to reduce payments under those programs. However, the United States has also not *eliminated* the marketing loan and counter-cyclical payments. Under its own reasoning, Brazil would have no basis for purporting to model the total elimination of those payments either.

106. Second, the United States notes that Brazil reasserts its arguments about the appropriateness of assessing the "short-run" response of "shocking" the system with elimination of marketing loan and counter-cyclical payments. As the United States has explained, Brazil confuses the question under Articles 5(c) and 6.3(c) of the *SCM Agreement*. The question under those provisions is what the present effects of the challenged measures are (and whether these effects comprise "significant" price suppression). The question is not what the effects are of *eliminating* anything. To the extent a counterfactual analysis is conducted to attempt to tease this out, the question is simply where the equilibrium would have been *today* had the challenged measures not been in existence. The question is not what *will* happen in the *short run* if a Member were to eliminate the challenged measures today. Brazil's citation of *Korea – Ships* confirms this precisely:

> price suppression is the situation where prices have been restrained by something, and price depression is the situation where prices have been pushed down by something. So the question to be answered is whether the "something" is subsidization. Looking at a counterfactual situation, *i.e.*, trying to determine *what prices would have been in the absence of the subsidy*, seems to us the most logical and straightforward way to answer this question.[152]

107. Indeed, in other disputes, Brazil has confirmed that in assessing trade effects using a counterfactual analysis, "elasticity values should be taken from long-run estimates and not short run estimates."[153] Brazil has provided no valid reason for why the analysis is different here.

(b) ***If simulations of such scenarios are performed, would the current values of the elasticities chosen (particularly the supply elasticities) to simulate the elimination of marketing loan and counter-cyclical programmes continue***

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[152] *Korea – Ships (Panel)*, para. 7.612.
[153] *U.S. – Continued Dumping and Subsidy Offset Act (22.6)*, para 3.101.

to be appropriate? Please kindly provide an explanation for the chosen answer.

108. The United States is surprised by Brazil's assertion now that its inflated U.S. supply elasticity is actually appropriate even for assessing a partial reduction of payments under U.S. programs. Brazil itself has argued that different elasticities are necessary for reduction of payments versus "permanent" removal of payments and has attempted to have the Panel dismiss the FAPRI parameters on the basis that they are not applied to "permanent" removal of payments.[154] Now – however – the Panel is to believe that the inflated Sumner elasticities are nonetheless appropriate for use in every context. Brazil's assertions about the these elasticities simply lack credibility. The United States has shown that the modeling parameters and assumptions that Brazil uses are grossly exaggerated.[155] This is true regardless of whether they put to an analysis of partial or full reduction of payments.

74. Brazil's view is that the data that the Panel must consider for its claim of present serious prejudice should be that covering the latest marketing year for which complete information is available, MY 2005, and where credible, evidence after 31 July 2006. Since in MY 2005, payments under Step 2 continued to be made by the United States (payments which the original Panel found to have contributed to adverse effects) how shall the Panel ascertain that any adverse effects observed in marketing year 2005 are due solely to the two subsidy measures which are the subject of the present serious prejudice claim – marketing loan and counter-cyclical payments?

109. The United States offers three observations about Brazil's answer to this question. First, Brazil's response to this question provides an interesting contrast to its response to Question 69 above. In that response, Brazil attempts to excuse its failure to provide empirical evidence regarding the effects of the marketing loan and counter-cyclical payment programs on the basis that "Brazil cannot unilaterally remove the U.S. subsidies to present direct evidence of what would actually happen to U.S. acreage, production, exports, and world prices without those subsidies. Only the United States can do so."[156] In its response to this question, however, Brazil argues that where the United States *has* removed a domestic support program, the Panel should *not* rely primarily on the "direct evidence of what would actually happen to U.S. acreage, production, exports, and world prices without" payments under that program but rather on Brazil's own "counterfactual" assertions about the effects of the removal of the Step 2 program (which are, in any event, heavily contradicted by the arguments presented by Brazil itself in the original panel proceeding and undermined by the empirical evidence).[157] In effect, Brazil suggests that – regardless of what the facts actually are and regardless of whether payments are being made under the challenged programs or not – the Panel must rely on whatever Brazil alleges about the effects of the payments. There is no basis for such a suggestion.

[154] Brazil's assertions about the FAPRI parameters are patently untrue. FAPRI has used their modeling system to analyze the removal of domestic subsidies under trade liberalization scenarios and the reduction of farm subsidies under various farm bill scenarios, including the "permanent" removal of payments. Indeed, in attempting to argue that elimination of the Step 2 program has had no effects on exports or prices, Brazil itself submitted and repeatedly cites to a FAPRI assessment of the effects of eliminating that program. *See* Brazil First Written Submission, para. 203 (addressing FAPRI, "Impacts of Commodity and Conservation Reserve Program Provisions in House and Senate Reconciliation Bills," FAPRI-UMC Report #15-05, December 2005(Exhibit Bra-484).)

[155] *See e.g.,* U.S. First Written Submission, paras. 319-328 and Annex I; U.S. Rebuttal Submission, paras. 349-386 and Annex I; U.S. Oral Statement, paras. 76-81 and Statement of Dr. Joseph W. Glauber; U.S. Comments on Answers to Parts D-E of First Set of Panel Questions, paras. 30-42; and U.S. Comments on Brazil's "Oral" Presentation, paras. 79-91.

[156] Brazil Answers to Second Set of Questions, para. 91.

[157] *See* U.S. First Written Submission, paras. 149-195; U.S. Rebuttal Submission, paras. 175-214; U.S. Oral Statement, paras. 54-59.

110. Second, the facts relating to the period after the removal of the Step 2 program – which Brazil attempts to have the Panel ignore – show U.S. plantings declining and U.S. exports declining dramatically even as the cost structure of U.S. upland cotton farms improves due to such factors as the use of genetically modified cottonseed. Brazil has not established that, despite these facts, U.S. marketing loan and counter-cyclical payments are somehow "significantly" suppressing world market prices. The decline in exports and the decline in predicted plantings are occurring even though both the marketing loan program and the counter-cyclical payment program remain in place and even though – according to Brazil – these programs are allegedly "designed" to provide consistently high payments to U.S. farmers. These facts are not consistent with the theories that Brazil has put forward purporting to establish the alleged "numbing" of U.S. production response and alleged substantial levels of overproduction and export of U.S. upland cotton.

111. Third, Brazil asserts that the removal of the Step 2 program should be assessed as part of a "non-attribution" analysis and suggests that the original panel's analysis somehow supports this approach. Brazil is wrong. The original panel never assessed the effects of Step 2 payments as part of any "non-attribution" analysis; Step 2 payments were, instead, part of the package of payments whose effects were *directly* at issue in the "present" serious prejudice analysis under Articles 5(c) and 6.3(c) of the *SCM Agreement*.

112. Nor does it make sense that *removal* of the Step 2 program would be part of a "non-attribution" analysis. As the Appellate Body has explained, a "non-attribution" analysis focuses on "ensur[ing] that the effects of other factors on prices are not improperly attributed to the challenged subsidies."[158] This requires separating out the effects of other factors suppressing world market prices and ensuring that they are not attributed to marketing loan and counter-cyclical payments. As removal of the Step 2 program is not suppressing any prices, it is not logical to speak of including that factor in any "non-attribution" analysis.

2. Increase in world market share - Article 6.3(d) of the *SCM Agreement*

Questions to the United States

75. Could the United States explain further the textual basis of its argument that "Article 6.3(d) is not concerned with absolute market share and whether or not in any given year a member's market share would have been lower if subsidies were removed"? (Rebuttal Submission of the United States, para. 401)

Questions to Brazil

76. What is the view of Brazil on the argument of the United States that an inquiry under Article 6.3(d) of the SCM Agreement requires two distinct elements: first, a demonstration of an increase in the world market share of a Member as compared to the average share it had during the previous period of three years, and, second, a demonstration that this increase in world market share compared to the average share the Member had during the previous period of three years is part of a

[158] *Upland Cotton (AB)*, para. 437. As the United States has noted in its prior submissions, Brazil has not made any meaningful attempt to "ensure that the effects of other factors on prices are not improperly attributed to the challenged subsidies." *Upland Cotton (AB),* para. 437. Brazil's "analysis" consists of unsupported assertions that nothing "attenuates" the link that it asserts between the marketing loan and counter-cyclical payments and allegedly significantly suppressed world market prices. This is entirely insufficient to meet Brazil's burden, especially in light of substantial evidence submitted by the United States (and even, unwittingly, by Brazil itself) showing the key importance of other factors (such as China's trade in upland cotton) affecting world market prices. *See e.g.,* U.S. First Written Submission, paras. 308-318; U.S. Rebuttal Submission, paras. 387-396.

consistent trend over a period when subsidies have been granted? (Rebuttal Submission of the United States, para. 399)

113. The United States respectfully refers the Panel to its general comments above regarding Brazil's claims under Articles 5(c) and 6.3(d) of the *SCM Agreement* as well to the U.S. arguments on this issue in its prior submissions.[159]

114. In its response to this question Brazil asserts that the second element of Article 6.3(d) – "this increase follows a consistent trend over a period when subsidies have been granted" – can be met simply by showing an increase in U.S. world market share from MY 1998 to MY 2005. Brazil's approach – if adopted – effectively write out of Article 6.3(d) both the reference to "this" increase and to a "consistent" trend.

115. As the United States explained in its answer to Question 75, Article 6.3(d) of the *SCM Agreement* is concerned with *increase* in world market share.[160] An *increase* is – by definition – "the action, process, or fact of making or becoming greater."[161] Thus, what is at issue in Article 6.3(d) is movement ("becoming greater"), not something static. The key question, then, is *what movement is relevant for purposes of that provision* The text provides the answer. The movement that is relevant is that in getting from point A – "the average share [the allegedly subsidizing Member] had during the previous period of three years," – to point B, the level in the year that is the subject of the claim. If upward movement – *i.e.*, "increase" or "growth" – is involved in getting from the former to the latter, and the upward movement is shown to be "the effect" of a challenged subsidy – the first element of Article 6.3(d) is satisfied.

116. An "increase" is also at issue in the second element of Article 6.3(d) – the requirement that "this increase" be shown to "follow[] a consistent trend over a period when subsidies have been granted." Again, the text makes clear which particular increase is at issue – it is "this increase" - *i.e.*, the *same* increase that was relevant for purposes of the first element. Thus, under the second element, the complaining party must show that "this increase" – the "increase in the world market share it had during the previous period of three years" – "follows a consistent trend over a period when subsidies have been granted."

117. Brazil's argues that "the United States attempts to read the separate element of a three-year average into the element of a 'consistent trend,'" but ignores the fact that Article 6.3(d) specifically refers to "this" increase, relating back to the reference to the increase over the previous three-year average. Brazil offers no reason why the drafters would have referred back to "this increase" if they had intended that a completely different increase – one defined by the complaining party – was to be the relevant increase for purposes of the second element of Article 6.3(d).

118. Instead, Brazil confuses two entirely separate questions. One question – just discussed – is what the relevant comparison is in assessing whether there has been an "increase" (*i.e.,* whether the proper points of comparison are the share of world production in a particular year versus the average share over the previous three-year period, as the text suggests, or rather two years selected by the complaining party, as Brazil urges). A second, and separate, question is whether an increase must be shown in *every* year in order to show that "this increase follows a *consistent trend* over a period when subsidies have been granted" (emphasis added). These are distinct issues. Contrary to Brazil's assertions, the United States has never suggested that for a "consistent trend" to be shown there must be an increase in every single year that subsidies have been granted. Nor is this a necessary implication of the U.S. interpretation of Article 6.3(d).

[159] *See e.g.,* U.S. First Written Submission, paras. 323-343; U.S. Rebuttal Submission, paras. 399-404; U.S. Answers to Second Set of Panel Questions, paras. 171-172.
[160] U.S. Answers to Second Set of Panel Questions, paras. 171-172.
[161] *The New Shorter Oxford English Dictionary* at 1350, Volume 1, (2002 Edition) (Exhibit US-148).

119. While there may not be a need to show an increase in *every* year, where – as here – a complaining party can only point to one[162] isolated year in which there has been an increase over the previous three-year average (and even that slight increase is shown to be both part of the ordinary fluctuation of world market share and caused by factors other than the challenged measures) there is clearly no basis whatsoever for an assertion of a "consistent trend."

120. Indeed, it is Brazil's interpretation that is inconsistent with the "consistent trend" language in Article 6.3(d). Brazil has argued that a complaining party should be able to satisfy the second element of Article 6.3(d) by simply selecting two end-points in the period that subsidies have been granted and drawing an upward-slanting line between the two points. However, this would simply show an increase. It would not necessarily show a "trend," and it would most certainly not show a "consistent" trend. To the contrary, it would render the term "consistent" entirely meaningless because – under Brazil's theory – there would only ever be two end-points and one line connecting them. This line could never be "consistent" with anything else because there would simply never be anything else with which to be "consistent." Brazil would – in effect – simply write "consistent" out of Article 6.3(d) altogether. This is not an permissible interpretation of Article 6.3(d).

> ***77. In this connection, could Brazil respond to the argument of the United States that Brazil has not shown that either of these elements are met with respect to the marketing loan and counter-cyclical payment programs"? (Rebuttal Submission of the United States, paras. 399-403)***

121. The United States respectfully refers the Panel to its general comments above regarding Brazil's claims under Articles 5(c) and 6.3(d) of the *SCM Agreement*, to the U.S. comments regarding Brazil's answer to Question 76, as well to the U.S. arguments on this issue in its prior submissions.[163]

C. CLAIM OF BRAZIL REGARDING THREAT OF SERIOUS PREJUDICE

<u>Questions to both parties</u>

> ***78. Could both parties comment on the statements of Canada that "(a)t issue is whether these programmes....threaten to cause serious prejudice simply by virtue of their existence" and that "(c)ertain subsidy programs, by their very nature, give rise to a constant likelihood of support that results in a permanent threat of serious prejudice"? (Third Party Submission of Canada, paras. 9-10)***

122. The United States respectfully refers the Panel to its general comments above regarding Brazil's "threat of" serious prejudice claims under Articles 5(c) and 6.3(c) of the *SCM Agreement* as well to the U.S. arguments on this issue in its prior submissions.[164]

> ***79. Could the parties state their views on the analysis of the ordinary meaning of the term "threat" in paras. 15-28 of the Third Party Submission of Canada?***

123. The United States respectfully refers the Panel to its general comments above regarding Brazil's "threat of" serious prejudice claims under Articles 5(c) and 6.3(c) of the *SCM Agreement* as well to the U.S. arguments on this issue in its prior submissions.[165]

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[162] Or, at most two, if one considers world production plus beginning stocks.

[163] *See e.g.*, U.S. First Written Submission, paras. 323-343; U.S. Rebuttal Submission, paras. 399-404; U.S. Answers to Second Set of Panel Questions, paras. 171-172.

[164] *See e.g.*, U.S. Rebuttal Submission, paras. 405-425; U.S. Answers to Second Set of Panel Questions, paras. 173-199.

Questions to the United States

80. How does the United States address the argument of Japan that in view of the different purposes of Parts III and V of the SCM Agreement the standard for determining threat of material injury in Article 15.7 of the SCM Agreement is an inappropriate standard for determining the existence of a threat of serious prejudice under Part III of the SCM Agreement? (Third Party Submission of Japan, paras. 8-12.)

81. How does the United States respond to the argument of Australia that "it is beside the point for the United States to argue that the programmes under consideration are due to expire in late 2007"? (Third Participant Oral Statement of Australia, para. 13)

82. Could the United States comment on the projections of marketing loan and counter-cyclical payments in Table 26 of Brazil's First Written Submission and on the projections of prices and subsidy payments in Table 27 of Brazil's First Written Submission? Could the United States explain how the data in these Tables support its argument that producers are likely to expect low or no marketing loan payments in MY 2007? (Rebuttal Submission of the United States, para. 418)

Questions to Brazil

83. How does Brazil address the argument of the United States that footnote 13 of the SCM Agreement "does not indicate that where a panel finds that a Member is causing present serious prejudice through the use of a subsidy, the panel automatically also finds that the Member is threatening to cause serious prejudice in the future through the use of the same subsidy"? (Rebuttal Submission of the United States, footnote 624)

84. Could Brazil confirm that its claim of threat of serious prejudice is submitted on a contingent basis i.e., that it does not request the Panel to make a finding on this claim if the Panel make a finding of present serious prejudice? How is the contingent character of this "threat of serious prejudice" claim reflected in Brazil's request for the establishment of a panel?

85. Could Brazil explain its request that the Panel "make factual findings with respect to its 'threat of serious prejudice' claim to allow the Appellate Body to complete the analysis, in case it were to disagree with the compliance panel's interpretation"? (First Written Submission of Brazil, para. 241) What are the precise "factual findings" which Brazil requests the Panel to make in this regard?

86. How does Brazil address the argument of the United States that the definition of "threat" of injurious effects in Article 15.7 of the SCM Agreement and Article 4.1(b) of the Agreement on Safeguards "in terms of their close proximity in time and their high probability of occurring" reflects the ordinary meaning of the word "threat" and that, as such, Article 15.7 of the SCM Agreement and Article 4.1(b) of the Agreement on Safeguards provide "useful contextual guidance" for the interpretation of "threat" of serious prejudice?

[165] *See e.g.,* U.S. Rebuttal Submission, paras. 405-425; U.S. Answers to Second Set of Panel Questions, paras. 173-199.

124. The United States respectfully refers the Panel to its general comments above regarding Brazil's "threat of" serious prejudice claims under Articles 5(c) and 6.3(c) of the *SCM Agreement* as well to the U.S. arguments on this issue in its prior submissions.[166] In addition, the United States submits the following observations regarding Brazil's answer to this question.

125. Article 3.2 of the DSU provides that "the dispute settlement system of the WTO . . . serves to . . . clarify the existing provisions of those agreements in accordance with customary rules of interpretation of public international law." One of these "customary rules" is that treaty terms are to be interpreted "in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose."[167] In its response to this question and Question 88, Brazil urges the Panel to ignore the U.S. application of this rule in interpreting the term "threat" in footnote 13. Brazil provides no basis for why Article 3.2 of the DSU should not be applied here.

126. As United States has explained, the ordinary meaning of the term "threat" includes *both* concepts of probability of occurrence and close proximity in time.[168] This is reflected in Articles 15.7 of the *SCM Agreement*, Article 3.7 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade ("*AD Agreement*"), and Article 4.1(b) of the *Agreement on Safeguards* in describing the meaning of the term "threat." By application of customary rules of treaty interpretation under Article 3.2 of the DSU, the ordinary meaning of "threat" of certain injurious effects as reflected in these other provisions provides important contextual guidance in interpreting "threat" of serious prejudice in Article 5(c)/footnote 13 of the *SCM Agreement*.

127. There is no merit to Brazil's arguments that the Panel should artificially strip out the concept of close proximity in time from the ordinary meaning of "threat" in footnote 13 and should disregard the important contextual confirmation provided in the definition of "threat" in Articles 15.7 of the *SCM Agreement*, Article 3.7 of the *AD Agreement*, and Article 4.1(b) of the *Agreement on Safeguards*.

128. Brazil alleges, for example, that "Article 4.1(b) and 2 of the *Agreement on Safeguards* as well as Article 15.7 of the *SCM Agreement* deal primarily with the threat posed by a potential surge of imports" but that "[b]y contrast, Articles 5(c) and 6.3as well as footnote 13 of the *SCM Agreement* deal with the likelihood of adverse effects – not subsidized imports – occurring sometime in future."[169] Brazil suggests that this is one reason why the concept of close proximity in time should be artificially stripped out of the ordinary meaning of "threat" for purposes of footnote 13. This argument is flawed.

129. First, it is wrong in its characterization of Article 15.7 of the *SCM Agreement*. Neither that provision – nor, for that matter its counterpart in Article 3.7 of the *AD Agreement* – "deal primarily with the threat posed by a potential surge of imports," as Brazil suggests. To the contrary, Article 15.7 expressly states that it is concerned with the "threat of *material injury*," not a "surge in imports." A "surge in imports" is not even required for a showing of material injury. To the contrary, Article 15.7 identifies as only *one* of five factors that administering authorities "should" consider ("*inter alia*") in making a "threat of material injury" determination whether there has been "a

[166] *See e.g.*, U.S. Rebuttal Submission, paras. 405-425; U.S. Answers to Second Set of Panel Questions, paras. 173-199.

[167] See *United States – Gasoline (AB)*, p. 17 (noting that "[this] general rule of interpretation [codified in Article 31 of the Vienna Convention on the Law of Treaties] has attained the status of a rule of customary or general international law. As such, it forms part of the 'customary rules of interpretation of public international law' which the Appellate Body has been directed, by Article 3(2) of the DSU, to apply in seeking to clarify the provisions of the General Agreement and the other 'covered agreements' of the Marrakesh Agreement Establishing the World Trade Organization. . . .)

[168] *See* U.S. Rebuttal Submission, para. 409.

[169] Brazil Answers to Second Set of Panel Questions, para. 172.

significant rate of increase of subsidized imports into the domestic market indicating the likelihood of substantially increased importation." The chausette to Article 15.7 even makes clear that "no one of [the five] factors by itself can necessarily give decisive guidance." In other words, Article 15.7 of the *SCM Agreement* could hardly be more clear that it does *not* "deal primarily with the threat posed by a potential surge of imports." Brazil's arguments premised on that assertion are, thus, irrelevant.

130. Second, Brazil ignores the fact that "injury" is itself classified as an "adverse effect" under Article 5 of the *SCM Agreement*. Indeed, Article 5 of the *SCM Agreement* makes clear in footnote 11 that "injury to the domestic industry" therein is "used here in the same sense as it is used in Part V." Thus, it is illogical for Brazil to assert that the focus in Article 5 on adverse *effects* somehow places a "threat of serious prejudice" inquiry into a fundamentally different category than a "threat of material injury" inquiry; one that precludes the Panel from consulting the ordinary meaning of "threat" in the latter context as important contextual guidance in interpreting the same word in footnote 13.

131. An inquiry into whether subsidized imports into the domestic market of a Member threaten to cause material injury is no less an inquiry into *effects* than an inquiry as to whether subsidies threaten to cause serious prejudice to the interests of another Member. The fact that one looks to the effects of subsidized imports while the other looks to the effects of subsidies is not material; the United States has never suggested that footnote 13 and Article 15.7 are identical provisions. And there is certainly no requirement that two provisions be identical in order for one to provide contextual guidance as to another.

132. Brazil also alleges that the Panel should read the concept of close proximity in time or "imminence" out of the ordinary meaning of the term "threat" in footnote 13 because the multilateral remedy available under Article 5 is somehow a "slow" remedy while the remedy available under Part V of the *SCM Agreement* is a "quick" remedy. Once again, the factual predicate of Brazil's argument is flawed. A remedy in WTO dispute settlement is not necessarily any more "slow" or "fast" than the process of applying duties under the *SCM Agreement*, *AD Agreement*, or *Safeguards Agreement*. Indeed, the pace of a particular WTO, CVD, AD, or safeguard proceeding necessarily depends on the particular circumstances of each proceeding.

133. Investigations by different Members' authorities require differing periods of time. And different Members may have different appeal mechanisms that affect the amount of time to obtain a remedy. In short, any number of factors could affect whether or not the domestic remedy available under the *SCM Agreement*, *AD Agreement*, and *Safeguards Agreements* is a slow or fast remedy. The same is true for the multilateral remedy available through WTO dispute settlement (e.g., the amount of time required for a remedy could depend on the complexity of the dispute brought by the complaining party, whether any appeals are made, the reasonable period of time for implementation of any adverse findings and other such factors). Brazil's generic assertions about the "slowness" or "quickness" of the different remedies is, thus, speculative at best.

134. In any event, Brazil neglects one simple fact – the drafters *chose* to use the same term ("threat") in all four contexts. If the remedies available thereunder were *so* different that same word could not even have the same ordinary meaning in the four contexts, the drafters could very well have chosen to use different words. They could very easily have inserted, for example, Brazil's preferred "significant likelihood" standard in footnote 13 to differentiate it from "threat" in Articles 15.7 of the *SCM Agreement*, Article 3.7 of the *AD Agreement*, and Article 4.1(b) of the *Agreement on Safeguards*. But they did not do so. They chose to use "threat" in all four contexts and – for clarity – even expressly reflected the ordinary meaning of that term in certain of the provisions. Brazil has no basis unilaterally to change the text now.

> ***87. Could Brazil comment on the argument of the United States that the standard of "significant likelihood" is without support in the text of the SCM Agreement or in the GATT/WTO dispute settlement reports cited by Brazil? (Rebuttal Submission of the United States, paras. 406, 410,413)***

135. The United States respectfully refers the Panel to its general comments above regarding Brazil's "threat of" serious prejudice claims under Articles 5(c) and 6.3(c) of the *SCM Agreement* as well to the U.S. arguments on this issue in its prior submissions.[170]

> ***88. Does Brazil agree or disagree with the proposition advanced by the United States that "[a] panel may consider the ordinary meaning of a term as reflected in a particular provision to interpret the same term in another provision (especially of the same agreement) without the need for an express cross-reference." (Rebuttal Submission of the United States, para. 411, footnote 635)***

136. The United States respectfully refers the Panel to its general comments above regarding Brazil's "threat of" serious prejudice claims under Articles 5(c) and 6.3(c) of the *SCM Agreement*, to the U.S. comments regarding Brazil's answer to Question 86, as well to the U.S. arguments on this issue in its prior submissions.[171]

> ***89. Brazil argues that marketing loan and counter-cyclical payments for upland cotton are designed "in such a manner that payments would be made in consistently large amounts". (First Written Submission of Brazil, para. 270)***
>
> > ***(a) Could Brazil in this regard discuss the data in Table 27 of Brazil's First Written Submission that show an increase in the projected farm price and AWP over the period MY 2006 - 2010 and a decline in projected marketing loan payments?***
> >
> > ***(b) How does Brazil respond to the argument of the United States that "by MY 2008, the projection is of no marketing loan payment at all"? (Rebuttal Submission of the United States, para. 419).***

137. The United States respectfully refers the Panel to its general comments above regarding Brazil's "threat of" serious prejudice claims under Articles 5(c) and 6.3(c) of the *SCM Agreement* as well to the U.S. arguments on this issue in its prior submissions.[172]

138. In addition, the United States notes that, in its response to this question, Brazil attempts to explain away the evidence – submitted by Brazil itself – undermining its assertions that marketing loan payments are "designed 'in such a manner that payments would be made in consistently large amounts.'" Table 27 submitted by Brazil in its own first written shows the AWP *increasing* over the period MY 2006-2010 and projected marketing loan payments *declining* over the same period. Brazil's response is, however, inexplicable.

139. Brazil delves into a discussion of "deterministic" versus "stochastic" projections of government outlays in its response to the Panel's question. However, according to Brazil's own notations, Table 27 presents, *inter alia*, the AWP and payments under the marketing loan and counter-

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[170] *See e.g.*, U.S. Rebuttal Submission, paras. 405-425; U.S. Answers to Second Set of Panel Questions, paras. 173-199.

[171] *See e.g.*, U.S. Rebuttal Submission, paras. 405-425; U.S. Answers to Second Set of Panel Questions, paras. 173-199.

[172] *See e.g.*, U.S. Rebuttal Submission, paras. 405-425; U.S. Answers to Second Set of Panel Questions, paras. 173-199.

cyclical payments projected by FAPRI. The total amount of government outlays shown in Table 27 were *not* projected by FAPRI; to the contrary, the government outlays were *estimated by Brazil*.[173] In any event, as USDA points out in the very document Brazil cites for the proposition that "deterministic projections, by their nature, tend to underestimate outlays":

> The Congressional Budget Office (CBO) and the *Food and Agricultural Policy Research Institute (FAPRI) have used a stochastic approach to estimate outlays and cost legislative proposals for some time*. CBO adopted a stochastic approach for crop sector analysis in September 1995 while working on the 1995/96 budget reconciliation/farm bill debate. *FAPRI adopted a stochastic approach just prior to the 2002 farm bill debate*.[174]

140. Indeed, the July 2006 FAPRI baseline from which the data in Table 27 is taken is simply an update of the "full" 2006 baseline published earlier. The earlier baseline clarifies that "[i]n recent years, we have reported average values from the stochastic analysis for government costs and farm income and traditional point estimates for all other variables."[175] Thus, the simple answer that Brazil fails to provide is that – at the time FAPRI issued its July 2006 baseline update FAPRI projected that in MY 2007 the marketing loan payment would be *less than one-half of a cent and thereafter would amount to nothing at all*. The very fact that the projection was made – projections that were considered sufficiently reliable for Brazil to include in its written submission and use in its modeling exercise – confirm that marketing loan program was not set up pursuant to some master "design" to result in large payments.

141. What the marketing loan program under the FSRI Act of 2002 *was* designed to do, moreover, was expire after MY 2007. Thus, regardless of whether projections are "deterministic" or "stochastic," whether they are of $1 or $1 billion, the fact is *none of them take into account the fact that, as currently scheduled, no marketing loan payments will be made under the FSRI Act of 2002 in MY 2008*. That fact alone renders Brazil's claims moot to the extent that they extend to any hypothetical measures in that year.

D. EXPORT CREDIT GUARANTEES

1. Outstanding export credit guarantees

<u>Questions to the United States</u>

90. The United States states, in para. 50 of its Opening Statement, that:

> ***... nothing in the SCM Agreement provides that "withdrawing" a "subsidy" allegedly "taking the form of a program" "includes an obligation to abstain from performing on commitments outstanding under that program as of the deadline for implementation." That argument improperly equates "performing on commitments under the program" with the "subsidy" itself. Such an equation was appropriate in Brazil – Aircraft (21.5), where Brazil continued to issue new WTO-inconsistent bonds even after the period of implementation on the basis that it had pre-existing contractual obligations to do so. However, it is not accurate here, where <u>the guarantees are not themselves prohibited subsidies</u>.***

[173] *See* Brazil First Written Submission, Table 17, n. 454.
[174] Explanatory Notes for Stochastic Budget Outlays, (Exhibit BRA-460)
[175] FAPRI 2006 U.S. Baseline Briefing Book, p. 1 (available at http://www.fapri.missouri.edu/outreach/publications/2006/FAPRI_UMC_Report_01_06.pdf).

Would the United States please clarify what it meant in the underlined sentence?

91. In paragraph 342 of its First Written Submission, Brazil indicates that the total amount of guarantees under the GSM 102, GSM 103 and SCGP programs outstanding on 1 July 2005 amounted to $8.5 billion.

(a) Does the United States agree with the figure provided by Brazil?

(b) Please indicate what proportion of that amount concerns exports of unscheduled products? (please distinguish between principal and interests)

(c) Please indicate what proportion of that amount concerns exports of scheduled products, and in particular rice (please distinguish, in each case, between principal and interest).

Questions to Brazil

92. Is it of any relevance to the Panel's assessment of Brazil's claims concerning "outstanding" export credit guarantees that what was at issue in Brazil – Aircraft (21.5) was the issuance, after the implementation date, of new bonds, and that bonds which had been issued prior to the implementation date could be redeemed for a number of years thereafter (see para. 46 of the US' Opening Statement at the panel meeting).

142. Contrary to Brazil's assertions, the situation in the present proceeding with respect to export credit guarantees issued prior to July 1, 2005 is not analogous to Brazil's continued provision of WTO-inconsistent bonds in *Brazil – Aircraft (21.5)*. Brazil's bonds continued to be prohibited export subsidies both before and after the date of implementation. By contrast, since July 1, 2005 (and, indeed, even before that time), U.S. export credit guarantees ceased being part of any program that is being operated at a "net cost to the government."[176] Thus, unlike Brazil, the United States has not attempted to continue providing prohibited export subsidies past the date of implementation.

93. The Panel notes that Exhibit Bra-516 indicates outstanding amounts for GSM 5 as of 30 June 2006 rather than as of 30 June 2005 as indicated in footnote 523 of Brazil's First Written Submission. Please explain.

2. Legal Bases for Brazil's export subsidies claims

Question to the United States

94. The United States has noted that the original Panel's findings (that the export credit guarantees at issue constituted prohibited export subsidies) were based on item (j). The United States has also asserted that it has based itself on item (j) in implementing the DSB recommendations with respect to export credit guarantees. Please clarify whether the Panel should understand the United States' argument in this respect as an argument concerning the scope of the present proceeding.

[176] *Upland Cotton (Panel)*, para. 7.804.

3. "Benefit" under Articles 1.1 and 3.1(a) of the *SCM Agreement*

Questions to both parties

> ***95. Brazil has taken the position that "different parties to a transaction involving a GSM 102 ECG derive different benefits from the GSM 102 ECG, each of which is potentially subject to assessment under Article 1.1(b) of the SCM Agreement" and has indicated that it is, in this proceeding, "primarily concerned" with the benefit received by the US exporter in the form of below-market fees (para. 404, Brazil's Rebuttal). The United States has challenged Brazil's approach of focusing on fees to the exclusion of other elements of the total cost of the loan. Please explain, referring to the provisions of the SCM Agreement and WTO jurisprudence (if any applicable), your position as to whether: (1) export credit guarantees and other types of subsidies may involve more than one type of benefit and/or recipient; (2) whether it is up to the complaining Member to decide which benefit it chooses to challenge.***

143. The United States respectfully refers the Panel to the U.S. response to this question.[177] In addition, the United States offers the following observation regarding Brazil's response.

144. Brazil's response assumes that the United States "argues that Brazil must prove that [an export credit] guarantee also resulted in a benefit to a foreign bank by lowering the 'total cost of funds' involved in the transaction."[178] This is a mischaracterization of the U.S. position. The United States has made no argument concerning the necessity to prove a benefit to any particular participant in a transaction or group of participants. Instead, consistent with Article 14(c) of the *SCM Agreement*, the United States has argued that the proper focus is on the guaranteed loan transaction itself, and whether the there is a "difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee."

145. The express focus under the text is on a comparison of two *transactions* to determine whether a benefit exists at all, not on whether a particular entity does or does not receive a benefit. Brazil has made no attempt to provide such specific information on individual loan costs and fees or to identify comparable commercial loans and their terms.

> ***96. The parties differ as to whether different types of loans can be compared as long as they have the same "average life." What support (economic literature, etc.) exists for your position on this issue?***

146. Brazil's response to this question appears to be irrelevant to the question posed by the Panel. Brazil offers an exhibit (BRA-686) in which the consultant retained by Brazil for purposes of this dispute expounds on "why at any point in time, the principal exposures between the two-year bullet loan and the three-year amortizing loan can be different."[179] However, the United States has never argued that a loan with principal payable over 3 years has the same principal exposure as a loan with principal payable over 2 years. To the contrary, the United States has simply demonstrated that the prosaic arithmetic concept of average life provides a common and straightforward basis for comparing the costs and fees derived for loans of differing principal repayment terms.[180]

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[177] U.S. Answers to Second Set of Panel Questions, paras. 206-211.

[178] Brazil Answers to Second Set of Questions, para. 203.

[179] Brazil Answers to Second Set of Questions, para. 225.

[180] U.S. First Written Submission, paras. 123-124; U.S. Rebuttal Submission, para. 153; U.S. Answers to Second Set of Panel Questions, paras. 212-218.

147. Brazil has previously argued that such a difference *necessarily* renders the two types of loans not comparable because "the patterns of credit risk to which the lender is exposed are very different in these two cases."[181] Brazil now appears to retreat from this unequivocal argument, when it states that the difference in principal repayment terms "pose *potentially* differing risks of default."[182]

148. Brazil's consultant states "the likelihood of default in the two periods *may* be different."[183] Presumably, therefore, they may also *not* be different. As the United States has previously observed, Brazil's analysis simply *assumes*, without a factual basis, "that the borrowing bank's credit outlook is sufficiently positive in the short term that there is a very low default likelihood perceived in the first two years . . . and a greater likelihood of default in the third year."[184]

149. Brazil's consultant expressly acknowledges that if the chance of default in each of the years is the same then there is no difference in spread between the two-year bullet loan and the three-year amortized loan.[185] However, he argues that if one assumes the risk of default is higher after the first year then "the amortizing loan commands a higher spread."[186] And, conversely, if one assumes higher risk of default in the first year, "the amortizing loan now has a lower spread."[187] While this may be true, in the absence of any factual basis in the examples before the Panel for an assumption that the risk is greater in the out years, then Brazil's theoretical disquisition is of no significance. Far from there being any such factual basis, however, the United States has actually submitted evidence that in a study of medium-term U.S. government-guaranteed loans, the authors found that "as the medium-maturity loans season the likelihood of default increases initially, peaks in the second year after origination, and declines thereafter."[188]

150. In any event, in the absence of any specific basis for assigning, in particular transactions, differing default risks in particular years, Brazil's analysis simply *confirms* the basic utility of average life for comparing pricing of loans of different principal repayment terms.

Questions to the United States

97. Assuming that the Panel accepts the United States' argument that "benefit" is to be assessed on the basis of the "total costs of funds," what do you consider Brazil must establish in order to meet its burden of proof in that respect? Must Brazil prove that a benefit is conferred in all instances (all transactions and all recipients)? In most instances?

98. Does the United States dispute the accuracy of Brazil's comparison of GSM 102 fees with Exim Bank fees? Does the United States agree that ExIm Bank and GSM 102 guarantees are (at least in certain circumstances) similar or comparable?

99. Please comment on Brazil's argument that the GSM 102 fees are not sufficiently scaled to take into account country risk (i.e. they vary only minimally according with country risk) (see, inter alia, paras. 410-412 Brazil's First Written Submission).

[181] Rebuttal Submission of Brazil, para. 429; *see also*, Oral Statement of Brazil, para. 219; Brazil's Comments on U.S. Answers, para. 140.
[182] Brazil Answers to Second Set of Questions, para. 225.
[183] Brazil Answers to Second Set of Questions, Exhibit Bra-686, para. 11.
[184] Oral Statement of Brazil, para. 220.
[185] Brazil Answers to Second Set of Questions, Exhibit Bra-686, para. 30.
[186] Brazil Answers to Second Set of Questions, Exhibit Bra-686, para. 31.
[187] Brazil Answers to Second Set of Questions, Exhibit Bra-686, para. 31.
[188] Glennon, Dennis and Nigro, Peter; "Measuring the Default Risk of Small Business Loans: A Survival Analysis Approach," *Journal of Money, Credit, and Banking*, Vol. 37, No. 5 (October 2005), pp. 945 (Exhibit US-152).

Questions to Brazil

> ***100. Assuming the Panel were to agree with the United States that the proper benchmark to determine "benefit" is the "total cost of funds" of the transactions, what elements of evidence has Brazil provided the Panel in this respect (other than evidence from the Regulations that the programme targets situations where no credit would be available on the market)? In answering, please address the United States' argument at para. 133 of its First Written Submission that "Brazil has made no attempt to provide such specific information on individual loan costs and fees or to identify comparable commercial loans and their terms".***

151. Effectively conceding that it has not provided the requisite specific information on loan costs and fees or identified comparable commercial loans and their terms, Brazil protests that it is "not in the position of an investigating authority" and therefore cannot be expected to produce "this type of data."[189] This does not excuse Brazil from making a *prima facie* case of breach. If it does not have evidence that the United States is breaching its WTO obligations – as the United States has argued is in fact the case – Brazil has no basis to make claims to that effect before a WTO panel. Brazil finds itself in no different position than domestic industries, who must submit sufficient evidence of subsidization (including financial contribution, benefit, and specificity within the meaning of Articles 1 and 2 of the *SCM Agreement*) and injury in order to warrant an investigation under Part V of the *SCM Agreement*.

152. Brazil next implies that the commercial bank that has provided specific transactional information submitted by the United States may be motivated to falsify such information because of a specific interest in maintaining the GSM 102 program.[190] These assertions are completely baseless and do not merit a response.

153. Brazil also mischaracterizes the arguments of the United States. Brazil asserts that "the United States argues, in essence, that the interest that the lender charges on a loan guaranteed by the U.S. government could be higher than the interest it charges on a loan guaranteed by a commercial enterprise."[191] Consistent with Article 14(c) of the *SCM Agreement*, however, the arguments of the United States have not been restricted to comparisons of interest alone, nor to a comparison of two transactions in which a guarantee is necessarily involved. Rather, the United States has noted that private sector commercial products comparable to the GSM-102 program are available in the marketplace and commercial lenders have provided unsecured financing to foreign banks who are CCC-approved obligors on terms the annualized cost of which was less than that available under the GSM-102 program.[192] This contradicts Brazil's sweeping assertions that GSM 102 guarantees are only provided where credit would not otherwise not have been available to foreign obligors.

154. Finally, Brazil asserts that "as a factual matter, [] Article 14(c) is not directly applicable to GSM 102."[193] The United States has never asserted that Article 14(c) is directly applicable. Rather, the United States – like the Appellate Body – has noted that Article 14 provides key contextual guidance in assessing "benefit." In the case of loan guarantees, it is Article 14(c) that is relevant.

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[189] Brazil Answer to Question 100, para. 226. Brazil later asserts that it has discharged its burden by virtue its "ExIm Bank fee comparison." *Id*., para. 244. This comparison of fees is not an appropriate analysis. Moreover, the United States has demonstrated, however, the elements of the Ex-Im Bank products render them not comparable to the GSM-102 guarantee. U.S. Answer to Question 98 (2 April 2007).

[190] Brazil Answers to Second Set of Questions, para. 226 and fn. 297.

[191] Brazil Answers to Second Set of Questions, para. 246.

[192] *See, e.g.*, U.S. First Written Submission, paras. 111-131

[193] Brazil Answers to Second Set of Questions, para. 234.

155. Article 14(c) recognizes that a loan guarantee is made for the sole purpose of supporting a loan transaction; the guarantee becomes an integral part of that transaction and has no value beyond it. The particular fee assessed for a guarantee is affected by the terms of the underlying loan transaction, who the parties are to the underlying loan transaction, the nature of the goods being purchased and sold, and any number of other factors. In turn, the terms of the underlying loan transaction and the costs and fees associated with that financing may be affected by the fees assessed.

156. Therefore, the drafters expressly provided that "a loan guarantee by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees." In other words, they expressly recognized that an assessment of the total costs of the transaction is necessary to assess whether a "benefit" is *actually* conferred by the guarantee. Brazil has provided no basis to depart from this logic.

101. Brazil argues that "[w]here guarantees are reserved for circumstances in which credit would not otherwise be available, there is no "comparable commercial loan absent the government guarantee," within the meaning of Article 14(c) of the SCM Agreement." (Brazil First Written Submission, para. 375). The Panel understands this argument of Brazil to focus on the foreign obligor. Brazil elsewhere indicates that it is principally concerned, in this proceeding, with the benefit to the US exporter (fees). Are these two arguments at tension?

4. Item (j) of the Illustrative List

Questions to both parties

102. What, in your view, explains the different results achieved by the two methods advocated, on the one side, by the United States in paragraphs 87-89 of its First Written Submission and by Brazil in Exhibit Bra-613 (other than the United States' criticism that Brazil has not taken recoveries corresponding to pre-1992 guarantees into account in its "cash basis" accounting calculations, of which the Panel is already aware)?

157. The United States appreciates the observation by Brazil that under the Federal credit reform accounting methodology, "application of re-estimates effectively converts the process to a retrospective, cash-basis accounting methodology."[194] It is precisely because of such re-estimates that the profitability of the export credit guarantee programs is evident.[195] As Brazil elsewhere notes in its answers to the Panel's questions, the required accounting methodology under the Credit Reform Act of 1990, "'measure[s] more accurately the costs of Federal credit programs' than does cash-basis accounting."[196]

158. In addition to this observation, the United States respectfully refers the Panel to its extensive arguments regarding the profitability of the export credit guarantee programs in its prior submissions.[197]

[194] Brazil Answers to Second Set of Questions, para. 266.
[195] *See, e.g.*, U.S. First Written Submission, paras. 81-99.
[196] Brazil Answers to Second Set of Questions, paras. 273, 285.
[197] *See e.g.*, U.S. First Written Submission, paras. 73-104; U.S. Rebuttal Submission, paras. 84-100.

103. To what extent is evidence pertaining to guarantees issued under the three programmes (GSM 102, GSM 103 and SCGP) under the prior fee schedule relevant to the Panel's analysis of the revised GSM 102 programme under item (j)?

159. The United States has already addressed all of Brazil's arguments in response to this question in its prior submissions. Brazil is simply incorrect to assert that CCC "predicts" that "'cohorts' of GSM 102 ECGs issued in FY 2006 and FY 2007 (and thus under the amended GSM 102 fee schedule) will suffer losses over the long term."[198] In this respect, the United States respectfully refers the Panel to the U.S. comments on Brazil's answer to Question 105 below as well as the U.S. Rebuttal Submission at paragraphs 108-126. With respect to the "cash results" that Brazil advances[199], the United States respectfully refers the Panel to the U.S. comments herein in response to Brazil's answers to Question 102 and 106.

104. Must a risk-based fee necessarily take into account foreign obligor risk? Please discuss and provide any relevant support for your position. Can foreign obligor risk be treated differently than country risk in this respect, and if so, why?

160. The United States respectfully refers the Panel to its own response to Question 104[200] and simply notes again that it establishes internal bank limits to govern exposure to potential defaults by foreign obligor banks in individual transactions.[201] Brazil does not dispute the fact of such limits but indicates that the United States has offered "no evidence" of the way in which it establishes such limits. In particular, Brazil suggests that "CCC does not account for differing ratings between individual non-sovereign foreign obligors in a country, [but] rather, it applies a single rating . . . for all non-sovereign foreign obligors within that country."[202] Brazil is incorrect.

161. As the United States has explained, CCC conducts an independent analysis of *each* foreign bank to establish the risk rating for such bank and the resulting bank limit.[203] The Office of Management and Budget ("OMB") establishes 11 sovereign and 9 non-sovereign risk categories for use by government agencies and programs subject to the Federal Credit Reform Act of 1990.[204] CCC uses the same risk category methodology to classify foreign banks it approves for the GSM-102 program. Generally, if a bank is itself considered to be sovereign, then it will not be rated better than the sovereign country rating. Similarly, if a bank is considered non-sovereign, then it generally will not be rated better than the OMB non-sovereign rating for its country. CCC's independent analysis of each bank applies a standard CAMEL approach, evaluating capital adequacy, asset quality, management, earnings, and liquidity of the foreign bank.[205]

105. What considerations must guide the Panel's decision to accept or refuse new evidence or arguments on issues that were addressed by the original Panel? Please discuss in light of the following:

(a) The original Panel found that original subsidy estimates, while not reflecting 'actual' figures, nevertheless provide a reliable measure of the United States government's own assessment of the profitability of the

[198] Brazil Answers to Second Set of Questions, para. 272.
[199] Brazil Answers to Second Set of Questions, paras. 276-278.
[200] U.S. Answers to Second Set of Panel Questions, paras. 246-248.
[201] U.S. First Written Submission, para. 78.
[202] Brazil Answers to Second Set of Questions, para. 281.
[203] U.S. First Written Submission, para. 78.
[204] U.S. First Written Submission, para. 78, fn. 120; U.S. Rebuttal Submission, para.118; "Informal consultation questions to the United States," question 19 (Exhibit BRA-517).
[205] U.S. First Written Submission, para. 78, fn. 120; U.S. Answers to Second Set of Panel Questions, para. 248, fn. 266 and 279-283.

export credit guarantee programmes. Is the United States asking the Panel to revisit that conclusion (see paras 108 ff. of the United States' First Written Submission).

(b) ***The United States presents evidence which, it argues, demonstrates that the three programmes examined by the original panel were operated at no net cost to the US government. Is there any issue as to whether the Panel can or should accept the United States' evidence in this respect?***

162. First, Brazil is incorrect to assert that "the CCC predicts that costs and losses for the 'cohorts' of GSM 102 ECGs newly issued in FY 2006, FY 2007 and FY 2008 will, over the long term, exceed fees, penalties and recoveries."[206] As the United States has explained, initial subsidy estimates in the U.S. budget are not derived from the specific experience of the CCC programs, nor do they in any way constitute a prediction of loss.[207]

163. Furthermore, the United States does not "ask the compliance Panel to ignore the original panel and the Appellate Body's findings" nor abandon "the original panel and Appellate Body's adoption of a forward-looking, future-oriented assessment under a methodology 'used and relied upon by the United States government to assess the estimated long-term net cost to the United States government of export credit guarantees,' in favor of a purely retrospective assessment of program performance."[208] To the contrary, the United States has expounded at length on the prospective viability of the program[209] and – unlike Brazil – on its profitability under the credit reform methodology "used and relied upon by the United States government."[210]

164. One additional factual assertion in Brazil's answer to Question 105 merits response. Brazil ascribes erroneous significance to "the USDA model" to which it refers in paragraph 302 of its answers and in Exhibit Bra-588. This is not a reference to a model specific to USDA of "expected loss rates or estimated default costs" particular to the CCC export credit guarantee programs, as Brazil asserts. Instead, it refers only to a cash flow model required of all U.S. government agencies providing international credit, which cash flow model is only an initial step in the budgetary process and which must, in any event, use risk ratings and assumed loss rates required by the OMB for all such agencies, irrespective of the particular program experience.[211] The OMB then also requires such agencies to use "a credit subsidy calculator . . . that agencies use to convert agency-estimated cash

[206] Brazil Answers to Second Set of Questions, para. 284.
[207] U.S. Rebuttal Submission, paras. 108-126.
[208] Brazil Answers to Second Set of Questions, para. 292.
[209] *See, e.g.*, U.S. First Written Submission, paras. 73-80; U.S. Rebuttal Submission, paras. 101-107, 127-128.
[210] *See, e.g.*, U.S. First Written Submission, paras.81-99;U.S. Rebuttal Submission, paras. 84-100.
[211] United States Government Accountability Office Report to Congressional Committees (GAO-04-531) September 2004: Export Import Bank - OMB's Method for Estimating Bank's Loss Rates Involves Challenges and Lacks Transparency, p. 7 (Exhibit US-73) ("To estimate their subsidy costs, credit agencies estimate the future performance of direct and guaranteed loans. Agency management is responsible for accumulating relevant, sufficient, and reliable data on which to base these estimates. To estimate future loan performance, agencies generally have cash flow models, or computer-based spreadsheets, that include assumptions about defaults, prepayments, recoveries, and the timing of these events and are based on the nature of their own credit program. Agencies that provide credit to domestic borrowers generally develop these cash flow assumptions, which OMB reviews, based on their historical experience. *For U.S. international credits, OMB provides the expected loss rates, which are composed of default and recovery assumptions, that agencies should use to estimate their subsidy costs.*") (Emphasis added)

flows into present values."[212] These figures can in no way be characterized to reflect that "CCC anticipates losses."[213]

> ***106. The parties disagree as to whether Brazil should include recoveries for pre-1992 guarantees in its cash basis accounting formula (Exhibit Bra-613). Is the Panel correct in understanding that Brazil's formula does not includes amounts for (1) claims paid after 1992 under pre-1992 guarantees; (2) fees paid on pre-1992 guarantees? If so, please explain the relevance or non-relevance of including recoveries under pre-1992 guarantees in light of the non-inclusion of costs and other revenues related to the same guarantees.***

165. The United States respectfully refers the Panel to its own response to this question[214] as well as to the comments of the United States below in response to Brazil's answer to Question 114.

Questions to the United States

> ***107. What can explain the discrepancy between the "credit guarantee liability" recorded in the CCC's financial statements (which suggest that the program is provided at a net cost to the US government) and the evidence presented by the US in para. 87 of its First Written Submission?***

> ***108. Please explain why the "liability" figure in the CCC's financial statements should not be considered by the panel to provide, if not the amount of actual losses, at least a reliable estimate of the CCC's own perception of the cost to the government of the programmes since their inception. Is the Panel wrong in understanding that a "credit guarantee liability" in this context means that the CCC considers that the programmes will not cover their costs and losses in the long term?***

> ***109. Please indicate to the Panel whether there have been occurrences of reschedulings prior to the occurrence of defaults and the payment of claims by the CCC.***

> ***110. Is it possible to calculate the "subsidy estimate net of reestimates" for GSM 102 alone (similar to what the US has done for all three programmes in para. 87)? If so, please provide a table recording the results of this exercise.***

> ***111. In paragraph 7.853, the original Panel stated that it "disagree(d) with the United States that we should 'eliminate' the data for certain, more recent, cohorts in our analysis." Is the United States asking that this Panel eliminate such data for the most recent cohorts (the table at para. 87 of the United States' First Written Submission includes data up to 2005 only). Why should this Panel do what the original refused to do? What would be the result of the United States "re-estimates" exercise if the original subsidy estimate for the 2006 and 2007 cohorts were included?***

[212] United States Government Accountability Office Report to Congressional Committees (GAO-04-531) September 2004: Export Import Bank - OMB's Method for Estimating Bank's Loss Rates Involves Challenges and Lacks Transparency, p. 10 (Exhibit US-73).

[213] Brazil Answers to Second Set of Questions, para. 302.

[214] The United States notes a typographical error in its response, however. In paragraph 261, the fourth sentence should read: "Therefore, it is inexplicable - and entirely disingenuous - that Brazil criticizes the United States for including recoveries received before 1992 (indeed as far back as *1980*)." The United States inadvertently included "not" before "including" in its response.

112. Please explain whether and how the CCC limits risks or control costs of the GSM 102 programme as regards foreign banks' individual credit ratings.

113. Please explain whether and how CCC country risk categories correspond to ICRAS ratings.

Question to Brazil

114. Brazil argues that "(t)hat the United States has, on one view of the data, beaten the odds and met its costs and losses over a series of years does not mean that ECG programs are structured and designed to do so" (para. 503, Brazil's Rebuttal). Is Brazil arguing that evidence regarding the actual operation and "profitability" of the programme (i.e. retrospective evidence) is irrelevant to the Panel's analysis under item (j)?

166. The United States notes that Brazil now appears to be advocating exclusively for "cash results" in respect of an analysis under item (j).[215] This appears to be a *wholesale abandonment of Brazil's position in the original panel proceeding* regarding the credit reform accounting methodology, a shift that can only be explained by the fact that the methodology now confirms the robust profitability of the programs, directly undermining Brazil's theory in the present proceeding. The United States recalls that Brazil had previously stated that "it does *not* intend for this revised constructed formula to *replace* the formula used by the U.S. government itself to track the costs of the CCC guarantee programs pursuant to the U.S. Federal Credit Reform Act."[216] Brazil's response to the compliance panel's Question 114 reflects a complete reversal of that position.

167. While Brazil's positions on the issue may shift to accommodate the results Brazil prefers, the overwhelming evidence confirms the profitability of the export credit guarantee programs. This evidence directly contradicts Brazil's claims that premiums charged under these programs are insufficient to cover the long-term costs and losses of the programs.

[215] Brazil Answers to Second Set of Questions, para. 314.

[216] Brazil's Answers to Questions Posed by the Panel Following the First Substantive Meeting of the Panel, para. 164 (Question 77) (11 August 2003) (emphasis in original).

ANNEX E

COMMUNICATIONS FROM PARTIES

ANNEX E-1

LETTER OF THE UNITED STATES

(7 November 2006)

The United States is in receipt of Brazil's communication dated 1 November 2006, and the Panel's 2 November 2006 invitation to comment on this communication. My authorities have instructed me to submit the following comments pursuant to the Panel's invitation.

In Brazil's 1 November communication, Brazil asks the Panel to seek all of the documents and information listed in Annex 1 to the communication – comprising more than 35 data or document requests[1] – because "*Brazil* considers that it is 'necessary and appropriate' for the compliance Panel to seek [these] documents and information."[2] For the reasons below, the United States respectfully requests that the Panel decline Brazil's request.

Brazil's request appears to be premised on the incorrect assumption that Article 13.1 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") authorizes panels to collect for a complaining party information that the complaining party deems to be "necessary and appropriate." This incorrect assumption is evident both in the assertion that "Brazil considers that it is 'necessary and appropriate' for the compliance Panel to seek [these] documents and information"[3] and in the requests that Brazil outlines in Annex 1 of it 1 November communication.[4] Contrary to Brazil's assumption, however, Article 13.1 is not intended for the convenience or use of the parties to a dispute. Rather, as the Appellate Body has emphasized, DSU Article 13.1 allows a panel "to seek information and advice . . . to help *it* to understand and evaluate the evidence submitted and the arguments made by the parties."[5] Indeed, the Appellate Body has cautioned against using this authority under DSU Article 13.1 "to make the case for a complaining party."[6] The United States notes the timing of Brazil's request – made even before Brazil has presented a single argument or piece of evidence, and therefore without possibly having established a *prima facie* case – and the sheer volume of documents and information that Brazil is asking the Panel to seek from the United States. In light of the foregoing, it is difficult to conceive of Brazil's request as anything but an effort to have the Panel make Brazil's case for it.

In any event, the United States notes that DSU Article 13.1 provides that Members should respond promptly and fully to any request by a panel for "such information as *the panel* considers

[1] Brazil lists 23 separate questions that it asks the Panel to pose to the United States, many of which are comprised of numerous parts and sub-parts (for example, Question 1 requesting information about the "Direct and Counter-Cyclical Payment Program[s]" has 4 parts, (A) through (D), many of which are themselves comprised of multiple sub-parts). By the U.S. count, there are at least 35 separate data or document requests, taking into account just the major parts of the questions in the Annex.

[2] Brazil's 1 November 2006 Communication, para. 3 (emphasis added).

[3] Brazil's 1 November 2006 Communication, para. 3.

[4] In Part A of the Annex, for example, Brazil states that "*Brazil* requests updated information on upland cotton planted and base acres under the Direct and Counter-Cyclical Payment Program for each the 2003, 2004, 2005, and 2006 marketing years." Similarly, "*Brazil* also requests information on base acreage and planted acreage for other 'program crops'." And "*Brazil* requests this information in the format outlined by the Panel." Brazil's 1 November 2006 Communication, Annex 1, Part A, para. 1 (emphasis added).

[5] Appellate Body Report, *Japan – Measures Affecting Agricultural Products*, WT/DS76/AB/R, para. 129 (adopted 19 March 1999) ("*Japan – Varietals (AB)*") (emphasis added).

[6] *Japan – Varietals (AB)*, para. 129.

necessary and appropriate" (emphasis added). It is, thus, within "the sound discretion of a panel"[7] – and not a complaining party – to decide what information is "necessary and appropriate" *for the panel's purposes*[8] within the meaning of DSU Article 13.1. "Necessary" means "[t]hat which cannot be dispensed with or done without; requisite, essential, needful,"[9] and "appropriate" means "specially suitable . . . proper, fitting."[10] Brazil fails to explain how the Panel can assess whether any of the documents and information listed in Annex 1 is "essential" or "suitable" for the Panel's objective assessment of the matter before it, and not to be used to make Brazil's *prima facie* case for it, before either party has even had the opportunity to present any arguments or any evidence in support of its case.

The United States notes that similar, premature requests by Brazil relating to DSU Article 13.1 have been rejected in other disputes. In *Canada – Aircraft* (DS70) – much like in this proceeding – Brazil submitted a letter before either party submitted its first written submission, requesting that the panel seek detailed information from Canada pursuant to DSU Article 13.1. The panel declined saying it would be "absurd" to request information "before receiving at least the first written submissions of both parties . . . since it would at once defeat the very purpose of the parties making written submissions."[11] The same consideration applies with equal force here.

The panel in *Canada – Aircraft II* (DS222) also rejected a similar request by Brazil to seek information from the responding party submitted before either party had filed any written submissions. That panel responded to Brazil's request saying that it "d[id] not consider it appropriate to seek any documents or information from either party until it has at least had an opportunity to review both parties' first written submissions."[12] Though it did ask both Brazil and Canada for

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[7] Appellate Body Report, *Argentina – Measures Affecting Imports of Footwear, Textiles, Apparel, and Other Items*, WT/DS56/AB/R, para. 84 (adopted 22 April 1998) ("*Argentina – Textiles (AB)*"). In that dispute, the Appellate Body rejected Argentina's claim that the Panel erred by "not acceding to the request of the parties to seek information from, and consult with, the IMF so as to obtain its opinion on specific aspects of the matter" before it. Recalling its reasoning in earlier disputes – in particular, Appellate Body Report, *EC – Measures Concerning Meat and Meat Products (Hormones)*, WT/DS26/AB/R, para. 147 (adopted 13 February 1998) – the Appellate Body explained that "Article 13 of the DSU enables a panel to seek information and technical advice as it deems appropriate in a particular case, and that the DSU leaves 'to the sound discretion of a panel the determination of whether the establishment of an expert review group is necessary or appropriate.' Just as a panel has the discretion to determine how to seek expert advice, so also does a panel have the discretion to determine whether to seek information or expert advice at all." *Argentina – Textiles (AB)*, para. 84. *See also European Communities – Trade Description of Sardines*, WT/DS231/AB/R, para. 302 (adopted 23 October 2002) (explaining that "[o]ur statements in *EC – Hormones*, [*Argentina – Textiles*], and *US – Shrimp*, all support the conclusion that, under Article 13.2 of the DSU, panels enjoy discretion as to *whether or not* to seek information from external sources.") (emphasis in original).

[8] A panel's purpose is to conduct an objective assessment of the matter before it and make such findings as will assist the DSB, as provided in Article 11 of the DSU. Contrary to Brazil's apparent belief, nowhere is a panel's purpose to make the case for one of the parties. Rather, information requested by a panel under Article 13 of the DSU could assist the Panel to understand the evidence and arguments that have been presented.

[9] The New Shorter Oxford English Dictionary, p. 1895 (Clarendon Press 1993).

[10] The New Shorter Oxford English Dictionary, p. 103.

[11] Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R, para. 9.50 (adopted 20 August 1999, as upheld by Appellate Body Report) ("*Canada – Aircraft (Panel)*"). In that dispute, the panel did not request any information from Canada pursuant to DSU Article 13.1 until after the panel received the parties' *second* written and oral submissions, by which time the panel had identified certain specific information *it* needed to address the issues before it. *Canada – Aircraft (Panel)*, para. 9.53.

[12] Panel Report, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R and Corr.1, para. 7.134 (adopted 19 February 2002) ("*Canada – Aircraft II (Panel)*"), para. 7.134.

information pursuant to DSU Article 13.1 after reviewing the parties' first written submissions, the panel explained that "[s]ince we are not a commission of enquiry, we did not consider it appropriate to seek additional information and/or documentation on the basis of Brazil's general request [filed before the parties had made any written submissions]. We only considered it appropriate to seek additional information/documentation from Canada *on the basis of specific information and/or arguments submitted by Brazil*."[13] By contrast, in this dispute, Brazil has yet to submit *any* "specific information and/or arguments" that could form the basis of a request by the Panel for information.

Indeed, Brazil's sole argument is that the information sought in Annex 1 is "necessary and appropriate . . . in light of the importance accorded to this information *by the panel in the original proceeding*."[14] Brazil fails to show that this assertion is even factually accurate. Brazil does not explain, for example, when the panel in the original proceeding allegedly asked for or received each of the documents and items of information to which Brazil asserts the panel "accorded importance," the context in which the panel allegedly considered this information, or the specific import it allegedly accorded to the information. Indeed, given that the bulk of the information sought by Brazil relates to periods *after* the original panel proceeding, it is unclear how this information could even have been before that panel.

Even leaving that aside, the United States notes that the issues in an Article 21.5 proceeding are not the same as those in an original proceeding. In this proceeding, the Panel is tasked with deciding disagreements between the United States and Brazil "as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings" of the DSB.[15] These issues were not before the panel in the original proceeding; indeed, they could not have been as there were no DSB recommendations or rulings at that time and thus there was no basis, during the original panel proceeding, to evaluate whether "measures taken to comply" with those recommendations and rulings existed or were WTO-consistent. Accordingly, even if the panel in the original proceeding *had* accorded importance to particular pieces of information in Annex 1, that would not mean that the same information would necessarily be "necessary and appropriate" in this Article 21.5 proceeding. The Panel could only make such a determination after considering the parties' evidence and arguments in this dispute.

Finally, Brazil argues that the Panel must collect the information in Annex 1 "at an early stage . . . given the shortened timeframe for the panel procedure, provided for in Article 21.5 of the DSU."[16] However, there is nothing in the DSU that suggests that an Article 21.5 panel may abdicate to the parties *its* discretion to seek information *it* considers to be "necessary and appropriate" simply because an Article 21.5 proceeding involves a shorter timeframe than an original proceeding. Brazil's premature request provides no valid basis for the Panel to determine to exercise that discretion.

In light of the foregoing, the United States respectfully requests the Panel to decline Brazil's request. If Brazil were to make a request at a more appropriate time in this proceeding, Brazil would still need to explain why, in light of the evidence and arguments presented by the parties *in this proceeding*, the Panel should consider the information requested to be "necessary and appropriate" for the Panel's objective assessment of the matter. The United States has difficulty understanding how the information in the current request goes to anything other than evidence that *Brazil* is interested in having (because it hopes it may help to make Brazil's *prima facie* case for it).

[13] *Canada – Aircraft II (Panel)*, para. 7.136 (emphasis added).
[14] Brazil's 1 November 2006 Communication, para. 3.
[15] DSU, Article 21.5.
[16] Brazil's 1 November 2006 Communication, para. 3.

ANNEX E-2

LETTER OF THE UNITED STATES

(20 November 2006)

The United States is in receipt of Brazil's 17 November 2006 first written submission. The United States notes that Brazil's submission comprises 173 pages in the main submission, a further 89 pages of argument in annexes, and 144 exhibits. Based upon an initial review over the weekend, these materials also include an econometric model that, on first impression, is substantially different from the model submitted by the same economist in the original proceeding in support of Brazil's arguments. In light of the enormous volume of the Brazilian submission, the complexity of the issues raised, and the econometric analyses advanced by Brazil, the United States respectfully requests that the time to prepare its first written submission be revised to 29 December 2006. This date is not only appropriate given the unique circumstances of this dispute, but is necessary to avoid prejudice to the United States.

Article 12.4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") provides that "[i]n determining the timetable for the panel process, the panel shall provide sufficient time for the parties to the dispute to prepare their submissions." Further, Article 12.2 of the DSU provides that "[p]anel procedures should provide sufficient flexibility so as to ensure high-quality panel reports, while not unduly delaying the panel process." Both provisions support the U.S. request.

First, in light of the complexity, length, and volume of the materials Brazil submitted as part of its first submission, the three-week period set out in the current timetable for the U.S. first written submission does not "provide sufficient time" for the United States to prepare that submission. Indeed, the U.S. ability to defend itself against Brazil's claims would be seriously prejudiced without additional time to review and prepare a response to Brazil's first written submission.

To put the U.S. request in perspective, a review of the submissions in all but two of 20 proceedings under DSU Article 21.5 reveals that Brazil's submission in this dispute is the most voluminous first written submission ever filed in such a proceeding. Indeed, as shown in the table below, there have been at least three Article 21.5 proceedings in which the responding party was given *more* time to prepare its first written submission than the timetable currently affords the United States. In each of those disputes, however, the complaining party's first written submission was approximately *one-fifth or less* the size of Brazil's first submission.

Dispute	**Complaining Party First Sub (Pages)**	**Time for Responding Party First Sub (Days)**
United States – Lumber (21.5 – Canada) (DS277)	55	30
Japan – Apples (21.5 – United States) (DS245)	34	24
United States – Shrimp (21.5 – Malaysia) (DS58)	46*	23
United States – Upland Cotton **(21.5 – Brazil) (DS267)**	**262***	**21**

* main submission plus annex(es)

Just as significantly, none of those disputes in which the responding party was given more time to prepare its first written submission than the timetable currently affords the United States involved the diversity and complexity of claims, the volume of exhibits, or the complex economic issues (including econometric analyses) that have been put forward by Brazil in its first submission in this dispute.

Indeed, Brazil's first written submission is more comparable, both in size and complexity, to the first submission recently filed by the United States, as the complaining party, in *European Communities – Measures Affecting Trade in Large Civil Aircraft* (DS316). That U.S. submission involved 249 pages of text and, as in this dispute, involved claims of both prohibited and actionable subsidies.[1] In the DS316 dispute, however, the European Communities has more than *12 weeks* to prepare its first written submission. It is the firm belief of the United States that both parties – and, further, all Members that have a systemic interest in the dispute – gain when panels have access to the full facts and arguments from the parties, and the arguments of each party are subjected to proper scrutiny. The United States expects that Brazil agrees and, therefore, finds it difficult to understand Brazil's opposition in this proceeding to the United States being given a reasonable opportunity for response.[2]

This U.S. request is the minimum period that would afford "sufficient time" for each party to prepare its submissions, which in turn would assist the Panel in its task to make an objective assessment of the matter (DSU Article 11) and produce a high-quality panel report (DSU Article 12.2). Further, the U.S. request would "not unduly delay[] the panel process." The United States is not requesting 12 weeks as the responding party received in DS316; it is requesting less than half that time.

The U.S. request would also not affect the overall timetable of the proceeding. Indeed, even if the subsequent filing dates are modified to accommodate the U.S. request while maintaining the time periods set out in the current timetable, there will still be two weeks between the last submission and the meeting with the Panel, permitting the latter to remain as scheduled.[3]

In addition, as the Panel will recall, by a communication dated 1 November 2006, Brazil asked the Panel to make more than 35 data and document requests of the United States, ostensibly pursuant to Article 13.1 of the DSU, asserting that "Brazil considers that it is 'necessary and appropriate' for the compliance Panel to seek [these] documents and information."[4] Upon consideration of that request, and U.S. comments in response, the Panel indicated that it would not decide on Brazil's request until it had an opportunity to review Brazil's first written submission.[5] Upon a preliminary review of that submission, the United States notes that Brazil has not explained why the Panel should consider that each of the items listed in Brazil's November 1 communication is "necessary and appropriate" within the meaning of DSU Article 13.1. Indeed, Brazil has not even

[1] However, Brazil in this dispute also advances claims under the *Agreement on Agriculture*.

[2] For example, Brazil argued in the organizational meeting that the United States should be limited only to *two* weeks to respond, even though it must have known (or had a very good sense) at that time of the size and scope of its first written submission. It is difficult to reconcile Brazil's position with its statement at the same meeting that it wishes to assist the Panel in producing a high-quality panel report. By contrast, the United States did not object to Brazil's request for additional time to prepare its first submission, even though Brazil has always been in control of the timing of the commencement of this proceeding.

[3] The new dates would be as follows: (a) U.S. first written submission (29 December); (b) Third Party submissions (5 January); (c) Brazil's rebuttal submission (11 January); and (d) U.S. rebuttal submission (30 January). The meeting with the Panel would remain as scheduled on 13 and 14 February. In the event the WTO is not able to receive a submission on 29 December, the U.S. first written submission could be due on the next WTO working day.

[4] 1 November 2006 Communication from Brazil, para. 3.

[5] 7 November 2006 Communication from the United States.

referred to most of the items it has requested that the Panel seek.[6] Given that Brazil has not considered these items as important to its own *prima facie* case, the United States assumes that Brazil has abandoned its request with respect to them.

On that basis alone, Brazil's requests can be rejected or dismissed. In addition, the United States expects to have in the U.S. first written submission further comments relevant to the documents and information requested by Brazil. The United States respectfully submits that these comments, and the evidence and arguments that the United States will itself submit, will assist the Panel in determining whether any information is "necessary and appropriate" for the Panel's purposes within the meaning of DSU Article 13.1.

This is precisely what the panels noted in the two *Canada – Aircraft* disputes (DS70 and DS222) in which Brazil submitted similarly premature requests relating to DSU Article 13.1. For example, in *Canada – Aircraft* (DS70), the panel explained that it would be "absurd" to request information "before receiving at least the first written submissions *of both parties* . . . since it would at once defeat the very purpose of the parties making written submissions."[7] Similarly, the panel in *Canada – Aircraft II* (DS222) stated that it "d[id] not consider it appropriate to seek any documents or information from either party until it has *at least* had an opportunity to review *both parties' first written submissions*."[8] The reasoning of those panels – that there is no basis to use Article 13.1 of the DSU to preempt the normal briefing process – is equally compelling in this proceeding.

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[6] Indeed, the only reference that Brazil makes to its request to the Panel to collect data under DSU Article 13.1 is in respect of a few of the items in Part A of the Annex to its 1 November communication (regarding base and planted acres). Brazil does not even mention the 25 data and document requests in Part B of the Annex to its 1 November communication.

[7] Panel Report, *Canada – Measures Affecting the Export of Civilian Aircraft*, WT/DS70/R, para. 9.50 (adopted 20 August 1999, as upheld by Appellate Body Report) (italics added).

[8] Panel Report, *Canada – Export Credits and Loan Guarantees for Regional Aircraft*, WT/DS222/R and Corr.1, para. 7.134 (adopted 19 February 2002) (italics added).

ANNEX E-3

LETTER OF THE UNITED STATES

(21 November 2006)

The United States is in receipt of the 8 November 2006 communication from the Panel inviting the United States to comment on possible logistical arrangements for opening to the public a portion of the panel meeting at which parties are invited to appear.[1] My authorities have instructed me to submit the following comments pursuant to the Panel's invitation.

As a threshold matter, the United States continues to invite Brazil to join the United States in its request that the panel meeting be made open to the public. In the meantime, the United States has invoked its right under Article 18.2 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* to make statements of its own positions public and, as an appropriate means to do this, has requested that the Panel exercise its authority to open to the public the U.S. statements and U.S. answers to questions presented in the panel meeting.

The United States believes that the logistical arrangements to accomplish this could be relatively straightforward while providing meaningful access to other Members and the public. As the United States noted in the 6 November 2006 organizational meeting, open meetings have successfully been held in the current *Hormones Compliance* disputes brought by the European Communities against the United States (DS320) and Canada (DS321). In those disputes, the first and second panel meetings with the parties, and the meeting with scientific experts, utilized a closed-circuit television broadcast of the panel meetings to a separate viewing room in the WTO where WTO Members and the public were able to observe the proceeding. The United States believes that the procedures used in those disputes could be adapted and used effectively in this dispute as follows:

- The logistical approach in the *Hormones Compliance* disputes required two rooms (one for the panel meeting, one for viewing the broadcast), a camera in the meeting room, a broadcast link between the two rooms, and technical support.

- In the first panel meeting with the parties in the *Hormones Compliance* dispute, room W was used for the panel meeting, and room CR was used as the viewing room. For the second panel meeting with the parties and the meeting with scientific experts, room CRI was used for the panel meeting, and room CRII was used as the public viewing room. The United States understands, based on its preliminary inquiries, that rooms CRI and CRII are available for use on 13-14 February 2007, the days on which the panel meeting in this dispute is currently scheduled.

- In the *Hormones Compliance* meetings, a camera was used to send video and audio feed (including audio feed of simultaneous translations) via closed-circuit from the meeting room to the public viewing room. The United States envisions that the same modalities could be used here.[2]

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[1] The panel meeting at which parties are invited to appear is referred to in paragraph 2 of the Panel's working procedures.

[2] Video and audio recording was not allowed in the *Hormones Compliance* disputes. The United States envisions that they would also not be permitted here.

- As Brazil has not yet agreed to open to the public its own statements and answers to questions, the audio and video feed would be turned off when Brazil makes its presentations. One option would be to link the audio and video feed to a single switch that could be turned on and off as necessary. The Panel could request that a member of the Secretariat assist in performing this task during the meeting.

- It is not yet clear that any confidential information will be at issue in this proceeding. To the extent that it is, any portions of the U.S. statements or answers to questions dealing with confidential information would not be open to the public. Additional safeguards to provide against the disclosure of confidential information could be undertaken. For example, it may be possible to include a delay in the broadcast to ensure that there would be no inadvertent disclosure of confidential information.

- The United States envisions that third parties would retain their ability to decide whether their submissions and statements are public. Any confidential statements would not be broadcast.

- In the *Hormones Compliance* disputes, the Secretariat ensured that at least two seats were reserved for each WTO Member delegation in the viewing room. It is the U.S. understanding that a number of delegations, including that of Brazil, availed themselves of the opportunity to view one or both of the panel meetings or the meeting with scientific experts. Delegations interested in reserving additional seats were requested to indicate this to the Secretariat. A certain number of additional seats were reserved for the public and allocated by the Secretariat on a first-come-first-serve basis upon receipt of a completed registration form. The Secretariat advertised the open meeting on its website and also made available on-line the forms for registration using the same notice and registration methods of the WTO's Public Symposium. Some days before the event the WTO External Affairs Office processed attendee applications that were received and issued badges to attendees. A similar approach could be used in this dispute.

As noted, these proposed logistical arrangements are based on those used successfully in the *Hormones Compliance* disputes. The United States remains prepared to continue to work with Brazil, the Panel, and the Secretariat to develop further any necessary arrangements for purposes of this dispute.

ANNEX E-4

LETTER OF BRAZIL

(22 November 2006)

1. Brazil is in receipt of a letter dated 20 November 2006 from the United States seeking to delay this panel proceeding by requesting additional time to file its First Written Submission. The United States also requests that the Panel not exercise its discretion, under Article 13 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU"), to request the United States to produce information set out in Brazil's letter dated 1 November 2006.

2. Brazil strongly opposes these two requests for the reasons set forth below.

Request to Delay Filing of U.S. First Written Submission

3. Brazil objects to the United States attempt to seek more than three weeks to produce its First Written Submission.

4. First, Brazil notes that the Panel indicated in its communication of 8 November 2006 that it might change its timetable "in light of unforeseen developments." However, neither the length nor the substance and content of Brazil's First Written Submission are an "unforeseen development," within the meaning of that footnote. Indeed, the core issues raised in the Brazil's First Written Submission are not new. As the Panel and the Secretariat are well aware, the United States and Brazil already exhaustively briefed the key legal, factual, and economic issues raised before the original panel and the Appellate Body during the period 2003-2004. In particular, the United States and Brazil filed many hundreds of pages of submissions addressing in detail numerous aspects relating to the nature and economic effects of the price-contingent subsidy measures at issue in this compliance proceeding – the Step-2 program, the marketing loan program, and the counter-cyclical payment program in the Farm Security and Rural Investment Act ("FSRI Act") of 2002, as they apply to upland cotton. Similarly, in these submissions, the United States and Brazil exhaustively briefed issues relating to the U.S. export credit guarantee programs that constitute export subsidies circumventing the United States export subsidy reduction commitments and that are, therefore, prohibited export subsidies

5. That extensive briefing resulted in detailed findings by the original panel that were upheld by the Appellate Body. The numerous cross-references in Brazil's First Written Submission to the report of the original panel and its findings of fact attest to the similar, if not identical, nature of most questions at issue in this compliance proceeding.

6. Second, the United States has been on notice of the issues that Brazil would raise in its First Written Submission for many months. Before the Dispute Settlement Body ("DSB"), Brazil emphasized several times that it considered that the marketing loan and counter-cyclical payment programs of the FSRI Act of 2002 were unchanged by the U.S. implementation measures and that it considered that they were continuing to cause serious prejudice to the interests of Brazil. Brazilian and United States trade officials held a number of informal discussions in Washington and Brasilia related to specific Brazilian concerns with the failure of the United States to implement the specific measures set out in Brazil's First Written Submission. If there were any doubts, the extensive questions submitted to the United States prior to the informal consultation held on 19 July provided additional notice to the United States that Brazil was focusing its attention on U.S. marketing loan, counter-cyclical payment and Step-2 programs, as well as the U.S. agricultural export credit guarantee programs. There is, therefore, nothing "unforeseen" in Brazil's First Written Submission that warrants granting the United States additional time.

7. Third, Brazil recalls that this panel operates under Article 21.5 of the DSU. While Article 12.9 of the DSU normally accords panels 6 months from the date of composition to issue a final report to the parties, Article 21.5 of the DSU provides that compliance panels "shall circulate its report within 90 days after the date of referral of the matter to it." Article 21.5 provides for fast-track proceedings aimed at the rapid resolution of a dispute that is already subject to recommendations and rulings of the DSB. Brazil agreed (along with the United States) at the time the Panel's procedures were adopted that the proceeding would take longer than 90 days, However, Brazil also emphasized at that time that this proceeding continues to operate under the fast-track rules consistent with the goal of an expedited resolution of the matter in this dispute.

8. In fact, the object and purpose of the accelerated panel proceeding under Article 21.5 of the DSU is to provide relief to complaining Members from the continued violation of WTO commitments by a defending Member following the expiry of the time period for implementation of the recommendations and rulings of the DSB. As Brazil's First Written Submission indicates, the United States has continued to heavily subsidize upland cotton and has actually increased the magnitude of marketing loan and counter-cyclical payments since the original panel's determination as well as increased the production, export and U.S. world export share of upland cotton. It also continues to provide export credit guarantee export subsidies in violation of its commitments under the *Agreement on Agriculture* and the *Agreement on Subsidies and Countervailing Measures.* The United States' request for further time seeks solely to prolong this situation of non-compliance.

9. In the course of these procedures, the United States will have multiple opportunities to present extensive arguments in response to Brazil's arguments set out in its First Written Submission. In addition to the U.S. First Written Submission due on 8 December 2006, the United States also has an opportunity to file a rebuttal submission on 9 January 2007. Further, the United States has the right to present a detailed oral statement at the hearing on 13 February 2007. The United States also will be given the opportunity to make a closing statement on 13 or 14 February 2007 before the Panel. Further, based on past experience, it is highly likely that United States will be asked a number of questions by the Panel and be given an opportunity to provide written answers to such questions after the panel meeting. These numerous opportunities to address arguments fully protect the U.S. (and Brazil's) due process rights in these expedited Article 21.5 proceedings.

10. It should also be noted that the timetable established by the Panel has guided the parties planning and scheduling. Based on the legitimate expectations that it will be followed, Brazil has planned and organized its participation in the different stages of this proceeding in accordance with this timetable. Any changes in the timetable would be particularly disruptive and would have a very negative impact on Brazil's participation, as they would require a rescheduling of activities over the end of the year period.

11. For the reasons set out above, Brazil requests that the Panel maintain the timetable as provided to the parties on 8 November 2006.

Production of Information Pursuant to Article 13.1 of the DSU

12. Brazil also disagrees with the United States assertion that it is not appropriate for the Panel to request the United States to produce certain information, as detailed in Brazil's letter of 1 November 2006. The Panel indicated in its communication of 8 November 2006 that it would communicate its decision on this matter following the receipt of Brazil's First Written Submission. In its First Written Submission of 17 November 2006, Brazil has presented its *prima facie* case that the United States' measures taken to comply either do not exist or, to the extend they exist, result in inconsistency with the covered agreements.

13. Based on the evidence and arguments presented by Brazil in its First Written submission[1], the Panel can confirm that the information requested in Brazil's letter dated 1 November 2006 will assist the Panel to make an objective assessment of the matter before it, in accordance with Article 11 of the DSU. The Panel is therefore in a position, as indicated in its 8 November 2006 communication to the parties, to decide on Brazil's request.

14. Moreover, and contrary to the United States assertion, Brazil does not ask the Panel to make its case for it. Rather, following the receipt of the information from the United States, Brazil will analyze these data and documents and present their relevance to the Panel.

15. In sum, Brazil continues to consider that it is appropriate and necessary for the Panel to exercise its discretion to request the United States to produce the information referenced in Brazil's 1 November 2006 letter. Brazil's First Written Submission provides a more than sufficient basis for the Panel to evaluate, in light of the findings by the original panel and the Appellate Body and the rulings and recommendations of the DSB, the likely relevance of this information in these proceedings. Given the expedited timeframes under Article 21.5 of the DSU, the Panel should not delay the exercise of its discretion to request the United States to produce the information. Any postponement of a decision might lead to an unwarranted delay of the circulation of the Panel's report.

[1] *See* for example para. 117 of Brazil's First Written Submission.

ANNEX E-5

LETTER OF BRAZIL

(24 November 2006)

Brazil is in receipt of a letter from the United States, dated 21 November 2006, commenting on potential logistical arrangements to open the meeting of the compliance Panel with the Parties to the public. In a communication dated 22 November 2006, the compliance Panel invited Brazil to submit comments on the U.S. letter, by close of business on 24 November 2006. Brazil thanks the compliance Panel for the opportunity to comment on the U.S. letter.

At the outset, Brazil recalls its position, noted by the compliance Panel in its communication of 8 November 2006, that it does not agree to the opening of the compliance Panel's meeting with the Parties to the public. Brazil's position remains unchanged. Therefore, Brazil cannot accept the proposal set out by the United States in its letter of 21 November 2006.

Brazil notes that in the dispute mentioned by the United States – DS320 and DS321 – the decision by the panel to open the hearing to the public followed a "common" request from the parties to the dispute (the European Communities, United States and Canada).[1] As pointed out above, however, this is distinctly not the case in the present dispute. Brazil objects to allowing public access to any part of the proceedings, by closed-circuit television broadcast or otherwise.[2]

In addition, Brazil wishes to draw the compliance Panel's attention to the fact that in DS320 and DS321 the meeting of the panel with third parties remained closed, as not all the third parties agreed to have it open for observation by the public.[3]

Thus, where any objection to opening the meeting to the public remained, the panel in DS320 and DS321 kept that portion of the hearing closed. The Panel did not allow broadcast while delegates from third parties agreeing to public access spoke, and switched off broadcast while delegates from third parties not agreeing to public access spoke. Rather, it kept the third party session closed altogether, given objections from some of the third parties.

The panel report in DS320 and DS321 has not yet been circulated, and we do not, therefore, have the benefit of its detailed reasoning on the legal basis for its decision to open its meeting with the parties to the public. Nonetheless, it is evident that the assent of *all* interested parties to the opening of the relevant portions of the meeting was a central element for that panel's decision to open the meeting with the parties. Where unequivocal consensus did not exist with respect to the meeting with the third parties, that panel elected not to open the meeting to the public, and, instead, followed the practice of every other panel to date, under paragraph 2 of the standard panel Working Procedures.[4]

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[1] WT/DS320/8 and WT/DS321/8.

[2] Moreover, Brazil notes that paragraph 2 of the compliance Panel's Working Procedures provides that the compliance Panel "shall meet in closed session," other than when it invites the parties and third parties to appear.

[3] WT/DS320/8 and WT/DS321/8.

[4] The panel in *EC – Aircraft* (DS316), again following an agreement between the parties to the dispute, has also accepted to open its hearings to the public. As of today, however, the only practical experience with opening WTO panel meetings to the public remains the meeting of the DS320 and DS321 panel with the parties in that dispute.

The United States evokes Article 18.2 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU") to claim a right to have at least some portions of the meeting with the Panel open to the public. Furthermore, the United States characterizes its proposal as "an appropriate means" to disclose statements of its own positions to the public. Brazil disagrees with the United States on both accounts.

First, nothing in Article 18.2 mandates or implies that to effect a Member's right to disclose its own positions or statements, panels must agree to open meetings to public observation. Members have at their disposal a myriad of "transparency" tools to make their positions known to the public, such as publicly-available webpages and press conferences or releases. Members are not dependent on open panel meetings to achieve any transparency goals.

Second, a Member's right to disclose its own positions cannot prejudice another Member's right to confidentiality. Such prejudice would arise were the compliance Panel to accept the U.S. proposal. A partial opening, as suggested by the United States, is not "appropriate", as it would compromise Brazil's interest in retaining confidentiality of the proceedings and, at the same time, would lead to an unbalanced and biased picture of the parties' arguments. By contrast, Brazil's position would not deprive the United States of resorting to other (and more "appropriate", given Brazil's objection) means to make its statements and submissions available to whomever the United States deems appropriate, while preserving Brazil's right to protect the confidential nature of this compliance proceeding.

ANNEX E-6

LETTER OF BRAZIL

(18 December 2006)

As with the majority of its submissions in the initial proceedings in this dispute and, increasingly, its submissions to panels and the Appellate Body in other disputes, the United States has failed once again to file its submission to the compliance Panel by the deadline of 5:30 p.m. on Friday, 15 December. The United States instead filed the electronic version of its submission 12 hours late, on Saturday, 16 December at 5:24 a.m. Moreover, as filed, the electronic version of the submission is corrupt; it does not include paragraph numbers, and, critically, ends 1.5 pages into its rebuttal arguments concerning Brazil's actionable subsidies claims.[1]

Despite the compliance Panel's generosity in granting the United States an extension to file its submission (from 8 December to 15 December), the United States failed to respect a deadline that it has known about for many weeks. Moreover, when the United States finally decided to file 12 hours after the deadline, it filed an unreadable document.[2] Neither in the letter covering the submission, nor in the email in which it transmitted the electronic version of the submission, does the United States offer any explanation or show good cause for untimely filing. In Brazil's view, the only explanation available for this increasingly common U.S. practice is hubris. The United States has essentially claimed for itself the right to decide when to file submissions in dispute settlement proceedings, in flagrant and unacceptable defiance of the Panel's authority.

In addition, such contemptuous behaviour seriously prejudices Brazil's rights. Because the time granted to prepare Brazil's rebuttal submission straddles a holiday period, the importance of preserving every day on either side of the holiday period is particularly paramount. The United States has exacerbated the problem not only by failing to file on time, but, additionally, by failing even belatedly to file a readable electronic version of its submission (or electronic versions of its exhibits) that could be transmitted to Brasilia. Cutting short the available time in advance of the holiday period prejudices Brazil's right to prepare a response; merely granting Brazil additional time to file its rebuttal submission will not resolve this problem. There is, obviously, no way to add additional days between now and the holiday period.

For these reasons – and as would be the case in virtually any domestic judicial or administrative proceedings of which Brazil is aware – Brazil requests that the compliance Panel reject the United States' submission as not timely filed. The deadline was clear and is expressed both in the compliance Panel's 28 November 2006 timetable and in paragraph 17(b) of the compliance Panel's Working Procedures. Panels have previously rejected evidence as not timely filed[3]; Brazil sees no reason why the same principle should not apply to the more egregious failure to file a submission by the deadline. In our view, this would be the only fair remedy under the present circumstances.

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[1] Brazil opened the file using Word Perfect, Microsoft Word and Interwoven Viewer, none of which were able to repair the file. At Brazil's request, the United States, notwithstanding the assertion that the problem to read the electronic version of the document sent on 16 December would be attributable to Brazil's word processing program, sent an electronic version of its first submission in PDF format on Sunday, 17 December.

[2] Nor did the United States extend Brazil the now common courtesy of providing its exhibits in electronic form, despite the fact that Brazil provided the exhibits for its own first written submission to the United States on time and electronically – an error of judgment that Brazil will not repeat in future. The U.S. exhibits are surely *available* electronically, as they were likely transferred electronically from USTR in Washington, D.C. to the U.S. Mission in Geneva.

[3] *See* Panel Report, *Canada – Wheat*, para. 6.140; Panel Report, *Australia – Salmon*, para. 8.4.

ANNEX E-7

LETTER OF THE UNITED STATES

(19 December 2006)

My authorities have instructed me to offer the following response to Brazil's 18 December 2006 letter requesting that the Panel reject the first written submission of the United States.

The United States sincerely regrets any inconvenience caused to the Panel, Brazil, or the third parties by the delay in providing its first written submission from the close of business on Friday to the early hours on Saturday morning. At the same time, the United States notes that Brazil's letter continues what has unfortunately become a familiar approach in this dispute. Brazil continually resists providing the United States sufficient time to prepare a response to Brazil's lengthy and multiply-flawed submissions and then, when the United States has nonetheless made extreme efforts to meet the very tight deadlines, Brazil complains in inaccurate and overheated rhetoric if the submission is not filed by 5:30 pm. It is very difficult to resist the conclusion that Brazil is doing this as a litigation tactic rather than any genuine effort to assist the Panel's work.

Brazil has repeatedly sought to deny the United States even the minimum time needed to present the Panel with the U.S. response. In its 20 November 2006 letter, the United States provided a detailed explanation of the size and complexity of the task before it in preparing a response to Brazil's first submission. Brazil, as the complaining party, had many months to prepare its 173 page first submission, which contained an additional 89 pages of argument in annexes and 144 exhibits, and included an econometric model that was substantially different from the model submitted in the original proceeding.[1] Brazil objected to the United States having even one additional day to prepare its response. The United States appreciates that the Panel agreed to provide additional time, and the United States can assure the Panel that the United States sought to make the most of the time available.

Officials of the United States worked nights and weekends to prepare the first U.S. written submission, including working all through the night on Thursday and Friday.[2] Brazil cannot seriously be suggesting that the United States expended this effort at sacrifice of families and health in order to "defy" a deadline.

To the contrary, Brazil once more seeks to distort or misrepresent events and deny the United States the opportunity to present facts and argument to respond to Brazil. In this latest iteration, Brazil argues that the Panel should simply summarily reject the U.S. submission.[3] Apparently for Brazil, it is Brazil and Brazil alone that should be able to present its case to the Panel and it is important for Brazil to block the United States from being able to respond.[4]

[1] Brazil filed its panel request on 18 August 2006, 3 months before its first submission was due, and of course Brazil was able to work on preparing its submission well before that.

[2] In light of the effort required of the United States to seek to meet the deadline, the United States has substantial difficulty with Brazil's complaint that receiving a submission early on Saturday morning rather than at 5:30 pm on Friday has affected Brazil's ability to enjoy a holiday.

[3] Letter from Brazil at 3 (18 December 2006).

[4] Brazil does not seem to want the Panel to know important facts that would help it to resolve the issues in dispute; for example, that contrary to Brazil's claims U.S. producers and exporters respond to market signals in the same way as their foreign counterparts; that U.S. producers and exporters are not "insulated" from these signals by the marketing loan and counter-cyclical payments programs; that the inflated results of Brazil's

Despite this, the United States has attempted to cooperate with Brazil. Brazil informed the United States that it was having difficulty opening the electronic version of the first U.S. submission on Saturday, 16 December. The problem Brazil raises appears only to occur when using a different word processing program (Microsoft Word) to open the document than was used to create it (WordPerfect).[5] Separate tests have shown that there was nothing wrong with the version as transmitted by the United States. Nonetheless, the United States copied the U.S. submission into a format requested by Brazil and resent the document to Brazil, the Panel, and the third parties, on Sunday, 17 December.

In addition, although the United States did not provide copies of exhibits to anyone electronically, Brazil asked on 16 December whether it could obtain an electronic version of exhibits. The U.S. representative in Geneva responded that he would pass Brazil's question back to capital for confirmation and immediately did so. However, in the morning of Monday, 18 December, shortly after opening of business in Washington and before U.S. authorities even had an opportunity to arrange to provide electronic versions to Brazil, Brazil submitted its 18 December letter accusing the United States of denying Brazil this "common courtesy"[6] and asserting that it would no longer repeat the "error in judgement" of submitting its own exhibits electronically.[7] Leaving aside Brazil's unfounded accusations, the United States notes that it is willing to provide electronic copies of its exhibits if the Panel considers that this would be helpful.

In any event, contrary to Brazil's request, the DSU does not authorize the "rejection" of submissions for the inability of a Member to meet precisely the time by which parties "should provide their submissions" according to a panel's working procedures.[8] To the contrary, the DSU provides that "[p]anel procedures should provide sufficient flexibility so as to ensure high-quality panel reports, while not unduly delaying the panel process." There is, thus, no basis for Brazil's request that the Panel "reject" the U.S. first submission. Indeed, the panel rejected similar requests by Brazil even in the original proceeding in this dispute.[9]

Nor is there any logic behind Brazil's allegation that it has been "seriously prejudice[d]" by the delay in receiving the U.S. submission and, thus, "the only fair remedy" is for the Panel to reject the U.S. written submission. To the extent that Brazil does consider it has been "seriously prejudice[d]" by not having the U.S. submission by close of business on Friday, 15 January, but

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econometric modeling result from assumptions that are not generally accepted and are out of line even with Brazil's own assumptions in the model used in the original proceeding; or that Brazil ascribes planting, production, export and price effects to the U.S. marketing loan and counter-cyclical payment programs that are "the effect" of other factors, including, *inter alia*, China's net cotton trade and its trade policy. These arguments and more are supported at length in the U.S. first written submission.

[5] The United States has opened without difficulty the document as sent to Brazil using WordPerfect. Accordingly, the United States is perplexed by Brazil's claim that the document was unreadable in WordPerfect.

[6] The United States is not certain of the basis for Brazil's characterization of this as "common courtesy." In the multiple disputes in which the United States has been involved, practice has varied considerably in this regard. Indeed, in the original proceeding in this dispute, the parties did not exchange electronic versions of all of their exhibits. Nor had the parties discussed exchanging electronic versions of exhibits in this proceeding.

[7] Letter from Brazil at 3, n. 2 (18 December 2006).

[8] This explains why Brazil is not able to point to any previous panel that has rejected altogether a submission made after the time for filing. Brazil instead relies on panel reports relating to untimely submission of evidence, for example, at the interim review stage, long after written submissions and oral presentations have been completed.

[9] *See* Communication from the Panel to Parties, para. 3 (13 October 2003).

rather, early Saturday morning, it would seem that an appropriate "remedy" could be to extend by an equivalent period Brazil's time to file its rebuttal submission.

The United States thanks the Panel for its consideration. The United States is providing a copy of this letter directly to Brazil and is providing a version of this letter with certain Brazilian confidential information redacted to the third parties.

ANNEX E-8

LETTER OF BRAZIL

(22 January 2007)

Brazil is in receipt of the United States responses to questions from the Panel, dated 19 January 2007. In its responses, the United States asserts that it provided data, in Exhibit US-64, that is fully responsive to Brazil's request for certain data, as set forth in Part A of Annex 1 of Brazil's communication to the Panel of 1 November 2006 ("1 November Request").

In this letter, Brazil corrects an error in its o m 19 January 2007 responses to the compliance Panel's questions, and corrects misstatements in the United States' responses.

First, Brazil notes that it inadvertently identified the relevant period for its data request as encompassing marketing years ("MY") 2002-2005.[1] In fact, Brazil's 1 November Request asked the compliance Panel to seek data for MY 2003-2006. Brazil asks that the compliance Panel seek the relevant data from the United States, in electronic form, for MY 2003-2006.

Second, Brazil directs the compliance Panel to certain misstatements in the United States' responses, submitted on 19 January 2007.

Contrary to its assertion in its 19 January responses, the United States has not provided data that is sufficiently responsive to Brazil's 1 November Request. While the United States appears to have given up its objection to providing this data[2], there are numerous deficiencies in the format and scope of the data in Exhibit US-64, rendering them incomplete and largely unusable (Brazil notes that the United States did not explicitly cite Exhibit US-64 anywhere in its First Written Submission.). Brazil brings three deficiencies to the attention of the compliance Panel:

1. <u>Data provided for MY 2005 only</u>

To begin, the data included in Exhibit US-64 are incomplete, as they are limited to marketing year ("MY") 2005. Brazil requested that the United States provide data for MY 2003-2006. Providing data for one out of four years hardly constitutes a complete response on the part of the United States to Brazil's 1 November Request.

Further, it appears that the United States withheld the requested data for MY 2003 and 2004, despite the fact that it had collected the data and presented selective summary information for these years in its First Written Submission. Brazil notes that the U.S. table in Section VI.A.(c) of its

[1] Brazil's Answers to Questions from the Panel Regarding Brazil's Request for Data Pursuant to Article 13.1 of the DSU, 19 January 2007, para. 10.

[2] Brazil originally requested the data on 29 June 2006. See Question 3 of Annex 2 b of Brazil's data request submitted on 1 November 2006. The United States' 19 January 2007 responses mark some progress, compared to the United States' refusal to provide such data in consultations with Brazil nearly six months ago, and in its initial reaction to Brazil's 1 November Request. See U.S. Communication to the Panel, dated 7 November 2006, para. 2.

First Written Submission[3] demonstrates that the United States has collected information on base and planted acreage in MY 2003 and 2004.

2. Data not provided in electronic form

Second, the document in Exhibit US-64 was printed out from an Excel file[4], demonstrating that the United States easily could have provided the data electronically, for use and analysis by the Panel, the Third Parties and Brazil.

Brazil requested that the United States provide the data in the same format as in the original proceedings.[5] As noted by the United States, the data presented to the original panel were included in an electronic spreadsheet on a CD-ROM.[6] The U.S. assertion that it "submitted precisely the same data in precisely the same format as that submitted in response to the original panel's Article 13 request"[7] is, therefore, inaccurate.

3. Data partially unreadable

Third, even on the paper version of the MY 2005-only data provided by the United States, information in certain cells is not readable, as the United States failed to accommodate the width of the column to the size of the number in these cells.[8] These problems could have been avoided had the United States provided the data in electronic format.

In sum, the data in Exhibit US-64 are deficient in both scope and form. Brazil reiterates its request of 19 January 2007 that the Panel request the United States to provide data on base and planted acreage fully responsive to Brazil's 1 November Request.[9] Brazil requests that the compliance Panel ask the United States to provide data in electronic form for MY 2003-2006.

[3] U.S. First Written Submission, para. 224.

[4] The document lists its file name in the bottom right hand corner of each page as "US-64 REPLACEMENT dcp 2005 sub sum.xls." The file name ending on ".xls" indicates that the source file is an Excel spreadsheets. *See* Exhibit US-64 (2005 Crop Year Subcategories)

[5] Part A of Annex 1 of Brazil 1 November Request, para. 1.

[6] U.S. Communication to the Panel, dated 17 January 2007, para. 2, footnote 3.

[7] U.S. Communication to the Panel, dated 17 January 2007, para. 2.

[8] *See, e.g.*, page 3 of Exhibit US-64 (2005 Crop Year Subcategories).

[9] Brazil's Answers to Questions from the Panel Regarding Brazil's Request for Data Pursuant to Article 13.1 of the DSU, 19 January 2007, para. 10.

ANNEX E-9

LETTER OF BRAZIL

(7 February 2007)

Consistent with its prior submissions in the above-referenced disputes, the United States has failed once again to file a submission *(i.e.,* its Rebuttal Submission) to the compliance Panel by the deadline of 5:30 p.m. on Monday 5 February. The United States instead filed the electronic version of its submission more than 6 hours late - at 11:39 p.m. on Monday 5 February. Neither in the letter covering the submission, nor in the email in which it transmitted the electronic version of the submission, does the United States offer any explanation or show good cause for untimely filing. This late filing is particularly egregious in view of the compliance Panel's 20 December 2006 Communication reminding the United States of its obligation under paragraph 17(b) of the Working Procedures to file all submissions to the Secretariat by 5:30 p.m., and in view of the extension granted the United States in the compliance Panel's 22 December 2006 Communication.

Unfortunately, the United States continues to act in a unilateral fashion in disregard of the rules and procedures of the DSU and in defiance of the compliance Panel's authority. As a result of various U.S. requests for extensions, the amount of time allotted Brazil to prepare a response to the U.S. rebuttal submission for the upcoming meeting with the compliance Panel has already been reduced from five weeks, under the original timetable, to three weeks, under the version of the timetable currently in effect. The late filing of the U.S. rebuttal submission has eliminated yet another day from the time allotted Brazil to prepare for the meeting.

For these reasons - and as would be the case in virtually any domestic judicial or administrative proceedings of which Brazil is aware - Brazil requests that the compliance Panel reject the United States' submission as not timely filed. The deadline was clear, and is expressed both in paragraph 17(b) of the compliance Panel's Working Procedures, and reiterated in the Panel's 20 December 2006 Communication. Indeed, Panels have previously rejected evidence as not timely filed[1]; Brazil sees no reason why the same principle should not apply to the more egregious failure to file a submission by the deadline. In our view, this would be the only fair remedy under the present circumstances. Given the systemic implications of the recurring United States' refusal to respect the timetable established by the Panel, I would like to inform you that it is Brazil's intention to raise this issue before the Dispute Settlement Body.

[1] *See* Panel Report, *Canada - Wheat,* para. 6.140*;* Panel Report, *Australia -Salmon*, para. 8.4.

ANNEX E-10

LETTER OF THE UNITED STATES

(12 February 2007)

My authorities have instructed me to offer the following response to Brazil's 8 February 2007 letter requesting that the Panel "reject" the rebuttal submission of the United States. The United States respectfully requests that the Panel reject Brazil's request.

The United States sincerely regrets any inconvenience caused by the delay in transmission of the U.S. submission from 5:30 p.m. to 11:30 p.m. on Monday, 5 February 2006. The United States was required to respond in a very limited time[1] to close to 220 pages of argumentation by Brazil[2] and over 1,000 pages of exhibits (in 61 separate exhibits). While staff in Geneva and Washington worked intensively during that time, including all weekend and around the clock on Sunday and Monday to do so, the United States was, regrettably, unable to compile and transmit the submission – including providing courtesy electronic copies of all 43 exhibits filed with the submission (as requested by Brazil) – precisely by 5:30 p.m. on 5 February.[3]

Nonetheless, Brazil's complaints in this regard are unfounded and ironic when one considers that, even with almost 4 weeks to respond to the U.S. first written submission, Brazil asked for an additional 8 days (*i.e.*, for a total of almost 5 weeks) to respond to the U.S. 11-page preliminary ruling request. And even more ironic is Brazil's complaint that: "As a result of various U.S. requests for extensions, the amount of time allotted Brazil to prepare a response to the U.S. rebuttal submission for the upcoming meeting with the compliance Panel has already been reduced from five weeks, under the original timetable, to three weeks, under the version of the timetable currently in effect." Not only were the extensions *requested by Brazil* (not the United States)[4], but that three-week period is the same amount of time that the United States had to respond to Brazil's rebuttal submission. Apparently, Brazil's view is that Brazil should be afforded more time than the United States at every stage of this proceeding. In addition, Brazil's request for the Panel to disregard the U.S. submission makes it once again apparent that Brazil considers that it should be the only party with the opportunity to present its views in this proceeding.

In any event, Brazil has no basis for its request that the Panel reject the U.S. rebuttal submission. Moreover, the United States regrets this latest effort by Brazil to divert the attention of the Panel and the United States and to deny the United States a meaningful opportunity to respond. As the meeting with the Panel and the close of this proceeding draw near, the United States hopes that Brazil will consider a more cooperative approach.

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[1] The United States had slightly more than three weeks (25 days) to respond to the main submission and annex and less than three weeks (20 days) to respond to Brazil's reply to the U.S. requests for preliminary rulings.

[2] Including a main submission, annex, and separate reply to U.S. requests for preliminary rulings.

[3] The United States has not only attempted to ensure that the Panel (and Brazil) have the most complete arguments well in advance of the meeting with the Panel but has also attempted to address the various complaints that Brazil has made along the way in this process, including complaints about receiving all exhibits in an electronic medium simultaneously with submissions. *See* Letter from Brazil, para. 2, n. 2 (18 December 2006).

[4] Indeed, the deadline for the U.S. rebuttal submission was shifted from 30 January to 5 February 2007, to accommodate the additional time granted to Brazil, at its request, which cut into the period available for the U.S. rebuttal submission, not because the United States sought additional time for that submission, as Brazil suggests.

ANNEX F

COMMUNICATIONS FROM THE PANEL TO PARTIES

* This communication was sent to the Parties as well as to the Third Parties.

ANNEX F-1

COMMUNICATION TO BRAZIL AND THE UNITED STATES

(8 November 2006)

Please find attached the Panel's final working procedures and timetable. [*Attachment omitted.*]

The Panel takes this opportunity to clarify the following:

1. The Panel has noted Brazil's request made in its letter dated 1 November as well as the comments of the United States, contained in the letter dated 7 November, on this request. The Panel declines to make a decision on Brazil's request at this point of time. The Panel will communicate to the parties its decision on this request after having received and considered Brazil's first submission. In this connection, the Panel reserves its right to amend the timetable (and the working procedures, as necessary) in relation to this issue.

2. The Panel has also noted that the United States stated in the organizational meeting that it may request a special procedure for the protection of certain information if the Panel decides to pose the questions requested by Brazil. We will revert to that issue if we actually decide to pose the questions.

3. In relation to paragraph 2 of the working procedures, the Panel has noted that the United States wishes to open up the portion of the meeting where it presents its own views and statements, while Brazil opposes opening the meeting to the public. The Panel draws the attention of the parties that opening up of any portion of the Panel meeting entails logistical considerations. The Panel invites the United States to submit comments, by close of business of Tuesday 21 November, on how exactly it envisages such opening to be logistically meaningful. The Panel reserves its right to amend the working procedures in relation to this matter.

4. In relation to paragraph 13 of the working procedures, the Panel has noted that Brazil proposed at the organizational meeting that the exhibits be numbered sequentially starting from the last exhibit number of the original panel proceeding. While the Panel does not oppose this idea, we do not find it necessary to oblige parties to do so. We will leave it up to the discretion of parties how to abide by paragraph 13 of the working procedures on the condition that any references to exhibits of the original panel proceeding will not create confusion with references to exhibits in this proceedings.[1] At any rate, the Panel clarifies that if parties intend to refer the Panel to an exhibit submitted in the original panel proceeding, it expects parties to attach such exhibits in its submission, and not just cite the exhibit number.

[1] For example, if the United States chooses not to follow Brazil's suggestion, it could number their exhibits in this proceeding starting from US (21.5)-1, or the US could ensure that whenever it refers to exhibits in the original proceedings, it is always clearly stated that the exhibit is from the original proceedings.

ANNEX F-2

COMMUNICATION TO BRAZIL AND THE UNITED STATES

(27 November 2006)

The Panel refers to the communication of Brazil dated 1 November asking the Panel to exercise its discretion under Article 13 of the DSU, and to the communication of the United Stated (dated 7 November) commenting on this request, as well as the communication of Brazil (dated 22 November) referring to this issue. The Panel notes that in the context of its argument regarding the significance of the magnitude of the marketing loan and counter-cyclical payments as a factor supporting the existence of a causal link between these two subsidies and significant price suppression for upland cotton, Brazil, in its first submission, reiterates its request originally submitted in a letter dated 1 November that the Panel ask the United States to provide certain information needed to allocate counter-cyclical payments to upland cotton production in MY 2003-2005.[1] In the same context, Brazil provides an estimate of the "counter-cyclical payments allocated to current upland cotton producers growing upland cotton on upland cotton or other crop base acreage" based on the MY 2002 ratio of allocated upland cotton counter-cyclical payments to total upland cotton counter-cyclical payments, multiplied by the total upland cotton counter-cyclical payments in MY 2003-2005.[2] The Panel is of the view that it cannot conclude at this stage that it is necessary and appropriate within the meaning of Article 13 of the DSU to seek the information requested by Brazil before the Panel has had the opportunity to review the arguments and supporting evidence, if any, that will be presented by the United States in response to Brazil's argument regarding the causal relationship between certain subsidies and price suppression for upland cotton.

In addition, the Panel refers to the request of the United States, dated 20 November, concerning the change of certain deadlines in the Panel's current timetable as well as Brazil's comments on this request, received 22 November. After carefully considering the request of the United States and the comments of Brazil, the Panel has decided to change the first portion of the timetable as follows. The Panel will inform the parties of the rest of the timetable in due course.

First submission of the United States:	15 December 2006
Submission of the Third Parties:	5 January 2007
Rebuttal submission of Brazil:	11 January 2007
Rebuttal submission of the United States:	30 January 2007

[1] First Submission of Brazil, para. 117.
[2] First Submission of Brazil, para. 118.

ANNEX F-3

COMMUNICATION TO BRAZIL AND THE UNITED STATES

(28 November 2006)

The Panel refers to, and follows up its communication sent to parties yesterday (27 November). Attached please find the full timetable containing all the relevant dates, which the Panel will now follow. [*Attachment omitted*.]

In addition, the Panel refers to the letter dated 21 November submitted by the United States, in response to the invitation from the Panel, offering its explanation to the request to open up the Panel's meeting to the public those parts that relate to US statements and US answers to questions. After carefully considering this letter as well as the letter from Brazil dated 24 November commenting on this US's letter, we inform parties as follows.

The Panel notes, first, that there is no precedent in WTO dispute settlement practice for a decision to open a (portion of) a panel meeting to the public based on a request by one party to a dispute that is opposed by another party.[1] Second, the Panel has carefully considered the argument of the United States in its letter dated 21 November that in requesting the Panel to open to the public US statements and US answers to questions presented in the panel meeting the United States is exercising its right under Article 18.2 of the DSU, second sentence. The Panel considers that there are various possible ways in which a party can disclose its statements to the public and that the United States has not explained why procedures the United States normally uses to disclose its statements in WTO dispute settlement proceedings to the public would not be adequate in this case. Furthermore, the right of party to disclose its statements of its positions must also be reconciled with the obligation of confidentiality in the third sentence of Article 18.2. Finally, the Panel considers that the practical arrangements proposed by the United States in its letter of 21 November 2006 pose serious practical and logistical difficulties.

For the above reasons, we decline to grant the request made by the United States.

[1] In the disputes in *United States – Continued Suspension of Obligations in the EC – Hormones Dispute* (WT/DS320) and *Canada – Continued Suspension of Obligations in the EC – Hormones Dispute* (WT/DS321), the Panels decided that its meeting with the parties would be open for observation by the public through a closed-circuit broadcast based on a common request received from the parties to those disputes. Significantly, the Panels in those disputes also decided that their meetings with third parties would remain closed as not all third parties had agreed to open those meetings for observation by the public.

ANNEX F-4

COMMUNICATION TO THE PARTIES AND THE THIRD PARTIES

(20 December 2006)

The Panel confirms receipt of the letter from Brazil dated 18 December on the late timing of the US submission, as well as the letter from the US dated 19 December commenting on this Brazil's letter. The Panel confirms that the electronic version of the US submission was, according to the record on the computer, sent at 5:25 am on Saturday 16 December.[1] Parties will recall that paragraph 17(b) of the Working Procedures provides that the submission be made "by 5:30 pm on the due date[]". The due date for this particular US submission was Friday 15 December.

The Panel notes that Brazil requests the Panel to "reject the United States' submission as not timely filed". The Panel declines to do so. However, the Panel regrets this delay by the United States, and requests the United States to abide by the deadlines established by the Panel concerning its future submission(s).

The Panel also notes that Brazil pointed out the issue about the readability of the electronic version of the submission initially sent (*i.e.* sent 5:25am).[2] On this matter, the Panel would like to inform the United States that it had the same problem as Brazil did.

The Panel does not expect any more communications from the Parties on this specific issue.

[1] While there is no record as to when the paper version was received, the Panel secretary confirms that the submission had not arrived as of 22:00 on Friday 15 December.

[2] The Panel further notes that Brazil regrets the lack of electronic version of exhibits.

ANNEX F-5

COMMUNICATION TO BRAZIL AND THE UNITED STATES

(17 January 2007)

The Panel has noted that Brazil reiterates, in its rebuttal submission submitted on 11 January 2007, its request that the Panel request, pursuant to Article 13.1 of the DSU, the United States to provide certain data.[1]

Mindful of our communications dated 8 November 2006[2] and 27 November 2006[3], before informing the Parties of the Panel's views on this issue, the Panel poses the following questions to the Parties:

> Question 1 (to Brazil): Does Brazil deem that the questions posed in Part B[4] of Annex 1 of its request submitted on 1 November 2005 ("1 November request" hereafter) are now unnecessary?
>
> Question 2 (to Brazil): Is Brazil asking the United States to respond to all of the questions posed in Part A of its 1 November request?
>
> Question 3 (to the United States): If the United States is of the view that the Panel should not pose to the United States any or all of the questions in Part A of Brazil's 1 November request, please cite the reasons for that view.
>
> Question 4 (to the United States): If the United States is of the view that the United States cannot respond to any or all of the questions (or any part thereof) in Part A of Brazil's 1 November request, please explain that view, bearing in mind the fact that the United States did provide the data to the original Panel.[5]

The Panel invites Parties to submit their responses to the above questions by close of business on 19 January 2007. Parties are free, if they so wish, to submit comments on a question posed to the other Party.

This communication from the Panel is without prejudice to the position of the Panel on the US request that the Panel make a preliminary ruling that the claims of Brazil against the marketing loan program and the counter-cyclical payment program are outside the scope of this dispute.

---

[1] See paragraph 514 of Brazil's rebuttal submission, referring to Sections 2.3.1.3.3 and 2.3.2 of the same submission.

[2] Paragraph 1 of the communication to the Parties dated 8 November.

[3] First paragraph of that communication.

[4] Concerning Export Guarantee Programs.

[5] See section VII A 4 of the report of the original panel (WT/DS267/R).

ANNEX F-6

COMMUNICATION TO BRAZIL AND THE UNITED STATES

(22 January 2007)

The Panel has carefully considered the United States' request for preliminary rulings and the arguments it makes in support of its view that some of Brazil's claims are outside the scope of this proceeding.[1] The Panel has also considered the arguments submitted by Brazil[2] and by the third parties[3] in response to the United States' request.

The Panel considers that the United States' request for preliminary rulings will be more appropriately addressed in our final report, after we have had the benefit of further submissions by the parties and third parties on the issues raised by the United States.

Thus, we do not consider that this is a case where the panel proceedings would be better served by an early ruling from the Panel on the United States' request. We therefore decline to grant the United States' request for preliminary rulings at this point.

---

[1] United States' First Submission and Request for Preliminary Rulings of 15 December 2006, paras. 22-56. The United States indicates in paras. 30, 44, 48 and 56 the specific findings it seeks from the Panel.

[2] In particular, Brazil's submission dated 16 January 2007.

[3] Australia, Canada, China, Japan and New Zealand addressed this issue in their submissions submitted on 5 January 2007.

ANNEX F-7

COMMUNICATION TO BRAZIL AND THE UNITED STATES

(16 February 2007)

In this communication, the Panel addresses two issues: (a) the issue raised by Brazil in its letter dated 7 February 2007 and (b) the conveying of the Panel's questions.

1. Brazil's letter dated 7 February 2007

The Panel acknowledges receipt of Brazil's letter dated 7 February, concerning the late filing of the United States submission on 5 February. The Panel has noted, *inter alia*, that Brazil requests that the Panel "reject the United States' submission as not timely".[1] The Panel has also taken note of the United States' letter dated 12 February asking the Panel to reject Brazil's request.

The Panel regrets that the United States has missed the deadline for the second time in this Article 21.5 proceeding. The Panel finds it extraordinary that the United States has missed so many deadlines in the original proceeding as well as in this Article 21.5 proceeding.[2]

On the other hand, the Panel considers that there is no provision in the DSU that allows a panel to simply reject an entire submission as not timely. The Panel does not consider that the two cases cited by Brazil support Brazil's request. Thus, we decline to grant the request made by Brazil.

2. Questions from the Panel

In accordance with paragraph 7 of the Working Procedures, the Panel poses the attached questions [*attachment omitted*] to the parties. The deadline for written responses is the morning of 27 February[3] for questions in sections A-C, and close of business of 6 March for the remaining questions. Please note that the Panel may pose some of the attached questions orally during the panel meeting.

Each party is free to respond to or comment on questions posed to the other party.

[1] Para. 3 of Brazil's letter dated 7 February.
[2] Section VII:A:5(a) of the original panel report (WT/DS267/R) describes this issue in detail.
[3] That is, when the meeting with the parties starts.

ANNEX F-8

COMMUNICATION TO BRAZIL AND THE UNITED STATES

(21 March 2007)

The Panel refers to the communication of Brazil dated 1 November 2006 requesting the Panel to exercise its discretion under Article 13 of the DSU to seek certain information and to the communications of the Panel on this issue dated 8 and 27 November 2006 and 17 January 2007. The Panel notes that Brazil's request was made prior to the filing of the written submissions in this case and that information on certain items identified in that request has since been provided to the Panel. The Panel also expects to receive information on issues raised in Brazil's request in response to the questions posed by the Panel on 15 March 2007. The Panel considers that at this juncture it is not necessary to seek more information in respect of issues identified in Brazil's request. The Panel may, however, decide to request this information at a later stage of this proceeding and may ask questions to the parties at any time, in accordance with paragraph 7 of the Panel's working procedures.

ANNEX G

WORKING PROCEDURES AND TIMETABLE OF THE PANEL

ANNEX G-1

WORKING PROCEDURES FOR THE PANEL

1. In its proceedings, the Panel shall follow the relevant provisions of the Dispute Settlement Understanding (DSU). In addition, the following working procedures shall apply.

2. The Panel shall meet in closed session. The parties to the dispute, and interested third parties, shall be present at the meetings only when invited by the Panel to appear before it.

3. The deliberations of the Panel and the documents submitted to it shall be kept confidential. Nothing in the DSU shall preclude a party to a dispute from disclosing statements of its own positions to the public. Members shall treat as confidential information submitted by another Member to the Panel which that Member has designated as confidential. Where a party to a dispute submits a confidential version of its written submissions to the Panel, it shall also, upon request of a Member, provide a non-confidential summary of the information contained in its submissions that could be disclosed to the public.

4. Before the substantive meeting of the Panel with the parties to the dispute, the parties shall transmit to the Panel first written submissions, and subsequently written rebuttals, in which they present the facts of the case, and their arguments and their counter-arguments, respectively. Third parties may transmit to the Panel written submissions after the first written submissions of the parties have been submitted but before the rebuttals of the parties have been submitted.

5. All third parties which have notified their interest in the dispute to the Dispute Settlement Body shall be invited in writing to present their views during a session of the substantive meeting of the Panel set aside for that purpose. All such third parties may be present during the entirety of that session.

6. At its substantive meeting with the parties, the Panel will ask Brazil to present its case. Subsequently, and still at the same meeting, the Panel will ask the United States to present its point of view. The Panel thereafter will ask third parties to present their views at the separate session of the same meeting set aside for that purpose. The parties will then be allowed an opportunity for final statements, with Brazil presenting its statement first.

7. The Panel may at any time put questions to the parties and to the third parties, and ask them for explanations either in the course of the substantive meeting with the parties or in writing. Answers to questions shall be submitted in writing by the date specified by the Panel.

8. The parties to the dispute and any third party invited to present its views shall make available to the Panel and the parties and other third parties a written version of their oral statements, preferably at the end of the meeting with the Panel, and in any event not later than the day after the meeting. Parties and third parties are encouraged to provide the Panel and other participants at the meeting with a provisional written version of their oral statements at the time that the statements are made.

9. In the interest of full transparency, the oral presentations shall be made in the presence of the parties. Moreover, each party's written submissions, including responses to questions put by the Panel, shall be made available to the other party. Third parties shall receive copies of the parties' first written submissions and rebuttals.

10. The parties shall provide the Secretariat with an executive summary of the claims and arguments contained in their written submissions, and, if necessary, oral presentations and answers to questions. These executive summaries shall not serve in any way as a substitute for the submissions of the parties. The summaries of the first written submission and rebuttal submission shall be limited to ten (10) pages each. The Panel will determine the page limit for executive summaries of parties' oral presentations and responses to questions, if necessary and as appropriate. The executive summaries shall be submitted to the Secretariat within one week of the original submission, or, if necessary, presentation and/or written replies concerned. Paragraph 17 shall apply to the service of executive summaries.

11. Parties shall submit any requests for preliminary rulings not later than in their first written submissions to the Panel. If Brazil requests such a ruling, the United States shall submit its response to the request in its first written submission. If the United States requests such a ruling, Brazil shall submit its response to the request prior to the substantive meeting of the Panel, at a time to be determined by the Panel in light of the request. Exceptions to this procedure will be granted upon a showing of good cause.

12. Parties shall submit all factual evidence to the Panel no later than in their first written submissions to the Panel, other than evidence necessary for purposes of rebuttals and answers to questions. Exceptions to this procedure will be granted upon a showing of good cause. In such cases, the other party shall be accorded a period of time for comment on the newly submitted evidence, as the Panel deems appropriate.

13. To facilitate the maintenance of the record of the dispute, and to maximize the clarity of submissions, in particular, the references to exhibits submitted by parties, it is suggested that parties sequentially number their exhibits throughout the course of the dispute.

14. The descriptive part of the Panel's report will include the procedural and factual background to the present dispute. There will be no description of the main arguments of the parties and third parties as such. Instead, the Panel will attach to its report the parties' submissions (executive summaries thereof, as appropriate) including first written submissions and rebuttal submissions, written versions of the oral statements, and each parties' replies to questions from the other party and from the Panel. Upon request of a party, specific portions of a submission designated by that party as confidential at the time of its submission will not be included in the submission attached to the Panel's report.

15. The parties and third parties to this proceeding have the right to determine the composition of their own delegations. The parties and third parties shall have responsibility for all members of their delegations and shall ensure that all members of their delegations act in accordance with the rules of the DSU and the Working Procedures of this Panel, particularly in regard to confidentiality of the proceedings. Each party and third party shall provide a list of the members of its delegation before or at the beginning of the meeting with the Panel.

16. Following issuance of the interim report, the parties shall have the time, as established by the timetable of the Panel, to submit written requests to review precise aspects of the interim report. Following receipt of any written requests for review, each party shall have the opportunity, within a period specified by the timetable of the Panel, to submit written comments on the other party's written requests for review. Such comments shall be strictly limited to commenting on the other party's written request for review.

17. The following procedures regarding service of documents shall apply:

(a) Each party shall serve its submissions directly on the other party. Each party shall, in addition, serve its first written submission and rebuttal submission on the third parties. Each third party shall serve its submission on the parties and other third parties. Each party and third party shall confirm in writing that copies have been served as required, at the time it provides each submission to the Panel.

(b) The parties and third parties should provide their submissions to the Secretariat by 5:30 p.m. on the due dates established by the Panel, unless a different time is set by the Panel.

(c) The parties and third parties shall provide the Panel with eight (8) paper copies of their submissions. All of these copies shall be filed with the Dispute Settlement Registrar, Mr. Ferdinand Ferranco (office number 2150).

(d) At the time that they provide the paper versions of their submissions, the parties and third parties also shall provide to the Panel, the other party and, as appropriate, third parties electronic versions of all submissions, in a format compatible with that used by the Secretariat, either on a diskette or as an e-mail attachment. E-mail attachments shall be sent to the Dispute Settlement Registry (DSRegistry@wto.org) with a copy to Mr. Hiromi Yano (hiromi.yano@wto.org).

ANNEX G-2

TIMETABLE FOR THE PANEL[1]

Panel established on 28 September 2006
Panel composed on 25 October 2006

a.	First written submissions of the parties:		
	1.	Complaining party (Brazil)	17 November 2006
	2.	Party complained against (United States)	15 December 2006
	3.	Third parties	5 January 2007
b.	Rebuttal submission from Brazil[2]		11 January 2007
c.	Rebuttal submission from the United States		5 February 2007
d.	Date of meetings with the parties and third party session		27 February 2007 (28 February, if necessary)
e	Issuance of the interim report, including descriptive part, findings and conclusions, to the parties		27 July 2007
f	Written comments on the interim report		3 September 2007
g	Parties' comments on each other's comments on the interim report		17 September 2007
h.	Issuance of the report to the parties		15 October 2007
i.	Circulation of the final report to the Members		after translation

[1] As actually followed.
[2] Brazil's responses to the US request for preliminary ruling was due 16 January 2007.

ANNEX H

REQUEST FOR THE ESTABLISHMENT OF A PANEL

Contents	Page

ANNEX H-1

WORLD TRADE ORGANIZATION

WT/DS267/30
21 August 2006

(06-3966)

Original: English

UNITED STATES – SUBSIDIES ON UPLAND COTTON

Recourse to Article 21.5 of the DSU by Brazil

Request for the Establishment of a Panel

The following communication, dated 18 August 2006, from the delegation of Brazil to the Chairman of the Dispute Settlement Body, is circulated pursuant to Article 21.5 of the DSU.

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1. On 21 March 2005, the Dispute Settlement Body ("DSB") adopted the Appellate Body report and the Panel report[1], as modified by the Appellate Body report, in *United States – Subsidies on Upland Cotton*, WT/DS267.[2]

A. Relevant Findings, and Recommendations and Rulings

2. Brazil summarizes below the findings of the Appellate Body and the Panel, and the recommendations and rulings of the DSB, that are relevant to this communication. Those findings, and recommendations and rulings, relate to (i) actionable subsidies and (ii) prohibited export subsidies.

3. The Panel and Appellate Body found, *inter alia*, that the price-contingent US marketing loan, counter-cyclical and Step 2 programs in the Farm Security and Rural Investment Act ("FSRI Act") of 2002 caused significant price suppression in the world market for upland cotton in violation of Articles 5(c) and 6.3(c) of the *Agreement on Subsidies and Countervailing Measures* ("*SCM Agreement*").[3] In paragraph 8.1(g)(i) of its report, the Panel found that:

> "[T]he effect of the mandatory price-contingent United States subsidy measures – marketing loan programme payments, user marketing (Step 2) payments, MLA payments and CCP payments – is significant price suppression in the same world market within the meaning of Article 6.3(c) of the *SCM Agreement* constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*."

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[1] WT/DS267/AB/R ("Appellate Body Report, *US – Upland Cotton*"); WT/DS267/R ("Panel Report, *US – Upland Cotton*").

[2] WT/DSB/M/186.

[3] Panel Report, *US – Upland Cotton*, paras. 8.1(g)(i) and 7.1416.

The recommendations and rulings adopted by the DSB directed the United States, under Article 7.8 of the *SCM Agreement*, to remove the adverse effects caused by these subsidies, or to withdraw the subsidies, by 21 September 2005.[4]

4. The Panel found that three export credit guarantee ("ECG") programs maintained by the United States to support the export of US agricultural products – the General Sales Manager 102 ("GSM 102"), General Sales Manager 103 ("GSM 103") and Supplier Credit Guarantee ("SCGP") Programs[5] – constitute export subsidies under Article 10.1 of the *Agreement on Agriculture*. The Panel further found that these three ECG programs are export subsidies applied in a manner that results in actual circumvention of US export subsidy commitments for rice, and other products – including upland cotton – for which the United States has not undertaken export subsidy reduction commitments ("unscheduled" products) and which were supported by the ECG programs. The Panel therefore concluded that these three ECG programs are inconsistent with Articles 10.1 and 8 of the *Agreement on Agriculture*.

5. Having found that these three ECG programs constitute export subsidies for purposes of its analysis of Brazil's claims under the *Agreement on Agriculture*, the Panel also found that for purposes of Brazil's claims under Part II of the *SCM Agreement*, the programs are similarly prohibited subsidies under Articles 3.1(a) and 3.2 of the *SCM Agreement*.[6]

6. As a result of these findings, the Panel recommended that the United States bring these three ECG programs, with respect to upland cotton and other unscheduled supported products, and to rice, into conformity with the *Agreement on Agriculture*.[7] Pursuant to Article 4.7 of the *SCM Agreement*, the Panel additionally recommended that the United States withdraw these prohibited subsidies without delay, and by no later than 1 July 2005.[8]

7. The Appellate Body affirmed these recommendations.[9] In addition, the Appellate Body reversed the Panel's finding that Brazil had failed to make a *prima facie* case that the United States had applied ECGs in a manner that resulted in actual circumvention of its export subsidy commitments with respect to pig meat and poultry meat, within the meaning of Article 10.1 of the *Agreement on Agriculture*; however, the Appellate Body was unable to complete the analysis for this claim.[10]

B. Measures Taken by the United States to Comply

8. To implement the recommendations and rulings of the DSB, the United States took the following actions:

(i) On 3 February 2006, the United States Congress approved a bill that repeals the Step 2 subsidy program for upland cotton.[11] The bill was signed into law on 8 February 2006,[12] and took effect on 1 August 2006.

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[4] Panel Report, *US – Upland Cotton*, para. 8.3(d).
[5] *See* 7 U.S.C. § 5622; 7 CFR Part 1493.
[6] Panel Report, *US – Upland Cotton*, para. 8.1(d)(i).
[7] Panel Report, *US – Upland Cotton*, para. 8.3(a).
[8] Panel Report, *US – Upland Cotton*, para. 8.3(b).
[9] Appellate Body Report, *US – Upland Cotton*, paras. 763, 764.
[10] Appellate Body Report, *US – Upland Cotton*, para. 763(f)(i).
[11] Deficit Reduction Act of 2005, US Public Law 109-171, Section 1103.

(ii) The US Department of Agriculture ("USDA") announced that as of 1 July 2005, it would no longer take applications for ECGs under GSM 103;[13]

(iii) As of 1 July 2005, USDA amended the fee schedules for ECGs issued under the GSM 102 and SCGP programs.[14]

C. Non-existence of Measures, and Omissions/Deficiencies of Existing Measures

9. Brazil believes that measures taken by the United States to comply with the recommendations and rulings of the DSB in some respects do not exist, and to the extent they do exist, are not consistent with the *Agreement on Agriculture* and the *SCM Agreement*. Brazil identifies below instances in which US measures do not exist, as well as omissions and deficiencies with respect to those measures taken to comply that do exist.

1. Non-existence and omissions/deficiencies regarding the actionable subsidy-related recommendations and rulings of the DSB

10. With respect to the actionable subsidy-related recommendations and rulings of the DSB, Brazil believes that the United States has failed to take appropriate steps to remove the adverse effects or withdraw the subsidies found to cause adverse effects. The United States' failure to take these steps results in US subsidies for upland cotton causing serious prejudice to the interests of Brazil, within the meaning of Articles 5(c) and 6.3 of the *SCM Agreement*.

11. Brazil divides its concerns regarding the US failure to take appropriate steps to remove the adverse effects or withdraw the subsidies into two parts: the non-existence of measures taken to comply, and the consistency of those measures taken to comply with the covered agreements.

(a) Non-existence of measures taken to comply

12. First, the only measure taken by the United States to comply with the adverse effects-related recommendations and rulings of the DSB (*i.e.*, the repeal of the Step 2 program, cited as measure taken to comply (i) in Section B above), did not take effect until 1 August 2006, or over 10 months following the expiry of the implementation period, on 21 September 2005. At least during the period 21 September 2005 through 31 July 2006, measures taken to comply did not exist, within the meaning of Article 21.5 of the DSU.

13. Second, the United States has taken no measures whatsoever to comply with the recommendations and rulings of the DSB concerning the US marketing loan and counter-cyclical

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[12] WT/DSB/M205, 17 February 2006, para. 91.

[13] *See* "USDA announces changes to export credit guarantee programs to comply with WTO Findings," USDA FAS Online News Release, 30 June 2005, available at http://www.fas.usda.gov/scriptsw/PressRelease/pressrel_dout.asp?PrNum=0092-05. *See also* "Notice to GSM-103 Program Participants", USDA FAS Program Announcement, 30 June 2005, available at http://www.usda.gov/documents/0094GSM103Notice.doc.

[14] *See* "USDA announces changes to export credit guarantee programs to comply with WTO Findings," USDA FAS Online News Release, 30 June 2005, available at http://www.fas.usda.gov/scriptsw/PressRelease/pressrel_dout.asp?PrNum=0092-05. *See also* "USDA changes its fees to risk-based method for the GSM-102 and Supplier Credit Guarantee programs", USDA FAS Online News Release, 30 June 2005, available at http://www.fas.usda.gov/scriptsw/PressRelease/pressrel_dout.asp?PrNum=0093-05. *See also* GSM-102 Fee Schedule, available at www.fas.usda.gov/excredits/gsm102fees.html. and SCGP Fee Schedule, available at www.fas.usda.gov/excredits/scgpfees.html.

payment programs under the FSRI Act of 2002, as amended, as well as payments made under these programs. In this respect, measures taken to comply do not exist, within the meaning of Article 21.5 of the DSU.

14. As a consequence of these two failures, the United States has failed, as directed by the recommendations and rulings of the DSB, to take appropriate steps to remove the adverse effects of or to withdraw the subsidies from the US marketing loan, counter-cyclical and Step 2 payment programs under the FSRI Act of 2002, as amended, as well as payments made under these programs. These failures mean that, as in previous marketing years, the US marketing loan, counter-cyclical and Step 2 payment programs under the FSRI Act of 2002, as amended, taken alone and/or considered together, as well as payments made under these programs, cause:

- significant price suppression in the world market for upland cotton, within the meaning of Article 6.3(c) of the *SCM Agreement*; and

- an increase in the US share in the world market for upland cotton in marketing year 2005, within the meaning of Article 6.3(d) of the *SCM Agreement*.

(b) Inconsistency of measures taken to comply with the covered agreements

15. The measure taken by the United States to comply with the adverse effects-related recommendations and rulings of the DSB, identified as item (i) in Section B above, is deficient, because it fails to remove the adverse effects or withdraw the subsidies, and results in inconsistencies with Articles 5 and 6.3 of the *SCM Agreement*. Specifically, the deficiency manifests itself in three inconsistencies:

(i) Serious prejudice, with Step 2

16. Brazil believes that the US marketing loan, counter-cyclical and Step 2 payment programs under the FSRI Act of 2002, as amended, taken alone and/or considered together, as well as payments made under these programs, cause:

- significant price suppression in the world market for upland cotton within the meaning of Article 6.3(c) of the *SCM Agreement*; and

- an increase in the US share in the world market for upland cotton in marketing year 2005, within the meaning of Article 6.3(d) of the *SCM Agreement*.

(ii) Serious prejudice, without Step 2

17. Notwithstanding the US measure taken to comply with the actionable subsidy-related recommendations and rulings of the DSB (*i.e.*, the repeal of the Step 2 program effective 1 August 2006, cited as measure taken to comply (i) in Section B above), Brazil considers that the US marketing loan and counter-cyclical payment programs under the FSRI Act of 2002, as amended, as well as payments made under those programs, cause serious prejudice to the interests of Brazil, within the meaning of Article 5(c) and 6.3 of the *SCM Agreement*.

18. Specifically, irrespective of the effects of the Step 2 program or payments thereunder, the US marketing loan and counter-cyclical payment programs under the FSRI Act of 2002, as amended, as well as payments made under those programs, cause:

- significant price suppression in the world market for upland cotton within the meaning of Article 6.3(c) of the *SCM Agreement*; and

- an increase in the US share in the world market for upland cotton in marketing year 2005, within the meaning of Article 6.3(d) of the *SCM Agreement*.

(iii) Threat of serious prejudice

19. Finally, Brazil believes that the United States threatens to cause serious prejudice to the interests of Brazil, within the meaning of Articles 5(c) and 6.3 of the *SCM Agreement*, and footnote 13 thereto, by failing to take appropriate steps to remove the adverse effects or withdraw WTO-inconsistent subsidies for upland cotton.

20. Specifically, Brazil believes that the US marketing loan and counter-cyclical payment programs under the FSRI Act of 2002, as amended, as well as payments mandated to be made thereunder, threaten to cause significant price suppression in the world market for upland cotton in marketing years 2006[15] and until the expiry or repeal of these programs.

2. Non-existence and omissions/deficiencies regarding the ECG-related recommendations and rulings of the DSB

21. Brazil believes that despite the measures taken to comply cited as items (ii) and (iii) in Section B above, the United States has failed to implement the DSB's recommendation that it withdraw the prohibited ECG-related export subsidies without delay, under the *SCM Agreement*, and otherwise bring itself into conformity with its obligations, under the *Agreement on Agriculture*. Specifically, Brazil believes that measures taken to comply with the recommendations and rulings of the DSB with respect to the ECG programs do not exist in some respects, and to the extent they exist, are not consistent with the *Agreement on Agriculture* and the *SCM Agreement*. In either case, the United States has failed to withdraw fully the ECG-related prohibited subsidies subject to the recommendations and rulings of the DSB.

22. Brazil divides its concerns regarding the US failure to withdraw fully the ECG-related prohibited subsidies into two parts: the non-existence of measures taken to comply, and the consistency of those measures taken to comply with the covered agreements.

(a) Non-existence of measures taken to comply

23. Brazil believes that with respect to ECGs issued under the GSM 102, GSM 103 and SCGP programs prior to 1 July 2005, but still outstanding subsequent to 1 July 2005, the United States has taken no action whatsoever to withdraw the subsidy and otherwise bring itself into conformity with its obligations. With respect to these outstanding ECGs, measures taken to comply do not exist, within the meaning of Article 21.5 of the DSU.

24. In this respect, Brazil's concerns with the US failure to take measures to comply extend to ECGs issued under the GSM 102, GSM 103 and SCGP programs prior to 1 July 2005, but still outstanding subsequent to 1 July 2005, to support the export of: upland cotton and other unscheduled products; and, rice.

[15] Marketing year 2006 lasts from 1 August 2006 until 31 July 2007.

(b) Inconsistency of measures taken to comply with the covered agreements

25. Brazil believes that the United States provides export subsidies (under Articles 1, 3.1(a) and 3.2 of the *SCM Agreement*, as well as under item (j) to the Illustrative List of Export subsidies included as Annex I to the *SCM Agreement* (the "Illustrative List")) through the GSM 102 and SCGP programs, and ECGs provided under these programs, and has applied those export subsidies subsequent to 1 July 2005 in a manner that results in circumvention of the United States' export subsidy commitments. In this respect, the United States' measures taken to comply are not consistent with Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*.

26. Specifically, and notwithstanding the US measures taken to comply cited as items (ii) and (iii) in Section B above, the GSM 102 and SCGP programs, and ECGs provided thereunder, are export subsidies under the *Agreement on Agriculture* and the *SCM Agreement*, based on the following two grounds:

- The programs and ECGs provided thereunder provide and constitute financial contributions (loan guarantees) that confer benefits on recipients, within the meaning of Article 1 of the *SCM Agreement*, and that are contingent upon export performance, within the meaning of Article 3.1(a) of the *SCM Agreement*; and, separately and independently,

- The programs do not levy premium rates adequate to cover the long-term operating costs and losses of the GSM 102 and SCGP programs, within the meaning of item (j) of the Illustrative List.

27. Further, subsequent to 1 July 2005, ECGs under the GSM 102 and SCGP programs have been applied to circumvent US export subsidy commitments, within the meaning of Article 10.1 of the *Agreement on Agriculture*. Brazil is concerned that ECGs under the GSM 102 and SCGP programs have been provided subsequent to 1 July 2005 to support the export of: upland cotton and other unscheduled products; and, rice, pigmeat and poultry meat, in excess of US reduction commitment levels for those products.[16]

28. As a result and to the extent of this violation of Article 10.1 (and, as a consequence, Article 8) of the *Agreement on Agriculture*, the GSM 102 and SCGP programs, and ECGs provided thereunder, are subject to the prohibition against export subsidies included in Articles 3.1 and 3.2 of the *SCM Agreement*. On the grounds cited in paragraph 26 above, Brazil believes that the GSM 102 and SCGP programs, and ECGs provided thereunder, are prohibited export subsidies, within the meaning of Articles 3.1(a) and 3.2 of the *SCM Agreement*.

D. Conclusion

29. Accordingly, because there is disagreement as to the existence and consistency with a covered agreement of measures taken to comply with the recommendations and rulings of the DSB, within the meaning of Article 21.5 of the Understanding on Rules and Procedures Governing the Settlement of

[16] Exports that benefited from GSM 102 and SCGP ECGs subsequent to 1 July 2005 are currently reflected in the July 2005 and September 2005 (fiscal year end), as well as July 2006 "Monthly Summary of Export Credit Guarantee Activity," USDA FAS Online, available at http://www.fas.usda.gov/excredits/Monthly/ecg.html.

Disputes ("DSU"), Brazil seeks recourse to dispute settlement under this provision.[17] Brazil requests that the DSB refer the matter to the original panel, if possible, pursuant to Article 21.5 of the DSU.

[17] Brazil notes that informal discussions regarding this matter were held with the United States on 19 July 2006; however, consultations within the meaning of Article 4 of the Understanding on Rules and Procedures Governing the Settlement of Disputes ("DSU") were not held.

WORLD TRADE ORGANIZATION

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UNITED STATES – SUBSIDIES ON UPLAND COTTON

Recourse to Article 21.5 of the DSU by Brazil

Report of the Panel

Corrigendum

In paragraph 7.8 last line, "Section IX.A.3" should read "Section IX.**B**.3".

In footnote 613, "Article 21 of the *Vienna Convention*" should read "Article **27** of the *Vienna Convention*".