United States – Subsidies on Upland Cotton: Arbitration Under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement (WT/DS267)

United States – Subsidies on Upland Cotton: Arbitration Under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement (WT/DS267)

Answers of the United States to the Questions from the Arbitrators

February 13, 2009
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Questions to both parties

(General)

1. In light of the fact that the Arbitrator has not adopted specific procedures for the handling of confidential information, please explain what specific treatment you consider is required for the protection of "WTO-confidential information", as referred to in your submissions.

   1. The information marked “WTO Confidential” in the U.S. submission reflected the treatment of this information, which relates to specific transactions by individual banks at then-current market conditions and figures derived from this information, when submitted to the compliance panel. Because of the sensitivity of the information, these figures cannot be disclosed to the public (and, accordingly, were redacted from the U.S. submission when it was made public).

   2. The United States notes that these responses also include a figure that requires “WTO Confidential” treatment. It is in the response to question 47, and has been marked with double brackets. Although Article 18 of the Understanding on Rules and Procedures Governing the Settlement of Disputes (“DSU”) does not by its terms apply to information submitted to an arbitrator, the United States would expect that Brazil would not disclose the WTO Confidential information to the public and would respectfully request the Arbitrators to confirm that the information is not to be disclosed to the public.

2. In light of the fact that both parties have presented single submissions covering both Brazil’s request in respect of actionable subsidies (WT/DS267/26) and its request in relation to prohibited subsidies (WT/DS267/21), please clarify:

   (a) whether the Arbitrator should consider that the arguments presented in the entirety of the submissions may be pertinent (and thus, may be taken into account by the Arbitrator) for the purpose of either proceeding, or whether various parts of the submissions should be considered to relate exclusively to one or the other proceeding; if the latter is the case, please indicate precisely which proceeding each paragraph of each submission relates to.

3. The United States submitted one document in response to Brazil’s methodology paper, as Brazil submitted a single methodology paper for both arbitrations and a single submission. However, the organization of all of the submissions shows that the analysis for the two arbitrations, has been separated to the extent possible. Thus, in the U.S. submission, Sections II and III relate to the arbitration on prohibited subsidies and Brazil’s request for countermeasures under Article 4.10. Section IV relates to the arbitration on actionable subsidies and Brazil’s request for countermeasures under Article 7.9.

4. The analysis is not as clearly separated in the introductions, conclusions and discussion of cross-sectoral suspension of concessions. However, this is not surprising, particularly because
before the analysis on cross-sectoral suspension of concessions can take place, the arbitrators will first assess, separately, the amount of countermeasures requested under Article 4.10 and the amount of countermeasures requested under 7.9. Until that point, the general discussion of the application and operation of Article 22.3 of the DSU is not clearly divisible. The sections that are not clearly related to prohibited subsidies or to actionable subsidies may be relevant to either proceeding.

5. The division of the presentation and the arguments in each submission, notwithstanding that each is a single document, reflects the fact that there are two separate arbitrations, based on two separate requests for countermeasures. The separate requests for countermeasures, in turn, reflect the different legal standards concerned and the different compliance obligations involved (including different time periods for implementation).

\[(b)\] whether the parties expect the Arbitrator to present a single report reflecting both proceedings or two separate reports.

6. Because there are two separate arbitrations, pursuant to two separate requests for countermeasures, the United States expects that the Arbitrators will issue two separate reports. Indeed, the DSU does not appear to provide for combining the reports from separate proceedings. The separate analysis is critical because the subsidies with respect to which the countermeasures are requested are separate, under two different legal standards. Moreover, key procedural facts, such as the reasonable period of time to comply, are different.

7. In addition, two separate reports would be important in the event of additional proceedings on any of the issues before the Arbitrators. For example, if Brazil imposes countermeasures under both requests and the DSB later finds that the United States is in compliance with respect to the recommendations and rulings of the DSB with respect to one set of measures (e.g., prohibited subsidies) but not the other (e.g., actionable subsidies) or vice versa, the separate reports would provide the necessary clarity for Brazil to remove countermeasures to reflect the U.S. compliance.

(proposed countermeasures for the prohibited subsidies)

3. \[Please clarify what the relevant time period should be for the calculation of the level of "appropriate countermeasures" under Article 4.10 of the SCM Agreement? In particular, please clarify the relevance of:

(a) the situation at the time of expiry of the period of time for implementation;\]

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1 Although under footnote 15 of the DSU the expression “arbitrator” is used in the singular, in these responses the United States uses “Arbitrators” in the plural to reflect that each proceeding has its own arbitrator, even if the same individuals are involved.
(b) the situation at the time of the compliance panel and Appellate Body rulings;

(c) the situation at the time of these proceedings; and

(d) any evolution that might have taken place in the existence, amount or impact of the measures at issue between these various moments.

8. The DSU does not specify the time period to be used for the calculation of “appropriate” countermeasures in the circumstances of this dispute. However, certain elements are clear or may be derived from the DSU. First, there is no significance attached as such to the situation at the expiry of the reasonable period of time for implementation. Rather, it is critical to take into account the specific recommendations and rulings of the DSB resulting from the compliance proceedings. In particular, the compliance DSB recommendations and rulings determine the inconsistency that remains.

9. Both Articles 4 and 7 of the SCM Agreement use the term “countermeasures” to describe and limit what the DSB may authorize. This term has significance. The term is used in the context of a Member’s failure to implement the DSB recommendations and rulings. In other words, the “countermeasures” are to be “counter” to the inconsistency with the DSB recommendations and rulings. Here, as a result of the compliance proceeding, the DSB has made recommendations and rulings as to the scope and nature of the remaining inconsistency (the “compliance recommendations and rulings”). It is these compliance recommendations and rulings that define the limit of any countermeasures.

10. The compliance recommendations and rulings are based on a particular time period which in turn is based on the terms of reference of the proceedings. A compliance panel’s terms of reference are established when the compliance panel is established. As a result, the relevant time period for the calculation of the level of “appropriate countermeasures” under Article 4.10 of the SCM Agreement would be the time period on which the compliance recommendations and rulings are based. In other words, the relevant time period is not the date on which the DSB adopts its compliance recommendations and rulings, but the time period used in making those compliance recommendations and rulings, which should be the time of the compliance panel’s establishment. Such an approach also has the advantage of avoiding the concern that parties might be constantly confronted with a “moving target” of measures or that the Arbitrators will be asked to make an award based on some presumption with respect to the consistency of measures that have not been examined or for which there are no DSB recommendations and rulings.

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2 In other circumstances, such as where there are no compliance recommendations and rulings, it may be appropriate to use the date of referral of the matter to the arbitrator as the relevant time period, since that is the date on which the arbitrator’s terms of reference are fixed.

3 Of course, in certain instances the arbitrator may itself be called upon to examine the consistency of certain measures. See, e.g., EC – Bananas III (Article 22.6).
11. This is not to say that the Arbitrators are limited to taking into account only the evidence that dates from that same time period. Consistent with the approach taken in prior proceedings, in evaluating the inconsistency with the compliance recommendations and rulings, the Arbitrators may determine it appropriate to examine more recent evidence. In this connection, an arbitrator’s working procedures may establish particular dates for the submission of evidence, as the Arbitrators have done in these proceedings.

12. This approach is consistent with the approach taken in prior arbitrations. For example, prior arbitrators have rejected the notion that it is the situation at the end of the period for implementation that controls. It is also consistent with the approach taken in the compliance phase of this dispute. For example, in this particular case, two things had occurred with respect to GSM 102 guarantees by the time of the compliance panel and Appellate Body proceedings. First, certain changes had been made to the operation of the GSM 102 program, such as implementation of the new fee structure that was announced on June 30, 2005. Second, more recent and updated data were available to demonstrate the performance of the program over time. Correctly, the compliance panel used the more recent information available to it, including new budget data showing re-estimates of initial subsidy estimates, by cohort, from 1992 to 2006. The compliance panel found that the United States had not brought its measures into conformity with its WTO commitments, and these findings were upheld by the Appellate Body.

13. Since the time of the compliance panel, additional data has become available on the operation of GSM 102 guarantees that provides more detailed and specific information about the guarantees. This additional data is the same type used by both the original and compliance panel, and it is also relevant to assessing the guarantees for the purposes of determining appropriate countermeasures. In fact, the inquiry for the Arbitrators (e.g., measuring the amount of the subsidy) is in some ways more exacting, so it is appropriate for the Arbitrators to use this better, more precise information.

14. It is also important to consider what would result if the Arbitrators were limited to

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4 See, EC – Bananas III (Article 22.6), para. 4.7, in which the arbitrator stated that to examine the original banana import regime “would mean to ignore altogether the undisputed fact that the European Communities has taken measures to revise its banana import regime. That is certainly not the mandate that the DSB has entrusted to us”; see also, Brazil – Aircraft (Article 22.6), paras. 3.37-3.40, in which the arbitrator indicated that it was examining the revised PROEX regime.

5 US – Upland Cotton (Article 21.5) (Panel), para. 3.16.


7 US – Upland Cotton (Article 21.5) (Panel), para. 5.1; Upland Cotton (21.5)(AB), para. 322.
examining the situation as it existed at the end of the implementation period or could not take into account any more recent evidence. An arbitrator could authorize countermeasures even where a Member has come into compliance; this would plainly be “disproportionate.” An arbitrator could also authorize countermeasures for an amount too high (for example, if the amount of a subsidy has decreased, such as due to changes in market conditions). This also would be “disproportionate.”

(proposed countermeasures for the actionable subsidies)

4. In light of the fact that Article 7.9 of the SCM Agreement refers to the "adverse effects determined to exist", please clarify what the relevant time period should be for the calculation of the level of countermeasures "commensurate with" such effects? In particular, please clarify the relevance of:

(a) the situation at the time of expiry of the period of time for implementation;
(b) the situation at the time of the compliance panel and Appellate Body rulings;
(c) the situation at the time of these proceedings; and
(d) any evolution that might have taken place in the existence or level of the "adverse effects" of the relevant subsidies between these various moments.

15. The DSU does not specify the time period to be used for the calculation of countermeasures “commensurate with the degree and nature of the adverse effects determined to exist” in the circumstances of this dispute. However, certain elements are clear or may be derived from the DSU. First, there is no significance attached as such to the situation at the expiry of the reasonable period of time for implementation. Rather, it is critical to take into account the specific recommendations and rulings of the DSB resulting from the compliance proceedings. In particular, the compliance DSB recommendations and rulings determine the inconsistency that remains.

16. Both Articles 4 and 7 of the SCM Agreement use the term “countermeasures” to describe and limit what the DSB may authorize. This term has significance. The term is used in the context of a Member’s failure to implement the DSB recommendations and rulings. In other words, the “countermeasures” are to be “counter” to the inconsistency with the DSB recommendations and rulings. Here, as a result of the compliance proceeding, the DSB has made recommendations and rulings as to the scope and nature of the remaining inconsistency (the “compliance recommendations and rulings”). It is these compliance recommendations and rulings that define the limit of any countermeasures.

17. The compliance recommendations and rulings are based on a particular time period which in turn is based on the terms of reference of the proceedings. A compliance panel’s terms of reference are established when the compliance panel is established. As a result, the relevant time
period for the calculation of the level of countermeasures “commensurate with the degree and nature of the adverse effects determined to exist” under Article 7.9 of the SCM Agreement would be the time period on which the compliance recommendations and rulings are based. In other words, the relevant time period is not the date on which the DSB adopts its compliance recommendations and rulings, but the time period used in making those compliance recommendations and rulings, which should be the time of the compliance panel’s establishment.\(^8\) Such an approach also has the advantage of avoiding the concern that parties might be constantly confronted with a “moving target” of measures or that the Arbitrators will be asked to make an award based on some presumption with respect to the consistency of measures that have not been examined or for which there are no DSB recommendations and rulings.\(^9\)

18. This is not to say that the Arbitrators are limited to taking into account only the evidence that dates from that same time period. Consistent with the approach taken in prior proceedings, in evaluating the inconsistency with the compliance recommendations and rulings, the Arbitrators may determine it appropriate to examine more recent evidence. In this connection, an arbitrator’s working procedures may establish particular dates for the submission of evidence, as the Arbitrators have done in these proceedings.

19. This approach is consistent with the approach taken in prior arbitrations. For example, prior arbitrators have rejected the notion that it is the situation at the end of the period for implementation that controls.\(^10\) It is also consistent with the approach taken in the compliance phase of this dispute. For example, in this particular case, by the time of the compliance panel findings, Step 2 payments had been eliminated by legislation, and market changes had occurred with respect to marketing loan and countercyclical payments. Correctly, the compliance panel used the more recent information available to it, including data covering the most recent complete marketing year.\(^11\) The compliance panel found that the United States had not brought its measures into conformity with its WTO commitments, and these findings were upheld by the

\(^8\) In other circumstances, such as where there are no compliance recommendations and rulings, it may be appropriate to use the date of referral of the matter to the arbitrator as the relevant time period, since that is the date on which the arbitrator’s terms of reference are fixed.

\(^9\) Of course, in certain instances the arbitrator may itself be called upon to examine the consistency of certain measures. See, e.g., EC – Bananas III (Article 22.6).

\(^10\) See EC – Bananas III (Article 22.6), para. 4.7, in which the arbitrator stated that to examine the original banana import regime “would mean to ignore altogether the undisputed fact that the European Communities has taken measures to revise its banana import regime. That is certainly not the mandate that the DSB has entrusted to us.”; see also, Brazil – Aircraft (Article 22.6), paras. 3.37-3.40, in which the arbitrator indicated that it was examining the revised PROEX regime.

20. Since the time of the compliance panel, additional data has become available on marketing loan and countercyclical payments that provides more detailed and specific information about payments from year to year. This data is relevant for assessing the amount of countermeasures that would be commensurate with the nature and degree of the adverse effects on Brazil from these payments, as assessed by the extent of significant price suppression. In fact, the inquiry for the Arbitrators (e.g., measuring “significant” price suppression) is in some ways more exacting, so it is appropriate for the Arbitrators to use this better, more precise information.

21. It is also important to consider what would result if the Arbitrators were limited to examining the situation as it existed at the end of the implementation period or could not take into account any more recent evidence. An arbitrator could authorize countermeasures even where a Member has come into compliance; this would plainly not be “commensurate with the nature and degree of the adverse effects determined to exist.” An arbitrator could also authorize countermeasures for an amount too high (for example, if the amount of a subsidy has decreased, such as due to changes in market conditions). This also would not be “commensurate with the nature and degree of the adverse effects determined to exist.”

5. With the possible exception of the US supply elasticity, Brazil and the United States disagree about the values of the elasticities (ROW supply elasticity, the US and ROW demand elasticities) that are used in the cotton simulation model submitted by Brazil. The parties also cite economic literature, e.g. studies published in economic journals, technical reports and the like, and other economic models of the cotton market that support the values of the elasticities they have chosen.

(a) Could the parties provide additional detailed information about the nature of the simulations being undertaken in these studies (e.g. what policies are being changed) and whether the simulations are short-term or long-term?

(b) Where the studies cited by the parties involve econometric estimations of these demand and supply elasticities, could they also include the standard errors of these estimates to the extent that these have been reported in the studies?

22. The United States would like to clarify its position on the U.S. supply elasticity. The United States does not agree with Brazil that the appropriate supply elasticity for the United States is 0.8 for a short-run analysis. The United States believes that if all elasticities, U.S. supply and demand and ROW supply and demand, were long-run elasticities, then a U.S. supply elasticity of 0.8 would be acceptable.

\[12\] US – Upland Cotton (Article 21.5) (Panel), para. 15.1; Upland Cotton (21.5)(AB), para. 447.
23. The United States relied on independent 3rd parties for its elasticity estimates. For the long-run, the United States relied on a study by Food and Agricultural Organization staffers. This study utilized the joint UNCTAD-FAO Agricultural Trade Policy Simulation Model (ATPSM). ATPSM is a comparative-static, multi-commodity, multi-region, partial-equilibrium global trade model designed primarily for simulating agricultural trade policies. It can simulate the effects of a range of trade policy instruments.

24. In this FAO study, the authors look at the long-run effect of a complete liberalization of domestic subsidies and tariffs for cotton. The first simulation is based on subsidy levels as reported in WTO notifications. Since many other studies had used the ICAC estimates of cotton subsidies, the authors also ran the simulation based on these subsidy estimates. In terms of the elasticities utilized in the study, the authors noted the following:

“[t]he value of price elasticities of supply and demand for all major cotton producing and consuming countries used for the base scenario in the ATPSM are shown in Annex 1 table 2. These parameters were checked, drawing upon the literature and market assessment. The 29 exhibited countries account for 90 percent of world trade and production. For all other countries for which rechecking was not done, the supply elasticity was set at 0.2 and the demand price elasticity was set at -0.2.”

25. The authors also included sensitivity analysis on the supply and demand elasticities. The authors found that the price effect for the scenario based on WTO notifications increased from 3.1 percent to 4.8 percent when the supply elasticities were 3 times the base scenario and the demand elasticities were 0.25 of the base scenario.

26. Although the United States believes the correct analysis is the long-run, the United States provided a short-run analysis to the compliance panel to demonstrate that with more appropriate short-run elasticities, the price effects were much lower than claimed by Brazil. The short-run elasticities utilized in that simulation provided to the compliance panel were also provided to the Arbitrator. The United States based its short-run elasticities on the Food and Agricultural Policy Research Institute’s (FAPRI) international cotton market model. During the original panel proceedings, Professor Sumner created a variant of this model to provide the panel with estimates of the impact of various U.S. cotton support programs. This model is a partial equilibrium model encompassing multiple regions. The model is typically used to provide baseline projections. While these baseline projections typically assume that current agricultural policies will remain in force in the United States and in other trading nations during the projection period, the model is also used to examine the impact of alternative policies and external factors for implications on production, utilization, farm and retail prices, farm income, trade and government costs. In fact, FAPRI used the model to look at the impacts of global agricultural liberalization.

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13 U.S. Written Submission, paras. 87-88.
27. Whereas the FAPRI model uses regional elasticities for the United States, the current Sumner model only utilizes a single elasticity for the United States. To arrive at the aggregate short-run supply elasticity for the United States, the United States weighted the regional elasticities by average planted acreage by region for the period MY2003-MY2005. The United States used the regional elasticities published in the FAPRI model documentation in December 2004. Thus, the aggregate U.S. supply elasticity is 0.21.

28. The U.S. estimate for the rest-of-world (ROW) supply elasticity was based on the latest documentation of the FAPRI modeling system at the time of the Compliance Panel. The United States estimated the ROW elasticity to be 0.33.

29. Since the Sumner model does not incorporate stocks, the United States adjusted demand elasticities to account for stocks, since the level of stocks can be important in a short-run analysis. To arrive at the U.S. demand and ROW demand elasticities, the United States did the following:

(a) Took U.S. mill demand elasticity from the FAPRI Working Paper entitled “Documentation of the FAPRI Modeling System.”

(b) Took stocks demand elasticity from the stock demand equation provided in the same working paper, evaluated over the MY2003-MY2005 average farm price and stocks level.

(c) Obtained total demand elasticity by weighting mill demand elasticity and stocks demand elasticity by the MY2003-MY2005 averages for stock and foreign mill demand.

(d) Calculated foreign mill demand and stock demand elasticities in a similar fashion, i.e., based on the FAPRI foreign mill demand and stock demand equations, weighted by MY2003-MY2005 averages for stock and foreign mill demand.

30. This method resulted in a U.S. demand elasticity of -0.822 and a ROW demand elasticity of -0.39. FAPRI does not provide standard errors for the cotton elasticities.

14 Exhibit US-111. See pp. 8, 11, 14, 17, 27, and 30 for regional supply elasticities.

15 Exhibit US-112. For individual country supply elasticities, see Appendix B, pp. 235-299.


17 Exhibit US-111, p. 42.

18 For further discussion of the U.S. calculations of short-run elasticities from the FAPRI model, see Annex I to the U.S. First Written Submission, recourse to Article 21.5, and Annex I to
6. Before the compliance panel, both Brazil and the United States referred to recent economic literature that calculated the production effect of countercyclical payments. This literature was reviewed extensively by the compliance panel which concluded that "there is no disagreement about the direction of those effects nor on the mechanisms by which the production effects are transmitted." [original footnote omitted] In the context of the parties' disagreement about the size of the coupling factor, could Brazil and the United States cite new empirical studies that may have been published in economic journals since then that bear on the question of how large the production effects from countercyclical payments are?

31. The United States is aware of three studies since the compliance panel proceedings. These studies are provided as exhibits US-72, US-73 and US-74. As was the case with the studies submitted during the compliance panel proceedings, none of the new studies deal directly with the impact of countercyclical payments for cotton on production, although one study addresses cotton countercyclical payments as a hedging instrument. These studies do show that countercyclical payments generally have a relatively small production impact.

32. The first study is by Bhaskar, Arathi and Beghin. This paper provides a summary and overview of research on decoupled payments, including countercyclical payments. Conclusions from studies reviewed in this paper that specifically examined countercyclical payments and have not previously been provided are below:

"Anton and Le Mouel (2004) employ a mean-variance approach to compute the magnitude of the risk effects of CCP. The assumed value of Rr matters but effects are overall small. The CCP program created risk-related effects in the magnitude of 0.9% for sorghum, 1.5% for corn and 1.9% for wheat." (Page 7)

"Makki, Johnson and Somwaru (2005) analyze the effects of CCP on farm-level income variability, crop choice and acreage allocation decisions by simulating an expected utility maximization model for a risk-averse representative Minnesota farmer facing price and output uncertainty. The farmer is assumed to buy revenue or yield insurance. The authors compare the certainty equivalent of the terminal period wealth under different assumptions about programs, acreage allocations and market conditions. The simulation exercise is conducted for the years 2002-04. Results indicate that CCP increase farm welfare considerably, especially in low price years. Farmers may increase acreage of crops with higher CCP rates, especially if base updating is allowed, as it was under the 2002 FSRI Act." (Page 9)

the U.S. Rebuttal Submission, recourse to Article 21.5.

19 Exhibit US-72.
33. The United States notes that this study shows larger effects, but the assumptions, especially about base updating, have not held (that is, there was no base updating in the 2008 farm bill), thus adding doubt about the conclusions.

34. An “analysis is conducted by Beckman and Wailes (2005) who analyze the impact of direct payments and CCP in the 2002 FSRI Act on acreage supply response for rice. They find that DP are decoupled while a $1 increase in CCP per year increases rice area harvested by 956.29 thousand acres for the six major U.S. rice producing states.” (Page 22)

35. The United States notes that this paper, which has not been published in a refereed journal, suggests very high production effects for rice. Rice acreage is around 3.2-3.5 million acres. However, upon closer inspection of the paper, there are significant problems with the estimations for countercyclical payments that call into question the validity of these results, as indicated by the following quote.20

“The estimated counter-cyclical lagged model had several problems such as the expected gross margin was not statistically significant. Multicollinearity was present between the direct payments and the counter-cyclical lagged payments; and both direct payments and the counter-cyclical payment lagged coefficients were statistically significant, indicating that both direct payments and counter-cyclical payments are coupled. The coefficient sign for direct payments was positive, indicating that if the government raised the direct payment rate area harvested would increase. A more significant aspect of this empirical specification was that there were only two years of counter-cyclical payments made if the time period is lagged; therefore, the marketing loss assistant payments (MLA) for the 2001 period were used as a proxy for the countercyclical data for 2002. These payments were $2.49/cwt; however, under the 2002 Farm Bill the maximum the current CCP payment can be is $1.65/cwt. Therefore, it seems the biggest problem with this model is missing data. This is difficult to fix; however, since the MLA payments seem to be the best proxy for the CCP lagged payment.” (Page 12-13)

36. The second study is by Anderson, Coble and Miller.21 “This research evaluates whether the introduction of countercyclical payments creates an incentive for program crop producers to hedge the expected government payment using futures and/or options. Results indicate that some

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20 We note that the references did not include a citation for this paper so we believe the paper is The Supply Response of U.S. Rice: How decoupled are income payments? Jayson Beckman and Eric J. Wailes, Graduate Research Assistant and L.C. Carter Professor Department of Agricultural Economics and Agribusiness, Division of Agriculture, University of Arkansas, Fayetteville, Arkansas. Selected paper prepared for presentation at the American Agricultural Economics Association Annual Meeting, Providence, Rhode Island, July 24-27, 2005.

level of countercyclical payment hedging is optimal for risk-averse decision makers. However, optimal hedge ratios depend on planting time expectations of marketing year average price as well as on what crop, if any, has been planted on countercyclical payment base acres. These results suggest that the ability to hedge may make these payments more decoupled but also illustrate the distortion of producer behavior induced by farm programs.” (Page 507)

37. The last study is by Coble, Miller and Hudson.22 This study reports analysis of the subjective expectations of producers for base updating and an analysis of the effect these expectations have on producer willingness to accept a buyout of the right to update. Several authors have suggested producer expectations for base acreage and yield updating in future farm bills create an incentive to alter planting and input decisions. Although the subject of this paper – base updating – is not directly relevant to the Arbitrator’s question (there have been no findings on base updating throughout this entire procedure), countercyclical payments are one of the variables used in the analysis. One quote is instructive:

“Interestingly, more producers think countercyclical payment rates will decline than believe marketing loan rates will decline. As a reviewer noted, producers may perceive the loan program with its link to production to be a more essential program than a program decoupled from production, and therefore believe it less likely to be eliminated.” (Page 34)

38. As with many studies about decoupled payments, where authors find positive production effects, such effects are small, difficult to quantify, and subject to many qualifiers.

7. Brazil and the United States disagree about the appropriate choice of the indicator for the expected market price. Brazil uses the one-year lagged price of cotton while the United States employs the futures price. It is reasonable to assume that rational farmers will choose the indicator that produces the lowest forecast error.

(a) To Brazil: Using as long a time series as Brazil sees fit, please provide calculations of the root mean square error of using lagged prices as forecasts for next period's price. (Please provide the data used in the calculations).

(b) To the United States: Using as long a time series as the United States sees fit, please provide calculations of the root mean square error of using futures prices (without deducting transport costs) as forecasts for next period's price. (Please provide the data used in the calculations).

39. At the outset, the United States recalls that the lagged price would not be known at the time when U.S. farmers begin their planting intentions or planting because the lagged price constructed for modeling purposes includes information after U.S. farmers have planted. For

22 Exhibit US-74, pp. 27-42.
further explanation, please see the U.S. reply to Question 61. For the modeling exercise, the United States was deducting the 5 cent basis to bring the futures price back to an “expected farm price.” Because the question could address the futures markets price forecast about the market price or the farm price, the United States provided the analysis for both the U.S. farm price and the U.S. market price (Memphis price) from MY1985 through MY2007.

Results:

(a) Season-average (weighted) producer price (farm price) of upland cotton \( P_p \) = f (January through March daily average price of that year’s December futures contract \( P_f \)(1985/86 through 2007/08)).

\[
P_p = b P_f
\]

Where: \( b = .897 \)  \( t \) statistic = 29.4  \( R^2 = .98 \)

**Root mean squared error (RMSE) = 9.03**

(b) Season-average (simple) Memphis price of upland cotton \( P_m \) = f (January through March daily average price of that year’s December futures contract \( P_f \)(1985/86 through 2007/08)).

\[
P_M = b P_f
\]

Where: \( b = .961 \)  \( t \) statistic = 28.2  \( R^2 = .97 \)

**Root mean squared error (RMSE) = 10.06**

Table 1, Summary Data:

<table>
<thead>
<tr>
<th>Crop Year</th>
<th>Season Avg. Farm Price (cents per lb)</th>
<th>Memphis Daily Avg. 1 1/16 (cents per lb)</th>
<th>Jan-Mar Daily Avg of Dec Futures Contract Price (cents per lb)</th>
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<tbody>
<tr>
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<td>56.8</td>
<td>60.5</td>
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<tr>
<td>1988/89</td>
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<td>56.7</td>
<td>59.8</td>
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<td>Price 1</td>
<td>Price 2</td>
<td>Price 3</td>
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<tr>
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<td>---------</td>
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<tr>
<td>2007/08</td>
<td>59.3</td>
<td>62.6</td>
<td>58.8</td>
</tr>
</tbody>
</table>
Sources:

season-average farm price of upland cotton:

http://usda.mannlib.cornell.edu/usda/ers/89004/table02.xls

Season-average Memphis price of upland cotton:


January through March daily average price of that year’s December futures contract:

http://data.theice.com/services/historical/buydata.aspx

The detailed data for the table is found in Exhibit US-75.

(cross-retaliation)

8. Please comment on the interpretation of the principles and procedures in Article 22.3 of the DSU and the description of the mandate of an arbitrator under Article 22.7 of the DSU with respect to these procedures and principles, as reflected in the Decision by the Arbitrator in the US – Gambling case (WT/DS285/ARB)?

40. As an initial matter, the United States concurs with the arbitrator in US-Gambling, when it stated that under Article 22.7 of the DSU the arbitrator’s mandate includes determination of whether the principles and procedures of Article 22.3 have been followed, where such a claim is has been referred to the arbitrator.

41. With regard to the standard for assessing proposed cross-agreement or cross-sectoral countermeasures and on the US-Gambling arbitrator’s approach to Article 22.3, the United States has some additional comments. On the standard for assessing a Member’s request under Article 22.3, the US-Gambling arbitrator stated:

“We have determined in the previous section that our task is to examine whether, in making a determination in this case, Antigua, as the complaining party, has considered the necessary facts objectively and whether, on the basis of these facts, it could plausibly arrive at the conclusion that it was not practicable or effective to seek suspension with respect to the same sector within the same agreement.”23

23 US-Gambling (Article 22.6), para. 4.27.
42. In its submission, Brazil characterizes this as a “plausibility” standard, but this interpretation does not fully reflect the arbitrator’s words. In addition to the requirement of plausibility, the standard includes requirements of objectivity and of necessary factual support. The complaining party must have “considered the necessary facts objectively” and drawn a plausible conclusion with regard to cross-sectoral or cross-agreement suspension of concessions “on the basis of these facts.”

43. Moreover, there is a strong preference in the DSU for suspension of concessions within the same sector and agreement. The hierarchy of Article 22.3, which was followed by the arbitrator in US-Gambling, reflects this. Members must first seek to suspend concessions in the same sector and agreement, and it is only as an exception to that general rule that Members may suspend concessions under other covered agreements. Deviation from the general rule requires that it would not be practicable or effective to stay in the same sector and agreement, and departing from suspension of concessions under the same agreement also requires that the circumstances are serious enough. Additional factors under Article 22.3(d) apply for parts (a)-(c) of Article 22.3.

44. Several other aspects of the US-Gambling award should be noted in considering how to approach Brazil’s request. These include:

(a) The arbitrator was correct to assess the amount (level) of suspension before conducting the analysis under Article 22.3. This is essential, because the amount of countermeasures/suspension of concessions is the key determinant of whether concessions or other obligations may be suspended under other agreements or in other sectors.

(b) The arbitrator properly observed that for the purpose of determining whether suspension of concessions outside the sector where the breach were found are necessary in order to be practical and effective, it is appropriate to take into account all of the trade in that sector.

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24 Written Submission of Brazil, para. 505.

25 US-Gambling (Article 22.6), para. 4.27 (emphasis added).

26 EC-Bananas III (Article 22.6), para. 3.7, stating that cross-agreement and cross-sectoral suspension of concessions should be exceptional.

27 US-Gambling (Article 22.6), para. 4.24.

28 US-Gambling (Article 22.6), para. 4.34.
c) With regard to the requirement that the circumstances be serious enough, the arbitrator observed that the analysis may vary from case to case. It then pointed to several different issues with respect to Antigua, including limited resources, lack of arable land, lack of economic diversity, small population, small trade volume, small GDP, and large economic disparity compared with the United States. On each of these issues, Brazil is in a significantly different situation than Antigua, and this should be reflected in the Arbitrators’ awards.

45. Similarly, although the United States concurs that trade volumes and trade impact may be relevant to an analysis of the factors under Article 22.3(d), the difference between Brazil and Antigua is so significant that it is difficult to assess how the arbitrators in *US-Gambling* might have decided if Brazil, not Antigua, had been requesting cross-sectoral suspension of concessions in that dispute.

9. Assuming, for the sake of argument, that Article 22.3 of the DSU is applicable to Brazil’s requests to take countermeasures under the GATS and the TRIPS Agreement, please clarify whether the Arbitrator should undertake a single assessment, or separate assessments, in relation to the countermeasures relating to the actionable and prohibited subsidies at issue? In particular, please clarify in this context whether the level of countermeasures to be taken into account in the assessment(s) should be the cumulated level covering both aspects or the level corresponding to each type of subsidy separately.

46. As discussed in the answer to question 2(b), the United States believes that there should be two separate awards to reflect the two separate arbitration proceedings. Similarly, separate assessment of Brazil’s requests for countermeasures under the GATS and the TRIPS Agreements would be needed to reflect Brazil’s two separate requests for cross-agreement suspension of concessions under DSU Article 22.3.

47. More specifically, the United States believes that the Arbitrators should undertake a separate analysis of the countermeasures under TRIPS and GATS for prohibited subsidies and for actionable subsidies. Not doing so would add confusion to the issues in the two separate proceedings that could create additional problems once countermeasures, if authorized, are imposed. For example, if Brazil chose to impose countermeasures for an amount less than the total for one of the arbitrations, would it be permitted to suspend concessions under TRIPS or GATS at that level? Or, would such cross-agreement countermeasures only be permitted if the

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29 *US-Gambling (Article 22.6)*, para. 4.108.

30 *US-Gambling (Article 22.6)*, paras. 4.109-4.110.

31 See Exhibit US-110 and U.S. response to Question 68.

32 *US-Gambling (Article 22.6)*, paras. 4.62-63, 4.103.
amount were higher? To take another possible example, if the United States withdrew one of the subsidies (e.g., marketing loan payments) but the other subsidies remained unchanged, would Brazil still be authorized to suspend concessions under other Agreements? And if so, for what amount?

48. The United States recognizes that the Arbitrator in each proceeding may consider the circumstances of one proceeding relevant to the award in the other proceeding. Consequently, the Arbitrator in one proceeding may take notice of the amount of countermeasures awarded in the other proceeding in determining if the total of the two proceedings together would justify suspending concessions under another sector or agreement. At the same time, a cumulative analysis alone will not clearly express the tasks assigned to the Arbitrators nor be helpful for resolving the dispute. In particular, a clear, separate analysis of each subsidy for the purposes of determining whether Brazil may suspend concessions under Article 22.3 would be most helpful, avoid additional concern between the parties, and would mitigate the confusion that could result from the scenarios in these examples. It would be most appropriate for the Arbitrator in each proceeding to define as closely as possible the countermeasures associated with each type of measure (e.g., marketing loan payment vs. countercyclical payment). Such an analysis and explanation may well help in implementation, and the United States respectfully requests each Arbitrator to frame its award accordingly.

Questions to the United States

(general)

41. Please clarify whether you agree that the burden rests on the United States to demonstrate that the countermeasures proposed by Brazil are not "appropriate" within the meaning of Articles 4.10 and 4.11 of the SCM Agreement and are not "commensurate with the adverse effects determined to exist" within the meaning of Article 7.9 of the SCM Agreement.

49. Yes, the United States agrees. The United States is challenging Brazil’s proposed countermeasures in these arbitrations, and so has shown that Brazil’s proposed countermeasures are not appropriate (with respect to prohibited subsidies) and not “commensurate with the degree and nature of the adverse effects determined to exist” (for actionable subsidies).

(a) In section II.A of the U.S. submission, the United States detailed the correct methodology for assessing the amount of the subsidy in this dispute, based on net cost to government,
United States – Subsidies on Upland Cotton: Arbitrations Under U.S. Responses to Arbitrators’ Questions
Article 22.6 of the DSU and Articles 4.11 and 7.10 of the SCM Agreement
February 13, 2009 – Page 19

and showed that the appropriate countermeasures would be zero, as the guarantees are demonstrably provided at no net cost to government.

(b) In section II.B, the United States explained how the number offered by Brazil – US$1.294 billion – had been inflated by Brazil’s methodology, making it plainly disproportionate with the appropriate level of countermeasures presented by the United States. Brazil has corrected some of the most egregious errors and shaved the number to US$155 billion, but this is still by far disproportionate with the correct calculation.

(c) In Section III of the U.S. submission, the United States explained that, because there are no findings of non-compliance with respect to Step 2, there is no basis for countermeasures at all. In other words, countermeasures at any level could not be appropriate.

(d) In Section IV of the U.S. submission, the United States explained the various legal and methodological flaws in Brazil’s approach, showing that the correct measure of the effects determined to exist were $30.4 million, and so any number at or above that figure – such as Brazil’s proposed $1.037 billion – would not be commensurate with the nature and degree of the adverse effects determined to exist under Article 7.9 of the SCM Agreement.

(e) In Section V of the U.S. submission, the United States disputed Brazil’s minimal – three paragraph – presentation regarding proposed countermeasures under TRIPS and GATS, showing the substantial amount of trade in goods that Brazil has with which to suspend concessions, should this be authorized. (Brazil presented longer arguments in its first submission, which the United States may now address (e.g., in the response to Question 68).

50. While the burden is on the United States, as the party challenging the proposed countermeasure, to show that Brazil’s proposals do not meet the applicable legal standard, Brazil is obligated to provide the evidence to support the facts it advances in support of its arguments and to provide the relevant facts needed for the Arbitrators to fulfil their mandates. Brazil’s presentation is deficient.

51. In several instances, Brazil’s response to the U.S. critiques is to protest that it has used the best information publicly available. But if the evidence in support of Brazil’s methodology is not sufficient, it would not become “sufficient” simply because other information was not available. For example, even supposing that, notwithstanding the ample time that Brazil had to prepare the methodology paper, it was not possible to locate better information with respect to GSM 102, Brazil was not compelled to use the methodology it chose with the derived

34 US-FSC (Article 22.6); para. 2.11, Brazil-Aircraft (Article 22.6), para. 2.9; Canada-Aircraft II (Article 22.6), para. 2.8.
parameters. Brazil could have advanced a different methodology, or could have used different sources of information.\(^{35}\)

52. Instead, Brazil set forth a methodology without sufficient evidentiary support. For example, its methodology provides no evidentiary support for several of the assumptions in the model, including the idea that the transactions concerning the obligors it deems “uncreditworthy” would not have occurred without GSM 102 guarantees. Such problems, along with the other flaws detailed in the United States submission, demonstrate that even if Brazil has submitted a methodology and some evidence, it has not met its burden if the evidence does not support the methodology it proposes.

42. Please confirm whether, in paragraph 7 of your Written Submission in fine, the terms “less 30.4” should be read as “less than US$ 30.4 million”.

53. Yes, in paragraph 7 of the United States Written Submission, the terms “less than 30.4” should be read as “less than US$30.4 million.”

54. The United States also would like to confirm that in paragraph 308 of its submission, the second sentence should begin “They range from about US$758 million to about US$269 million . . . .” The numbers are correct in Table 11, which accompanies paragraph 308.

(proposed countermeasures for prohibited subsidies – GSM 102)

43. Please clarify what, in your view, constitutes "appropriate countermeasures" within the meaning of Article 4.10 of the SCM Agreement. Please clarify in particular:

(a) why you consider that the countermeasures should be "appropriate to the findings made" (para. 16 of your Written Submission) or "appropriate to the prohibited subsidy finding of the panel" and whether this constitutes, in your view, the applicable standard for the calculation of countermeasures under Article 4.10 generally. What does it mean in practice?

(b) whether you consider that the basis for assessing what constitutes "appropriate countermeasures" varies from case to case depending on "the specific circumstances of the case" (see para. 25 of your Written Submission);

(c) whether you consider that this standard requires or implies that "appropriate countermeasures" may reflect the amount of the subsidy, the trade effects of the measure on the complainant, or something else;

\(^{35}\)For example, Brazil could have made use of some of the sources from the readily-available scholarly literature, as discussed in the response to question 51.
(d) what parameters or considerations are generally relevant to an assessment of the "appropriateness" of proposed countermeasures, and in particular to an assessment of whether the proposed countermeasures would be "disproportionate" within the meaning of footnote 9;

(e) why you consider that a calculation based on the "benefits from GSM 102 ECGs", as defined in Brazil's Methodology Paper and Written Submission, (independently of whether Brazil's actual calculation of these benefits is correct or not) would not lead to "appropriate countermeasures";

See para. 74 of Brasil’s Written Submission

55. The applicable standard for calculation of countermeasures under Article 4.10 is found in the text of Article 4.10, including footnote 9. That is, countermeasures must be “appropriate” and “not disproportionate.” The choice of the term “appropriate” (as opposed to “equivalent”) does indicate a less strict numerical relationship between the countermeasures and the subsidy with respect to which they are being assessed. But the caveat that the countermeasures cannot be disproportionate – set out plainly in the footnote – shows that there is a limitation on possible countermeasures. As footnotes 9 and 10 explain, “appropriate countermeasures” cannot be “disproportionate” in light of the fact that the subsidies dealt with are prohibited – in other words, it is not just the adverse effects caused by the subsidies that are of concern, as it is under Article 7. Rather, the subsidies themselves are of concern. In this dispute, the “subsidy” is defined in relation to the cost to the government of the GSM 102 guarantees.

56. Brazil goes too far to suggest that “appropriate” countermeasures would simply be “reasonable” countermeasures – the negotiators of the SCM Agreement chose the term “appropriate” and not “reasonable.” Brazil also goes too far in arguing that the term “countermeasures” implies a focus on inducing compliance. If the question were inducing compliance alone, one might argue that the higher or closer to infinity the measure, the more likely to induce compliance. Rather the “countermeasures” are to “counter” the inconsistency with the SCM Agreement. The measures would “counter” that inconsistency by offsetting it. The definitions of the term “counter” include: “tending in the opposite direction; duplicate, serving as a check” and “answer with a countermove; counterbalance.” These definitions include the concept of “balance” or “duplicate” – the appropriate “countermeasure” would thus appear to be one appropriate to balance out the inconsistency or duplicate the loss of concessions resulting from the breach.

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36 Written Submission of Brazil, paras. 31 and 43.

37 The New Shorter Oxford English Dictionary, 1993. Counter: “Acting in opposition; lying or tending in the opposite direction; opposed, opposite; duplicate, serving as a check” and “Act or speak against; contradict, oppose; answer with a countermove; counterbalance.”
57. In practice, applying the standard requires examining what the proposed countermeasures must be compared to, or assessed with respect to. As the United States has explained, in its context in the SCM Agreement, the term “countermeasure” means that the countermeasure is compared or assessed with respect to the inconsistency with the WTO Agreement, since it is that inconsistency that the “measure” is to “counter.” In light of the compliance recommendations and rulings, the best approach for GSM 102 guarantees is to start from the amount of the subsidy (as measured by net cost to government) and make certain adjustments to reflect the impact of the subsidy on Brazil. This is the best approach because it reflects the specific circumstances before the Arbitrator, and the specific circumstances may affect the interpretation of what is “appropriate” for a particular dispute. Prior arbitrators have recognized this. For example, in Canada-Aircraft, the arbitrator stated that it was “authorized to consider the relevant factors constituting a totality of the circumstances at hand” in order to determine what was “appropriate.” In doing so, it expressed agreement with the arbitrator in US-FSC that “countermeasures should be adapted to the particular case at hand.”

58. Consequently, the compliance recommendations and rulings are critical for determining what is “appropriate” in the circumstances of this dispute, whether described as the “findings made” or the “prohibited subsidy finding of the panel.” (With respect to Article 4.10, which only applies to prohibited subsidies, any findings would be “prohibited subsidy findings.”) In this particular dispute, where the DSB found that GSM 102 export credit guarantees constitute an “export subsidy” because they are provided against premia which are inadequate to cover the U.S. government’s operating costs and losses under the terms of item(j) of the illustrative list, a calculation of the amount of the subsidy based on net cost to government is the correct measure of the subsidy. An adjustment for the impact on Brazil, as described in the response to Question 45, will allow the Arbitrator to determine “appropriate” countermeasures. This approach is based on both “amount of the subsidy” and “trade effects.”

59. In terms of other considerations, countermeasures that are punitive, not supported by evidence, or not supported by the findings of the panel plainly would be disproportionate.

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38 Canada-Aircraft II (Article 22.6), para. 3.37.

39 Canada-Aircraft II (Article 22.6), para. 3.37 (quoting US-FSC (Article 22.6), para. 5.12).

40 Past arbitrations on prohibited subsidies have also used an approach based on the amount of the subsidy, but in each case the Arbitrators explored different ways to calculate the “amount of the subsidy.” Brazil-Aircraft (Article 22.6); Canada-Aircraft II (Article 22.6), US-FSC (Article 22.6).
60. Several of the factors Brazil relies upon for determining “appropriate” countermeasures should not be relied upon in this case.\textsuperscript{41} First, to the extent Brazil would rely on the prohibited nature of the subsidy as a consideration, it is important to recall that the prohibited nature of the subsidy is already accounted for by the fact that a special or additional rule applies, a rule that distinguishes prohibited subsidies from actionable subsidies (\textit{i.e.}, the subsidy itself is prohibited in its entirety rather than just to the extent it causes adverse effects). Specifically, the standard for assessing the proposed countermeasures is unique to prohibited subsidies, requiring that countermeasures be “appropriate” and “not disproportionate.” Thus, it is not necessary to rely upon the “prohibited” nature of a subsidy in itself to determine countermeasures. Similarly, the fact that the subsidy continues to exist should not be a parameter. If the subsidy has been withdrawn, there would be no need for countermeasures at all, and so such a consideration would not add to the analysis. The fact that Brazil has characteristics of a developing country also is not relevant here – this approach would result in different levels of countermeasures as appropriate depending on who brings a dispute, which would not have a relationship to the compliance recommendations and rulings or “counter” the inconsistency.

61. Finally, to respond to part (e) of the Arbitrator’s question, “appropriate” countermeasures in the circumstances of this dispute preclude Brazil’s approach. Brazil’s methodology cumulates, without sufficient evidence, multiple alleged “benefits” (supposed interest rate subsidy and additional trade resulting from the purported interest rate subsidy). This collection of benefits is speculative, and (particularly in light of the lack of evidence on additionality and pass through) it is not at all clear these are results of the “wrongful act” of the United States in providing the subsidy. By contrast, the cost to the United States government of providing the GSM 102 guarantees directly assesses the measure of the United States that has resulted in findings of inconsistency and is based on the DSB compliance recommendations and rulings.

62. An assessment of “appropriate” countermeasures should relate to the breach of WTO commitments (that is, providing the subsidy).\textsuperscript{42} In \textit{Canada-Aircraft}, the Arbitrator rejected the proposal to include alleged lost sales, and instead determined the amount of the subsidy based on a calculation of the difference in payment streams due to the subsidy for existing contracts,\textsuperscript{43} rejecting an approach that would have used estimates on lost sales and full loan amounts. Although not under Article 4.10 of the SCM Agreement, it is worth noting that in \textit{United States-Gambling}, the arbitrator rejected the use of a “multiplier” that would add the value of other economic effects to the value of the nullification or impairment.\textsuperscript{44} \textsuperscript{41} Written Submission of Brazil, paras. 36-38. \textsuperscript{42} \textit{US-FSC (Article 22.6)}, para. 6.31. \textsuperscript{43} \textit{Canada-Aircraft II (Article 22.6)}, para. 3.63. \textsuperscript{44} \textit{US-Gambling (Article 22.6)}, para. 3.123.
63. The difficulty of using Brazil’s approach is underscored by the gaps in evidentiary support for the essential assumptions in its methodology. This is not surprising, given the complexity of the operation of the guarantees, but nonetheless shows that Brazil’s approach is not appropriate in the circumstances. Particularly for measures that affect many different economic actors (banks, farmers, brokers) and a broad set of products, it is impractical to undertake the kind of analysis that would be necessary to measure “benefit” accurately enough that any countermeasures authorized would not be disproportionate.

44. In paragraph 16 of your Written Submission, you indicate that the DSB’s recommendations and rulings in this case are based only on findings that the United States conferred export subsidies via GSM 102 because the program operated at a net cost to the US Government. You also note in the same paragraph that appropriate countermeasures should be “tightly tied to the specific standard underlying the findings adopted by the DSB”. Finally, you state that “the GSM 102 operates at no net cost to government” (emphasis added). Please clarify how your analysis takes into account the analysis by the Appellate Body in paras. 301 to 321 of its report, and its conclusion, in light of these elements, that the panel had not erred in finding 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” (para. 322 of the Appellate Body 21.5 report and the preceding analysis in paras. 301 to 321 of the report).

64. The finding that the GSM 102 guarantees confer an export subsidy was made solely “by applying the standard set out in item (j) of the Illustrative List” of Export Subsidies. The DSB’s recommendations and rulings are therefore based only on findings that the United States conferred export subsidies via the GSM 102 guarantees because they operated at a net cost to the U.S. Government, i.e., that the premiums charged were inadequate to cover the long-term operating costs and losses. The original and compliance panels both declined Brazil’s request to make findings based on some alternative theory of why these subsidies were financial contributions that provide a benefit based on export performance. Consequently, the appropriate basis on which to evaluate countermeasures is the extent to which, if at all, such premia are or are not adequate to meet such costs.

65. To that end, in its Written Submission, the United States provided extensive evidence that as from July 1, 2005, the GSM 102 program operates at no net cost to the U.S. Government.


47 The findings of the compliance panel are specifically limited in time to “export credit guarantees issued after 1 July 2005". US-Upland Cotton (Article 21.5), para. 15.1(c).
This is principally based on the most recent U.S. Government subsidy re-estimate data, which the Appellate Body has characterized as “‘compelling’ evidence as to what one should anticipate under the revised GSM 102 program.”

66. As noted in paragraph 301 of the Appellate Body report, two competing versions of “critical quantitative data” were submitted to the compliance panel on the question whether premiums charged under the GSM 102 program were adequate or inadequate to cover long-term operating costs and losses of that program. On the one hand, the United States had submitted to the compliance panel its re-estimate data, as of the 2008 U.S. budget, for cohorts 1992-2006. On the other hand, Brazil submitted “the CCC’s Financial Statements [to] indicate the program is making losses.”

67. Quantitatively, therefore, the competing critical data, as alleged by the respective proponents, were profit of $403 million versus losses of “$220 million with respect to post-1991 guarantees that were outstanding as of 30 September 2006.”

68. The Appellate Body observed that “the critical quantitative data before the Panel give rise to conflicting conclusions. The data also give rise to similar probabilities that point to opposite conclusions as to the binary outcome in item (j).” They examined other evidence to discern, in light of the competing quantitative data, whether “it is more likely than not that the revised GSM 102 program operates at a loss.” It is the propriety of such additional examination that the Appellate Body discusses and analyzes in paragraphs 302-321. Such analysis extended, however, solely to the question of whether – and not the extent to which – GSM 102 conferred an export subsidy, and had only “a supplementary role to play in an assessment conducted under item (j).” The primary evidence remained the quantitative data: “We stated our view that the

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48 U.S. Written Submission, paras. 47-54 and Table 1 therein.


51 US-Upland Cotton (Article 21.5) (AB), para. 300.

52 US-Upland Cotton (Article 21.5) (AB), para. 301.


analysis under item (j) should proceed primarily on the basis of quantitative evidence, where such evidence is available."

69. Ultimately, the compliance panel found that “the GSM 102 export credit guarantee program constitutes an export subsidy” under item (j), and that panel “did not err in [so] finding.”

70. Such supplementary analysis for purposes of the question of whether the GSM 102 program confers an export subsidy is distinct, however, from the exercise before the Arbitrators. The exercise before the Arbitrators is to determine the appropriate amount of countermeasures. The critical quantitative data forming the primary basis for the determination under item (j) is therefore the relevant data.

71. Brazil alleged to the compliance panel that the GSM 102 program suffered, over a 15-year period, losses of “$220 million with respect to post-1991 guarantees that were outstanding as of 30 September 2006.” Over a 15-year period, that would constitute approximately $14.7 million per year.

72. Although the Appellate Body affirmed the determination of the panel that the GSM 102 program conferred an export subsidy, it specifically criticized the compliance panel’s dismissal of the importance of the re-estimate data, noting “we consider that the re-estimates data, which show better-than-expected historical performance, are an important indicator of the revised GSM 102 program’s likely future performance.” Accordingly, in light of that history and as the Arbitrators are assessing the level of appropriate countermeasures to impose, the United States offers the re-estimates data as of the 2009 budget, which includes one more year of data than that before the compliance panel and includes further information on the actual, positive financial performance of the same guarantees /cohorts that were considered by the compliance panel.


56 US-Upland Cotton (Article 21.5) (AB), para. 322. Contrary to Brazil’s suggestion that “the United States now appear to call into question the DSB’s recommendations and rulings [by] referring to the revised GSM 102 program as an ‘alleged subsidy,’” it is clear in context that the United States was referring to the alleged amount on which to base countermeasures. Compare, Written Submission of Brazil, para. 94, with U.S. Written Submission, para. 107.

57 US-Upland Cotton (Article 21.5) (AB), para. 300.

58 US-Upland Cotton (Article 21.5) (AB), paras. 295, 448(b)(i).

59 US-Upland Cotton (Article 21.5) (AB), para. 299.
45. Please explain the relationship between your statement that "the appropriate countermeasures are those based on the net cost to the US government" (para. 25 of your Written Submission) and your statement that "Brazil may only take such countermeasures with respect to the impact of the alleged subsidy on itself" (para. 107 of your Written Submission) (emphases added). Please clarify in this context:

(a) whether you consider that it is the cost to government of the subsidy or its impact on the Member seeking an authorization to take countermeasures (or something else) that should be the basis for determining the level of the countermeasures;

(b) how apportioning a portion of the amount of the subsidy to Brazil would reflect the impact of the subsidy on Brazil;

(c) how the net cost to government, but excluding the two elements identified in para. 108 of your Written Submission, would reflect the impact of the subsidy on Brazil; and

(d) how exactly you propose to apportion the amount of the subsidy to reflect only the "the impact" of the subsidy on Brazil.

73. In this dispute, given that item (j) of the illustrative list is the sole basis for the findings with respect to GSM 102, along with the complexity of the operation of the guarantees (multiple parties concerned, difficulty in determining effects), the Arbitrator should use the net cost to government of the subsidy as the basis for its analysis of what “appropriate” countermeasures would be. At the same time, the net cost to government represents the entire amount of the subsidy, and using the entire amount would be disproportionate. It would treat the GSM 102 program as if it affected only Brazil, and as if – notwithstanding Brazilian banks’ use of the guarantees – all effects on Brazil are negative. Therefore, an adjustment must be made to take into account the impact of the subsidy on Brazil. The ideas of cost to government and impact on the Member are not mutually exclusive. To the contrary, they are two sequential steps in the analysis.

74. The methodology for net cost to the government, as noted above, results in a calculation of the full amount of the subsidy. It does not separate individual “country-specific” costs to the United States or subsidy effects. So, reducing the possible countermeasures from the full amount of the subsidy to the impact on Brazil requires a different, complementary approach. In terms of how this reflects the impact on Brazil, the goal is to consider what countermeasure is appropriate with respect to the breach of Brazil’s rights. No other Member was a party to this dispute, the DSB recommendations and rulings govern only the United States and Brazil, and Brazil is not entitled to seek to enforce the rights of other Members. Indeed, the Arbitrator is not tasked with either enforcing nor affecting the rights of other Members.

75. In paragraph 108 of its submission, the United States stated that two items should be adjusted for out of the full amount of the GSM 102 subsidy, in order to correctly account for the
impact on Brazil: (1) Brazilian bank participation; and (2) Brazilian producers’ interests in GSM 102 guarantees. Together, these relate to the guarantees under the program, the agricultural products exported under loans guaranteed under the program – and Brazil’s relationship to both. The participation of Brazil’s banks should be excluded because this is participation Brazil elects to do, which banks may benefit from. In other words, Brazil is not entitled to a countermeasure for a subsidy to Brazil. Indeed, the United States would be surprised to learn that Brazil is complaining about subsidies from which Brazil benefits. Similarly, Brazilian producers’ interests must be taken account of to reflect any subsidy to Brazil. In addition, the analysis of appropriate countermeasures should take into account how Brazil is affected compared to other Members, so that the calculation of proposed countermeasures will not be erga omnes. The percentage of Brazil’s trade in agricultural goods is a reasonable proxy for this.

76. The relevant data is as follows:

Table 2, Brazilian Bank Participation, GSM 102

<table>
<thead>
<tr>
<th>Program Year</th>
<th>Registration Guarantee Value</th>
<th>Percent of Program</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>$810,615,021</td>
<td>28.15%</td>
</tr>
<tr>
<td>2005</td>
<td>$253,738,537</td>
<td>11.69%</td>
</tr>
<tr>
<td>2006</td>
<td>$76,137,700</td>
<td>5.60%</td>
</tr>
<tr>
<td>2007</td>
<td>$161,214,923</td>
<td>10.85%</td>
</tr>
<tr>
<td>2008</td>
<td>$696,985,271</td>
<td>22.86%</td>
</tr>
</tbody>
</table>

Table 3, Brazil Share in Agriculture Trade:

<table>
<thead>
<tr>
<th>Brazil’s Share of World Agricultural Exports Excluding the U.S. Market 2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil’s agricultural exports to world</td>
</tr>
<tr>
<td>Brazil’s agricultural exports to the United States</td>
</tr>
<tr>
<td>Brazil’s agricultural exports to world excluding U.S. market</td>
</tr>
</tbody>
</table>

60 Note that Brazilian banks may be involved in transactions not involving imports to Brazil.

61 Note, Brazil’s share of world agricultural production, excluding the United States, was 3.7% in 2007.
77. Using this data, the Arbitrator could apportion the amount of the subsidy in two steps. First, the amount of the subsidy would be multiplied by the percentage of participation excluding Brazilian banks (e.g., 94.4% for 2006). Second, that product would be multiplied by Brazil’s share of world agriculture exports (4.9%).

46. Could the United States provide details of how the net present value of loan guarantees under the GSM 102 program in FY 2006 were calculated, including whether it used the Ohlin formula or some version thereof, and please describe the parameter values used.

78. The net present value of loan guarantees were calculated in accordance with the requirements of the United States Office of Management and Budget (OMB). OMB Circular A-11 (2008)\textsuperscript{62} in section 185.2 provides:

> “The subsidy cost is the estimated present value of the cash flows from the Government (excluding administrative expenses) less the estimated present value of the cash flows to the Government resulting from a direct loan or loan guarantee, discounted to the time when the loan is disbursed. The cash flows are the contractual cash flows adjusted for expected deviations from the contract terms (delinquencies, defaults, prepayments, and other factors). Present values must be calculated using the OMB Credit Subsidy Calculator 2. The OMB Credit Subsidy Calculator 2 discounts the cash flow that is estimated for each year (or other time period) using the interest rate on a marketable zero-coupon Treasury security with the same maturity from the date of disbursement as that cash flow. A

\textsuperscript{62} Exhibit US-8.
positive net present value means that the Government is extending a subsidy to borrowers; a negative present value means that the credit program generates a "profit" (excluding administrative costs) to the Government.”

79. Section 185.6 further provides a definition of discount rates, which also elaborates the discounting function used for present value purposes.

“(g) Discount rates mean the collection of interest rates that are used to calculate the present value of the cash flows that are estimated over a period of years. The discount rates are based on the Treasury rates in the economic assumptions for the budget year. For loans made, guaranteed, or modified in FY 2001 and thereafter, the cash flow estimated for each year (or other time period) is discounted using the interest rate on a marketable zero-coupon Treasury security with the same maturity from the date of disbursement as that cash flow. The discount rate assumptions for the budget will be provided by OMB in a file for use with the OMB Credit Subsidy Calculator 2. The rate at which interest will be paid on the amounts borrowed or held as an uninvested balance by a financing account for a particular cohort is a disbursement-weighted average discount rate (for cohorts before 2001) or single effective rate (for cohorts 2001 and after) derived from this collection of interest rates. Actual interest income or expense for financing accounts must be calculated with the OMB Credit Subsidy Calculator 2.”

80. Each cash flow is discounted using the interest rate on a zero-coupon Treasury security with the same maturity as that cash flow, regardless of the term of the loan. Cash flows that would occur exactly at the end of one year are discounted using the interest rate on a Treasury zero that would mature in exactly one year. Cash flows expected at the middle of the third year are discounted using the interest rate on a Treasury zero that would mature in three and one-half years. The basket-of-zeros method defines the present value of any collection of future cash flows as the market price of a collection (or “basket”) of Treasury zeros that, at maturity, exactly matches the cash flows. The formula employed is not specifically the Ohlin formula. The present value of the cash flow observations is computed by summing the products of the observation for a particular frequency (f), timing (t), and period (n) by the present value factor for the same frequency, timing, and period.:

\[
\text{Present value} = (X_{ft1} \times P_{ft1}) + (X_{ft2} \times P_{ft2}) + \ldots + (X_{ftn} \times P_{ftn})
\]

81. The present value, in this computation, is the market price of a collection of zero coupon bonds that, at maturity, exactly match the amounts and maturities of the cash flow observations; hence, the term “basket-of-zeros.”

\[63\] See, Exhibit US-76, p. 61. Although this guide is stamped “draft,” it is the current operational user guide.
47. The United States claims that, when re-estimates are taken into account, this always acts to reduce the initially-estimated budget cost of export credit guarantees, and thus that its initial estimates of the budget cost of these guarantees are always too high. Could the United States explain the reasons, including any specific methodologies required under the Federal Credit reform system, which mean that it persistently overestimates the initial budget cost of these guarantees?

82. The fact that the initial subsidy estimates consistently overestimate budget costs of GSM 102 guarantees has been an issue before the decisionmakers throughout the Cotton proceedings. Even Brazil has repeatedly acknowledged that in the U.S. budget “original estimates were too high.”

83. First, the initial subsidy estimates published in the U.S. Government budget are calculated before any use is made of the export credit guarantee program in the year for which the estimate is made and are based on historically overly-optimistic projection of the actual use of the program. These overly optimistic projections are not required under the Federal Credit reform system, and CCC is revising its approach in order to employ more realistic projections.

84. More significantly, however, one specific methodology required under the Federal Credit reform system contributes materially to the unduly high initial estimates. Through publication of the fiscal year 2008 budget, CCC, in establishing the initial estimates, has been required 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.

85. The U.S. Office of Management and Budget (OMB) provides all federal government agencies that extend international credit with “expected loss rates,” which are composed of default and recovery assumptions, key components of calculated subsidy costs. OMB also provides the discount rates that are used to calculate initial subsidy estimates. This heretofore mandated methodology continues to make certain assumptions that are not consistent with CCC’s experience in the GSM 102 program.

86. Each sovereign borrower or guarantor is rated on an 11 category scale, ranging from A through F- (or their numerical counterparts, categories 1-11) (the Interagency Country Risk Assessment System or “ICRAS” rating). OMB is responsible for determining the expected loss

\[\text{\textsuperscript{64}\text{Second Oral Statement of Brazil (7 October 2003), para. 70 (original panel); Brazil’s Comments on U.S. Rebuttal Submission (27 August 2003), para. 60 (original panel).}}\]

\[\text{\textsuperscript{65}\text{US-Upland Cotton (Article 21.5) (AB), para. 298.}}\]

\[\text{\textsuperscript{66}\text{See, US-Upland Cotton (Article 21.5) (Panel), paras. 14.66, 14.72; U.S. First Written Submission to the Compliance Panel, paras. 100-104; U.S. Rebuttal Submission to the Compliance Panel, paras. 108-126.}}\]
rates associated with each ICRAS risk rating and maturity level. 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 U.S. Government would recover in the event of default. Such assumption are very conservative. For the GSM 102 program, however, no country below a certain ICRAS rating is eligible for the program 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 GSM 102 program. The assumed recovery rate is a key driver of the expected loss rates and generate a subsidy rate that CCC and every other U.S. Government international credit agency must apply. This one-size-fits-all approach largely explains the continuing presence of a positive original subsidy estimate for the GSM 102 program for the fiscal year 2006 and 2007 cohorts.

87. CCC has asked OMB for permission to prepare estimates based on the experience of the GSM 102 program. For the fiscal year 2009 cohort, OMB has allowed CCC to use GSM 102 program-specific assumptions for recovery rates in lieu of OMB assumptions for recovery rates. However, OMB continues to require CCC to use ICRAS ratings and the OMB methodology for default rates incorporated in the development of initial subsidy estimates.

48. If the GSM 102 programme has operated, over a long term period, at no net cost, it raises the question why the US deems it necessary to introduce a government-backed programme of export credit guarantees when private commercial banks would apparently have found this business profitable. Is the no net cost standard obtained because funds are supplied to the programme at government borrowing rates (which are inevitably lower than the cost of funds to the private sector) and without taking into account the need for a return on capital which the private sector would demand?

88. Worldwide, there are very many government-backed export credit agencies that provide loans, insurance, or guarantees, where one or more private sector actors may be engaged in similar lines of business for profit. A government role in such activities is well-recognized. In fact, given the current reluctance of certain private financial actors to enter into profitable activities, the Director-General of the WTO and numerous other officials and governments have explicitly called on governments to increase their trade finance activities.

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67 For the GSM-102 program, no country below ICRAS rating [ ] is eligible. U.S. Rebuttal Submission to the Compliance Panel, para. 119.

68 See Upland Cotton (Article 21.5) (Panel), para. 14.72 and fn. 675; U.S. Rebuttal Submission, paras. 108 ff; Exhibit US-113 (submitted as Exhibit US-73 to the Compliance Panel); see also U.S. Further Submission (30 September 2003), para. 147; U.S. Answer to Original Panel Question 221(g) (22 December 2003); U.S. Further Rebuttal Submission (18 November 2003), para. 196; U.S. Closing Statement at Second Panel Meeting (3 December 2003), para. 10.
89. As the OECD Working Party on Export Credits and Credit Guarantees has stated as recently as November 24, 2008: “Official export credit support and finance play an enhanced key role in counterbalancing instability in periods of economic uncertainty and risk-averse behaviors of economic players, by helping to fill the gap where market capacities are temporarily limited.” In that statement, OECD participants and other non-member economies, including Brazil, pledged continued export credit support for international trade deals for emerging and developing economies to retain access to financing for imports in the present financial crisis. Similarly, at the 11th Annual Consultation Meeting between OECD Export Credit Committees on November 18, 2008, representatives from civil society organizations “agreed that there was a lack of cross border finance and that this was damaging to international trade flows.”

90. Brazil’s argument in this arbitration, however, would treat as a prohibited export subsidy any offer by an export credit agency of financing terms more favorable than those offered by such “risk-averse economic players,” notwithstanding its salutary effect of counterbalancing instability and promoting cross border finance and international trade flows.

91. Furthermore, as a general matter, and independent of the context of the acute economic exigencies giving rise the OECD statement, the question appears to equate a cost to government standard with market-based pricing. Market valuation of risk, and therefore its appetite to take it, oscillates over time. Over the long term, the market will price the exact same risk differently depending on a variety of factors, such as market liquidity and perceptions of political risk. Export credit agencies take up the business when the private market withdraws. International agreements, like the WTO SCM Agreement or the OECD Arrangement on Export Credits, recognize this and have adopted particular parameters under which governments may undertake such activities as the provision of export credits. However, the no net cost standard is an issue of accounting and not market-pricing, and the question appears not to recognize such distinction.

92. In response to the specific question of the Arbitrator, the United States observes that the consistently solid performance of debt reschedulings provides an obvious explanation for the profitability of the program in the long-term. The Arbitrator will recall the April 2, 2007, U.S. Answer to Panel Question 102 (at paragraph 242) and the accompanying Table 2:

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

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69 “Major exporters pledge ongoing credit support for developing country imports,” Export credits and the financial crisis - Statement by the OECD Working Party on Export Credits and Credit Guarantees, 24 November 2008, available at http://www.oecd.org/documentprint/0,3455,en_2649_37431_41723702_1_1_1_1,00.html.

70 11th Annual Consultation Meeting between OECD Export Credit Committees, 18 November 2008, available at http://www.oecd.org/documentprint/0,3455,en_2649_34199_41761105_1_1_1_1,00.html.
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

<table>
<thead>
<tr>
<th></th>
<th>Projected ($)</th>
<th>Actual ($)</th>
<th>Variance (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003 reestimate -- 2004 projected and actual</td>
<td>89,772,079</td>
<td>202,970,637</td>
<td>226%</td>
</tr>
<tr>
<td>2004 reestimate -- 2005 projected and actual</td>
<td>133,267,525</td>
<td>240,208,256</td>
<td>180%</td>
</tr>
<tr>
<td>2005 reestimate -- 2006 projected and actual</td>
<td>139,280,938</td>
<td>505,481,067</td>
<td>363%</td>
</tr>
</tbody>
</table>

93. The Arbitrator will recall that the re-estimate process has required CCC to use OMB-mandated assumptions about recovery rates. As a result, to the extent that actual experience of the program far exceeds the OMB assumptions about recoveries, such over-performance is readily understood.

94. To illustrate the point, the following table shows on a strictly cash basis the claims paid, amounts recovered directly, and amounts repaid under rescheduled agreements as of the end of fiscal year 2008. To be clear, these numbers do not reflect estimates, re-estimates, or net present value calculations. They simply set forth actual cash transactions attributable to the particular cohort, without regard to the specific year in which the cash transaction occurred. Total claims paid for cohorts 1992-2002 approximate $2.4 billion. Total recoveries are approximately $3.2 billion, of which approximately $2.68 billion was collected pursuant to rescheduling agreements.
### Exhibit US-8, section 185.33:

“Why do financing accounts earn interest?

The basic purpose of a guaranteed loan financing account is to accumulate funds to finance future default costs. Subsidy cost payments to the account, fees collected, and other collections are retained in the financing account as an uninvested balance and earn interest at the same rate as the discount rate used to calculate the subsidy cost. The subsidy cost payments, fees, other collections, and interest earnings will be sufficient to finance the net default costs if the initial estimate of subsidy cost is correct. In direct loan financing accounts, undisbursed Treasury borrowings earn interest at the same rate as the financing account pays on its debt owed to Treasury so that borrowing from Treasury for subsequent disbursements during the year does not have any effect on the results of operations or net financial position of the financing account.”

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### Table 4: Claims paid, amounts recovered directly, and amounts repaid under rescheduled agreements as of the end of fiscal year 2008

<table>
<thead>
<tr>
<th>Cohort</th>
<th>Claims paid</th>
<th>Recovered</th>
<th>Net Claims</th>
<th>Amounts repaid under rescheduled agreements as of 9/30/2008</th>
<th>Net claims minus total repayment under reschedulings</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Principal</td>
<td>Interest</td>
<td>Late Interest</td>
<td>Total</td>
<td></td>
</tr>
<tr>
<td>1992</td>
<td>1,338,655,002</td>
<td>480,204,436</td>
<td>858,405,634</td>
<td>995,275,191</td>
<td>630,421,711</td>
</tr>
<tr>
<td>1994</td>
<td>65,354</td>
<td>65,354</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1995</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>1996</td>
<td>101,937,764</td>
<td>101,937,764</td>
<td>0</td>
<td>9,253,426</td>
<td>50,831,518</td>
</tr>
<tr>
<td>1997</td>
<td>204,285,288</td>
<td>837,975</td>
<td>203,447,313</td>
<td>33,881,501</td>
<td>87,769,911</td>
</tr>
<tr>
<td>1999</td>
<td>13,331,041</td>
<td>5,274,885</td>
<td>8,056,156</td>
<td>5,913,669</td>
<td>1,399,671</td>
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<tr>
<td>2000</td>
<td>3,692,576</td>
<td>2,769,601</td>
<td>922,975</td>
<td>153,030</td>
<td>36,220</td>
</tr>
<tr>
<td>2001</td>
<td>218,465,991</td>
<td>218,465,991</td>
<td>0</td>
<td>131,440,171</td>
<td>25,509,409</td>
</tr>
<tr>
<td>2002</td>
<td>4,612,194</td>
<td>4,612,194</td>
<td>0</td>
<td>284,308</td>
<td>42,061</td>
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<tr>
<td>2003</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
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<tr>
<td>2004</td>
<td>16,722,709</td>
<td>2,933,036</td>
<td>13,789,673</td>
<td>0</td>
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</tr>
<tr>
<td>2005</td>
<td>0</td>
<td>0</td>
<td>0</td>
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<tr>
<td>2006</td>
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<tr>
<td>2007</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
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<tr>
<td>2008</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
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<tr>
<td>Total</td>
<td>2,403,665,870</td>
<td>532,172,531</td>
<td>1,871,493,339</td>
<td>1,592,300,774</td>
<td>1,084,341,922</td>
</tr>
</tbody>
</table>

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95. Operation of the GSM 102 program requires minimal borrowing from the U.S. Treasury. Indeed, the CCC financing account also routinely has funds on deposit with the U.S. Treasury on which it receives interest from Treasury. Rates on funds borrowed from or on deposit with the U.S. Treasury are calculated in the same way.\(^{71}\) The chart at Exhibit US-77 reflects interest paid
to or received from the U.S. Treasury in each fiscal year since 1992 in connection with the export credit guarantee programs.\textsuperscript{72}

96. One can readily see from the table reflecting interest paid and received that the profitability of the GSM-102 program is not because of preferential government borrowing rates but because of the fees charged and the strong performance of rescheduled debt.

49. \textit{Assuming, for the sake of argument, that the Arbitrator considers that the amount of prohibited export subsidies should be calculated using the net cost to government approach, why is the value of the additional exports made possible by those prohibited subsidies (leaving aside the issue of how the additional exports are to be estimated) not to be included in the amount of appropriate countermeasures?}

97. There are several problems with adding “additional exports” to an estimate of the amount of the GSM 102 subsidy for the purposes of determining appropriate countermeasures. First, the calculation of the amount of the subsidy – whether by net cost to government or based on the interest rate subsidy – is a calculation of the \textit{total} subsidy. Additions to it would exceed the total subsidy and so would be disproportionate with it.

98. Next, with respect to the possibility of additional exports, the evidence does not support the “additionality” effect Brazil has presented. It is not clear what relationship any such exports have to the subsidy. There is no indication that GSM 102 guarantees affect the equilibrium price for the commodities concerned, and in fact Brazil has specifically ruled out that possibility, and so it is not clear the guarantees could generate any additional quantity of exports on that basis. Therefore, any subsidy can be fully accounted for within existing transactions without bringing in the notion that guarantees cause exports. Brazil’s assumption that transactions by “uncreditworthy” obligors would not take place \textit{at all} is an extreme version of ignoring the fact that the evidence does not support the idea of additional U.S. exports to the detriment of Brazil or anyone else.

99. Finally, including additional exports (done properly, not as Brazil has inappropriately calculated) would require an additional level of complexity to the analysis in terms of the different parties that may be affected by GSM 102 guarantees and the different mechanisms by which they are affected. For example, a bank obligor may be a “beneficiary” of the financing; if an “interest rate subsidy” is passed-through to importers, than the importer may be a “beneficiary,” and, if additional exports are included, U.S. producers could also be a “beneficiary.” But whether – and the extent to which – any of these parties will benefit from the subsidy depends on complex issues, including the critical issue of pass-through (which Brazil simply assumes). In addition, if the subsidy – in the form of the amount passed through – is to the importer, including the benefit related to additional exports (a benefit to the exporter) would be double-counting.

\textsuperscript{72} Exhibit US-77.
50. The United States has criticised the data used by Brazil for its estimation of the annual dollar amount of GSM 102-guaranteed loans. In response Brazil has offered to apply its methodology to the "internal USDA data" that is in the possession of the United States if it agrees to disclose this or provide it to Brazil. Please provide a reply to this offer from Brazil. Would not the provision of this data remove one of the problems in the methodology identified by the United States?

100. The United States provides with these responses data for all GSM 102 transactions for the fiscal year 2006 cohort. Among other things, this data provides values and quantities for all goods subject to fiscal year 2006 GSM 102 guarantees; all obligor banks by name and the country of such obligation; and the credit period for each guarantee. The United States has not included the particular names of exporters, importers, or the holder of the guarantee, as such information is not necessary for Brazil’s methodology.

101. Although the use of “internal U.S. data” would result in a different set of countries and commodities for Brazil’s methodology, including, for example, the list of obligors by country or region and commodities in Worksheet 3 of Exhibit Bra-722, such differences are insignificant compared to the overwhelming flaws elsewhere in Brazil’s methodology. Although use of the U.S. data would eliminate the improper use of and extrapolation from the CCC exposure report, including Brazil’s historical allocation exercise, failure to correct the other flaws in Brazil’s methodology would render the country/commodity pairings largely irrelevant. Because Brazil’s flawed method for measuring both full and marginal additionality counts the full value of GSM 102 transactions as the measure of additionality, to use actual GSM 102 transactions by country and commodity would not significantly change the value of the additionality Brazil alleges. Under Brazil’s method, the only figure that matters, in essence, is the total value of GSM 102 sales transactions for the products at issue for FY2006. The differences between internal U.S. data and Brazil’s use of the public data are trivial with respect to the aggregate value of transactions. Brazil’s faulty allocations are virtually meaningless in the context of their overall methodological approach, and the use of correct transactional data does not overcome the magnitude of methodological error.

51. The United States has criticised the credit ratings applied by Brazil to CCC-approved foreign obligors. One of the shortcomings that the United States has highlighted is Brazil’s reliance on information from only one ratings firm (Standard and Poor). Brazil has subsequently expanded its sources of information on credit ratings, using the same database (Bankscope) employed by the United States in its submission to recalculate the credit ratings of CCC-approved foreign obligors. As both the parties have stated Bankscope is not in itself a rating firm but combines financial information and ratings from various ratings firms. Does this not address one of the major criticisms made by the United States against Brazil’s methodology? If not, please explain why despite Brazil’s

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73 Exhibit US-78.
use of Bankscope (and Standard and Poor) the United States believes that problems remain.

102. Brazil’s acknowledgment that other ratings services provide credit ratings for banks only minimally addresses the numerous U.S. criticisms of Brazil’s methodology. Significant problems remain.

103. The United States initially notes that Brazil’s limited expansion of sources of information raises questions about Brazil’s methodology in the application of bank ratings in the first place, as direct disparities exist between Brazil’s October submission and its January submission. In the October submission, Brazil relied solely on ratings information from Standard and Poor’s (“S&P”). As the United States understands the January submission, Brazil additionally had examined new sources, and the S&P ratings would not have changed. However, a direct comparison of Exhibit Bra-696 with Exhibit Bra-722 (worksheet 6) reveals no fewer than 38 changes in the applicable S&P ratings.74

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74Bank of Nova Scotia Jamaica Ltd; Jamaica: from AA- to missing.
Banco Cuscatlan; El Salvador: from BB to missing.
Banco G&T Continental, S.A.; Guatemala: from missing to BB-
Banco Industrial; Guatemala: from missing to BB-
Banco Continental de Panama; Panama: from BBB- to missing.
Bank of America (Asia); Hong Kong: from A to missing.
Equitable-PCI Bank; Hong Kong Branch: from B to missing.
Philippine National Bank; Hong Kong Branch: from B- to missing.
Wing Lung LTD; Hong Kong: from BBB to missing.
Woori Bank; Hong Kong Branch: from A- to missing.
Bank Turam Alem; Kazakhstan: from missing to BB-
Ukrสสคtsbank; Ukraine: from missing to B-
Banco Mercantil del Norte (Banorte); Mexico: from BBB- to BB+
Scotiabank Inverlat S.A.; Mexico: from BBB to BBB-
Impexbank; Russia: from BB+ to missing.
International Industrial Bank (IIB); Russia: from B+ to B
JSC Rosbank; Russia: from B to B-
Banco Bradesco; Brazil: from BB+ to BB-
Banco do Brasil; Brazil: from BB to BB-
Banco do Estado de Sao Paulo (BANESPA); Brazil: from BB to missing.
Banco Itau; Brazil: from BB+ to BB-
Banco Itau BBA S.A.; Brazil: from missing to BB+
Banco Safra; Brazil: from BB to BB-
Banco Santander Brasil; Brazil: from BB to BB-
Banco Votorantim; Brazil: from missing to BB-
Uniao de Bancos Brasileiros (Unibanco); Brazil: from BB to BB-
104. Much more significant, and unaffected by the inclusion of additional sources of bank credit ratings, is Brazil’s continued classification “as uncreditworthy [for] those approved foreign obligors with a rating at or inferior to 11 on the 18-point numerical rating scale.” The result of this choice is that, instead of undertaking its interest rate subsidy calculation on the basis of the particular credit rating of the bank, Brazil ascribes the lowest default probability of 18 (“uncreditworthy”) to each such bank and makes its calculations on that basis.

105. Brazil alleges that “the United States itself accepts the very same distinction used by Brazil [a]s a relevant metric” and that this “threshold used by Brazil is widely applied in the capital markets.” Both of these assertions are false.

106. Brazil treats all banks as either investment grade or uncreditworthy. Nothing exists in between for purposes of the methodology. Brazil’s methodology makes no allowance for the creditworthiness of banks below investment grade. As the United States previously noted, even the Standard and Poor’s “Long-Term Issuer Credit Ratings” do not starkly characterize obligors rated below BBB- as “uncreditworthy.” They simply state that “obligors rated ‘BB’, ‘B’, ‘CCC’, and ‘CC’ are regarded as having significant speculative characteristics,” and in fact, for example, even an obligor rated as low as “B” “currently has the capacity to meet its financial commitments.”

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Banco de Comercio Exterior de Colombia; Colombia: from missing to BB
Development Bank of the Philippines; Philippines: from missing to BB-
Equitable PCI Bank; Philippines: from B to missing.
Security Bank Corporation; Philippines: from Bpi to missing.
Korea First Bank; Korea: from missing to A-
National Agricultural Cooperative Federation; Korea: from missing to A-
Garanti Bankasi; Turkey: from missing to BB-
HSBC Bank A.S.; Turkey: from missing to BB
Is Bankasi; Turkey: from missing to BB-
T.C. Ziraat Bankasi; Turkey: from missing to BB-
Vakiflar Bankasi; Turkey: from missing to BB-
Yapi Ve Kredi Bankasi; Turkey: from missing to B

75 Written Submission of Brazil, para. 183.

76Brazil’s Methodology Paper, paras. 34, 36

77 Written Submission of Brazil, para. 184

78 See, U.S. Written Submissions, para. 162, fn. 246; Standard & Poor’s Ratings Definitions, Long-Term Issuer Credit Ratings, available at
107. Brazil’s own written submission recognizes that “non-investment grade” or “speculative grade” is not synonymous with “uncreditworthy”: “The term ‘investment grade’ historically referred to bonds and other debt securities that bank regulators and market participants viewed as suitable investments for financial institutions. Now the term is broadly used to describe issuers and issues with relatively high levels of creditworthiness and credit quality. In contrast, the term ‘non-investment grade,’ or ‘speculative grade,’ generally refers to debt securities where the issuer currently has the ability to repay but faces significant uncertainties, such as adverse business or financial circumstances that could affect credit risk.”\(^79\) Capital markets therefore do not ascribe the same meaning of absolute uncreditworthiness as Brazil to a credit rating less than 10.

108. Brazil continues to assert that it is using a U.S. Department of Commerce (“Department of Commerce”) methodology “to calculate a counterfactual market interest rate associated with a single probability of default common to the entire class of uncreditworthy obligors.”\(^80\) But unlike the Department of Commerce, Brazil assumes that all obligors with a credit rating inferior to 10 are uncreditworthy. The Department of Commerce makes no such assumption.\(^81\) As the United States has previously explained, the Department of Commerce first makes a determination, based on independent criteria, whether or not a bank is creditworthy, and only upon a specific determination of uncreditworthiness does it employ a corresponding default probability. Consistent with the foregoing description of “non-investment grade,” the Department of Commerce recognizes that banks that are not investment grade may indeed be creditworthy and should not have the default probability for uncreditworthy borrowers automatically ascribed to them.

\(^79\) Written Submission of Brazil, para. 184, fn. 151 (italics added)

\(^80\) Written Submission of Brazil, para. 196. See also, Written Submission of Brazil, para. 200.

\(^81\) Brazil mischaracterizes the U.S. Written Submission when it states: “As a first alternative to the USDOC methodology, the United States appears to suggest that for uncreditworthy obligors, the USDOC might consider using ‘national average interest rates’. This is simply false.” Written Submission of Brazil, para. 198. The United States suggested no such thing, and Brazil puts the cart before the horse. The United States observed that in determining, in the first instance, whether an obligor is or is not creditworthy, the Department of Commerce, unlike Brazil’s methodology, first looks at objective criteria, such as “the actual experience of the firm in question in obtaining comparable commercial loans.” If the borrower happens to have taken out no comparable loans in the relevant period, “a national average interest” may be used. U.S. Written Submission, paras. 157-160. Only after a determination of uncreditworthiness, does the Department of Commerce ascribe a corresponding default probability.
109. If one were to ignore all other objections to Brazil’s methodology and use all of Brazil’s
collections other than the assignment of a default probability of 18 to obligors with credit
ratings inferior to 10, and instead use the default probability associated with the actual or
otherwise imputed credit rating, the interest rate subsidy calculation would fall by more than 57
percent, from $237.4 million to $101.35 million.\textsuperscript{82}

110. Brazil asserts that the United States has not established that the application of Brazil’s
default probability methodology leads to inappropriate or disproportionate countermeasures.\textsuperscript{83} The United States respectfully submits that the effect of simple application of actual credit
ratings belies Brazil’s assertion. Moreover, as Brazil’s calculation of additionality relies on its
inappropriate and disproportionate calculation of interest rate subsidy and its misplaced
assertions of uncreditworthiness,\textsuperscript{84} countermeasures based on its notions of additionality are
similarly inappropriate and disproportionate.

111. As noted, such inappropriateness and disproportionality are evident even if one were to
ignore other methodological problems that remain. Nevertheless, such problems indeed remain.
The most significant of these is the treatment of unrated banks. The 57 percent reduction in
interest rate subsidy occurs even though that calculation accepts – solely for purposes of such
calculation – the rating that Brazil ascribes to each bank. Brazil’s methodology, however,
ascribes unduly negative ratings to many banks.

112. Even with the introduction of the Bankscope reports, according to Brazil, no rating exists
for more than 40 percent of the banks (77 of 183).\textsuperscript{85} With respect to these banks, Brazil retains
its unfounded assumption that unrated banks are necessarily inferior to rated banks. Brazil
continues to treat “unrated foreign obligors from countries in which at least one approved foreign
obligor was rated, as one credit rating, or ‘notch’, below the worst-rated CCC-approved foreign
obligor.”\textsuperscript{86} Brazil also continues to treat “unrated foreign obligors from countries in which no
CCC-approved foreign obligor was rated” as four ‘notches’ below sovereign.”\textsuperscript{87}

113. In its Written Submission, the United States provided no fewer than 29 examples to refute

\textsuperscript{82} Exhibit US-79.

\textsuperscript{83} Written Submission of Brazil, para. 194.

\textsuperscript{84} \textit{See} U.S. Written Submission, paras. 196-210.

\textsuperscript{85} Written Submission of Brazil, para. 170.

\textsuperscript{86} Written Submission of Brazil, para. 171.

\textsuperscript{87} Written Submission of Brazil, para. 171.
Brazil’s original definition and treatment of unrated banks. If, as Brazil suggests, this is cherry-picking, then the United States has submitted an orchard. In response to the U.S. submission, and after examination of the additional ratings from Fitch and Moody’s, Brazil no longer regards many of these banks as “unrated.” Several of these original examples, however, remain “unrated” under Exhibit Bra-722. These include: Banco BBM, S.A. (Brazil); Multi Credit Bank of Panama (now known as Multibank); Banco Reformador, Guatemala; Banco Financiero del Peru; and Finansbank, Romania.

114. The Arbitrator will recall that the United States provided particular factual information with respect to these banks regarding specific transactions in international credit markets, including interest rates markedly in contrast to those that Brazil would impute to them. Those documents speak for themselves.

115. In addition to those examples already provided, the United States has examined the now revised set of “unrated” banks and can identify numerous additional examples in which the terms of actual borrowings similarly belie the notion that such banks should necessarily be assigned a rating one notch below the worst-rated bank in the country. As was the case in the U.S. Written Submission, paras. 143-154. Furthermore, as the United States originally noted, these were only illustrative, not exhaustive of the examples available to refute Brazil’s assertion.
Submission, these examples are illustrative, not exhaustive:

(1) RosEvroBank (Russia). All “unrated” Russian banks receive a rating of 16 under Brazil’s methodology. Between October 10, 2005, and December 28, 2006, this bank nevertheless secured over $125 million of either dollar or euro-denominated loans, with terms of between 1 and 7 years. Among these is a two-year dollar denominated loan for $12 million at 8.21 percent, and a two-year euro-denominated loan at 6.68 percent. Other “unrated” banks also secured favorable financing.

(2) Bank of Nova Scotia Jamaica Ltd. (Jamaica). Assigned a very low rating of 16, this bank is a subsidiary of Scotia Bank in Canada, which itself regularly lends to the Jamaican subsidiary at LIBOR, plus 1 percent.

(3) Banco de America Central (BAC) (formerly Bancocredomatic) (El Salvador). The financial statement of this bank as of December 31, 2006, reflects nearly a dozen foreign-currency denominated loans from international banks, due between 2007 and 2009, bearing interest rates from 4.8 percent to 9.2 percent.

(4) Banco Nacional de Costa Rica (Costa Rica). Banco Nacional de Costa Rica is the largest bank in Costa Rica, yet remains unrated, which illustrates the fallacy of Brazil’s notion of the necessity of a credit rating for “signalling” its financial strength. Its 2006 financial statement reflects long-term foreign currency borrowing in 2006 from Barclays

most favorable to Brazil’s litigative interests. It is, however, somewhat arbitrary. It does not explain why an average of ratings, for example, would not provide a more balanced and accurate view of credit risk. Brazil’s approach also does not allow for potentially anomalous outliers in ratings. Brazil offers only one example for its assertion that use of the worst rating is supposedly common. The obscure iTraxx index appears to be devised, however, for a very narrow and specialized purpose of trading in the now much maligned credit default swaps. See, http://www.indexco.com/iTraxx/overview.asp; http://www.investopedia.com/terms/i/itraxx.asp; and http://ideas.repec.org/p/hhs/lunewp/2005_024.html.


99 Exhibit US-82, p. 3.

100 Exhibit US-83, pp. 22-25.

101 Exhibit US-84, p. 1 (country rank = 1).

102 Written Submission of Brazil, paras. 175, 177.
Bank at interest rates between 6.60 percent and 6.84 percent.\(^\text{103}\)

(5) ABN Amro, Istanbul Branch (Turkey). As a mere branch, it would not receive a separate credit rating, because the risk of the parent is ascribed to the branch. The appropriate rating, to the extent any formal rating is appropriate at all, is the rating of ABN Amro Holding, NV, which is rated by Fitch at AA- and by Moody’s at Aa3, which both correspond to a high investment grade rating of 4.\(^\text{104}\) No Standard and Poor’s rating appears. Brazil assigns a rating of 17.

(6) GSD Yatrim Bankasi (Turkey). The 2006 financial statements of this bank (treated as a 17, like all “unrated” Turkish banks) reflect medium/long term foreign currency borrowings with fixed interest rates from 4.54 percent to 6.65 percent.\(^\text{105}\)

(7) Equitable PCI Bank (Philippines). Assigned a dismal rating of 17, for borrowings, this bank nevertheless entered into (mainly short-term) borrowings denominated in foreign currency with annual fixed rates ranging from 4.0 percent to 5.7 percent in 2006, and from 1.9 percent to 7.0 percent in 2005.\(^\text{106}\)

(8) United Coconut Planters Bank (Philippines). Like all Philippine banks, this bank is relegated to a rating of 17 by Brazil’s methodology, but it enjoyed significant foreign currency borrowings in 2006, and the highest rate it paid for any borrowings was 13 percent.\(^\text{107}\)

(9) Bank Pozitif Kredi ve Kalkınma Bankasi (Turkey). Also assigned a rating of 17 by Brazil, this bank on April 28, 2006, obtained a one-year syndicated loan for $40 million, at an interest rate of LIBOR plus 0.75 percent.\(^\text{108}\)

\(^{103}\) Exhibit US-85, pp. 56, 16.

\(^{104}\) Exhibit US-86.

\(^{105}\) Exhibit US-87, p. 48.

\(^{106}\) Exhibit US-88, p. 4. Also forced by Brazil’s methodology into a rating of 17, Allied Bank of the Philippines similarly enjoyed rates of 3.75 percent to 5.5 percent for short term foreign currency borrowings in 2006. Exhibit US-89, p.65 (excerpted in exhibit at p. 3). In Mexico, in 2006, Banco Regional de Monterrey (Banrejio) obtained short-term dollar-denominated loans at an interest rate of 6.06 percent. Exhibit US-90, p. 53.

\(^{107}\) Exhibit US-91, p. 46.

116. In response to such information, Brazil asserts: “That some unrated banks were able to raise funds in a foreign currency does not detract in any way from Brazil’s argument that, in the absence of specific information to the contrary, a rated bank must be treated as ‘more’ creditworthy than an unrated one.” But this assertion would require accepting that actual information regarding access to international credit markets during the relevant period is not specific information regarding the creditworthiness of an entity. Brazil is using credit ratings as a proxy for quantifying “creditworthiness” for the calculation of benchmark interest rates. But actual interest rates would certainly be a better indicator, indeed the best evidence, of benchmark interest rates during the particular period of time. Brazil’s assertion is simply adherence to its methodology, regardless of actual facts.

117. Brazil further attempts to dismiss such factual information by asserting that “the ability to secure a single loan does not make an uncreditworthy obligor creditworthy. . . . The USDOC says so itself.” To the contrary, the Department of Commerce says, “in the case of firms not owned by the government, the receipt by the firm of comparable long-term commercial loans unaccompanied by a government-provided guarantee will normally constitute dispositive evidence that the firm is not uncreditworthy.”

118. Alternatively, if one were to accept Brazil’s theory that “a rated bank must be treated as ‘more’ creditworthy than an unrated one,” then this would imply that all same-country banks with a credit rating superior to that imputed to “unrated” banks should be ascribed benchmark interest rates commensurately better than the actual interest rates the “unrated” banks in fact received. The copious examples that the United States provides here and has previously provided demonstrate that the benchmark interest rates routinely exceeding 27 percent or more are disproportionate and inappropriate.

119. Brazil argues that the United States has offered “no alternative to the methodology adopted by Brazil.” To the contrary, the U.S. suggests that Brazil should first examine what real-world interest rates were during the applicable period of time. It is ironic that Brazil, while attempting to characterize itself as an imitator of the methodology of the U.S. Department of

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109 Written Submission of Brazil, para. 174.

110 Written Submission of Brazil, para. 192.


112 Written Submission of Brazil, para. 174.

113 Exhibit Bra-722, Worksheet 8.

114 Written Submission of Brazil, paras. 86, 172.
Commerce, fails even to attempt this initial step of any Department of Commerce analysis.\textsuperscript{115}

120. Brazil asserts that its approach of universally finding all sub-investment grade obligors uncreditworthy is “less arbitrary” than the Department of Commerce approach of examining comparable commercial loans.\textsuperscript{116} However, Brazil embraced the Department of Commerce approach when it used a Department of Commerce formula for its interest rate calculations. It is, at a minimum, disingenuous to reject the Department of Commerce approach to creditworthiness determination from the exact same regulation.\textsuperscript{117}

121. Brazil then appears to suggest that it is incapable of undertaking any effort in this regard: “while an investigating authority in a U.S. countervailing duty proceeding may have the power to demand information from respondents to enable a review of their individual borrowings (as well as the power to adopt adverse inferences if its requests are not complied with), Brazil does not have the ability to secure the relevant information from foreign obligors in preparing its methodology.”\textsuperscript{118}

122. However, none of the information provided by the United States with respect to financial statements of banks or their borrowings has been obtained in its capacity as an investigating authority. In fact, such financial statements and borrowing information are largely readily available on the web. To illustrate, the United States provides several examples directly relevant here:

Scotia Bank Jamaica

http://www.scotiabank.com/jm/cda/content/0,1679,CCDjm_CID184_LIDen_SID4_YID1,00.html

Banco Nacional de Costa Rica


BAC (El Salvador)

https://www.bac.net/elsalvador/esp/banco/empresa/empresabac-estfinancieros.html

Banregio (Mexico)

\textsuperscript{115} See, U.S. Written Submission, paras. 157-160.

\textsuperscript{116} Written Submission of Brazil, para. 189.

\textsuperscript{117} See 19 CFR 351.505(a)(4).

\textsuperscript{118} Written Submission of Brazil, para. 191.
http://portal.banregio.com/modules.php?name=Content&pa=showpage&pid=123

GSD Yatirim Bank Turkey


Bank Pozitif Turkey


Allied Bank, Philippines


Chinatrust Commercial Bank, Philippines


Equitable PCI Bank, Philippines (now owned by Banco de Oro; new bank was re-named Banco de Oro Unibank)


Philippine Bank of Communications, Philippines


United Coconut Planters Bank, Philippines


Finansbank, Romania (now known as Credit Europe Bank)

http://www.crediteurope.ro/eng/despre_financiar.php

Multibank (formerly Multi Credit) Panama


BBM Brazil

http://www.bbm.com.br/bbm/web/index_pti.htm

123. With respect to the lone remaining example (Peru) of Brazil’s methodology by which
“unrated” banks are assigned a credit rating four notches below the sovereign rating, the United States initially notes its prior submission in respect of Banco Financiero del Peru.  

124. Finally, to further underscore the serious problems in Brazil’s approach, the United States has prepared, at Exhibit US-92, a discussion of academic literature on export credit guarantees. This literature discusses the key parameters of Brazil’s approach, including interest rate subsidy, additionality, and pass-through. The results of these studies plainly show that Brazil’s methodology is not supportable. While Brazil’s methodology relies on an interest rate subsidy of more than 20%, the range of possible interest rate subsidies in the literature described in Exhibit US-92 starts at nearly zero and has a maximum of less than eleven. In terms of additionality – where Brazil assumes transactions would simply not occur in the absence of GSM 102 guarantees – the literature simply does not support any such assumption. The fact that Brazil’s results diverge so sharply from the literature shows that mere correction of certain data issues cannot fix Brazil’s methodology. Of course, as the United States has explained, the correct way to calculate “amount of the subsidy” in this dispute for GSM 102 is using the net cost to government, and not any approach based on interest rate subsidy. However, the academic literature shows that Brazil’s methodology is not sound even on its own terms.

52. The United States applies the US Department of Commerce methodology to construct a counterfactual market interest rate only if the particular firm is first determined to be uncreditworthy. Brazil has argued that that the rationale offered by the US Department of Commerce for the development and application of its methodology applies equally to creditworthy borrowers. Please explain whether the United States is of the view that extending the application of the methodology to creditworthy borrowers leads to inappropriate or disproportionate countermeasures? If so why?

125. Use of the U.S. Department of Commerce (“the Department”) methodology to construct a (long-term) benchmark lending rate for creditworthy (investment- and non-investment- grade) borrowers results in disproportionate countermeasures, which are not appropriate with respect to GSM 102 guarantees.

126. If the subsidy benefit from a government loan is measured in terms of the rate the borrower would otherwise pay on the market for a comparable loan, there is no need to guess or speculate about what that rate might be in the case of a creditworthy borrower because such borrowers are, by definition, able to secure financing from commercial (market-based) sources. For this reason, in the case of a creditworthy borrower, the Department’s regulations (“Regulations”) explicitly direct the Department to rely, where possible, on the actual experience of the borrower, i.e., on commercial loans actually taken out by the borrower. And in the absence of such loans, the Regulations direct the Department to rely on a national average.

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lending rate. Thus, because either borrower-specific or national average lending rates are almost always available, the Department’s benchmark rate for creditworthy borrowers is almost always an actual lending rate from a commercial (market-based) source. It is only in the exceptional case of an uncreditworthy firm, which is, by definition, not able to secure financing from a commercial (market-based) source, that the Regulations direct the Department to construct a benchmark lending rate.

127. An obvious and direct consequence of the misapplication of the Methodology to a creditworthy borrower is that the resulting (constructed) benchmark interest rate will significantly overstate what such a borrower would otherwise pay on the market for a loan comparable to the government loan. The overstatement is the result of a benchmark interest rate (generated by the Methodology) that is much higher than it should be to reflect the probability of default for a creditworthy borrower. This is not at all surprising, since the Methodology is explicitly designed to generate a benchmark interest rate that reflects the default probability for an uncreditworthy borrower. This increase in the benchmark interest rate necessarily leads to disproportionate countermeasures.

53. The United States objects to Brazil's use of a single probability of default common to the entire class of uncreditworthy obligors to calculate a counterfactual market interest for these borrowers. It regards this as a “misapplication of the Department of Commerce approach” to undertake “[s]ummary assignment of a default probability associated with the abysmal rating of 18 to all obligors below investment grade”. In response, Brazil argues that this is precisely what the DOC does (paragraph 197 of Brazil's submission). Could the United States please clarify the methodology employed by the DOC to calculate a counterfactual market interest rate for the class of un-creditworthy borrowers.

128. The U.S. Department of Commerce ("the Department") methodology (the “Methodology”) generates a benchmark interest rate that is explicitly designed to reflect the probability of default for an uncreditworthy borrower. Since this probability is relatively high, this constructed benchmark interest rate is relatively high, and the higher the default probability, the higher the constructed benchmark rate. Contrary to Brazil’s claim, the Department’s definition of “uncreditworthy borrower” is not all borrowers with less than an investment-grade credit rating. Under the Department’s regulations (the “Regulations”) and the Methodology, an uncreditworthy borrower is a borrower that the Department determines, after a detailed analysis of the borrower’s financial health and ability to service debt obligations, cannot secure financing from conventional commercial sources. The Department’s creditworthiness determination is based on a number of factors, including the receipt of any commercial long-term loans, the present and past financial health of the firm, the firm’s ability to meet its costs and fixed financial

120 19 CFR 351.505(a)(3).

obligations, and evidence of the firm’s future financial position.\textsuperscript{122} The set of borrowers who cannot secure financing from conventional commercial sources is clearly different (fundamentally so) from the set of borrowers who can secure financing from conventional commercial sources, but just not at investment-grade rates (which is most borrowers). The borrowers in the latter set are clearly creditworthy (by definition); they are just not investment-grade creditworthy.

129. This distinction between borrowers who are investment grade and those who are not, but who are creditworthy nevertheless, is evident in the Department’s uncreditworthiness analyses. For example, in one recent investigation, the Department found that while a respondent’s quick ratio, cash flow and other figures did “indicate some weakness, taken by themselves, they did not establish a reasonable basis to believe or suspect that the respondent was uncreditworthy.”\textsuperscript{123} In another recent investigation, the Department found that “while certain financial ratios indicate some degree of financial distress . . . we preliminarily determine [the respondent] to be creditworthy.”\textsuperscript{124}

130. In a 2001 investigation, the Department found that while some of the respondent’s ratios were “problematic and seem to show a poor trend over the years” the Department did not determine that the respondent was uncreditworthy and stated, explicitly, that “[t]he Department notes that there is a substantial difference between a firm being a credit risk and being uncreditworthy.”\textsuperscript{125} The Department also found that while another respondent “failed to meet its obligations with respect to floating rate notes denominated in U. S. dollars . . . we note the difference between being a high credit risk and being uncreditworthy.”\textsuperscript{126} Clearly, the DOC does not treat all firms below investment grade as uncreditworthy, as Brazil alleges.

54. \textit{In explaining why it chooses a different set of elasticity values in calculating marginal additionality from the withdrawal of GSM 102 subsidies, Brazil claims that this is because those subsidies affect a smaller fraction of total US export transactions. Thus, the counterfactual being considered is not significant enough to shift US domestic or world prices, and thus too small to cause large-scale supply or demand responses in the United States and elsewhere. Could the United States please provide a response to this defence offered by Brazil of its choice of elasticity values.}

\begin{itemize}
\item \textsuperscript{122} 19 CFR 351.505(a)(4).
\item \textsuperscript{123} Exhibit US-105, page 14.
\item \textsuperscript{124} Exhibit US-106, page 3.
\item \textsuperscript{125} Exhibit US-107, page 4.
\item \textsuperscript{126} Exhibit US-107, page 5.
\end{itemize}
131. In its Annex I to Brazil’s arbitration submission, Drs. Sumner and Sundaram state, “[i]deally, elasticity estimates should be customized to suit a specific policy scenario.” (Para. 49) According to their arguments, this means that when a large impact is expected (as it is by Brazil in the serious prejudice analysis), the value of the elasticity should be large; and when a small impact is expected (as it is by Brazil in the GSM 102 analysis), the value of the elasticity should be small. And thus, there is not an inconsistency between the elasticities chosen for the marginal additionality modeling and the serious prejudice modeling. It is wholly inappropriate to base elasticities on an assumed result. The price elasticity of supply and demand reflect the responsiveness of the actors to a one percent change in price, and are not dependent on the type of policy being analyzed. While the specific policy may influence whether to use short-run or long-run elasticities, preconceived views of the likely impact of a policy cannot determine the value of the elasticity.

132. As the United States reported in its Annex I to its First Submission, recourse to Article 21.5, FAPRI has used the same elasticities for various policy analyses that would have varying degrees of impacts:

“The FAPRI model has been used for several analyses that model large reductions in government supports. For example, in November 2002, FAPRI released a study that considered the effects of unilateral removal of U.S. domestic support programs on world markets.\(^{127}\) In November 2005, FAPRI released two separate studies that analyzed the effects of the October 2005 U.S. agriculture proposal in the Doha Development Agenda negotiations.\(^{128}\) In each of those assessments, the FAPRI analysts utilized the standard FAPRI acreage equations. They did not consider that it was necessary or appropriate to modify the elasticities.” (Page 13)

133. Brazil still has not explained their different approach to elasticity choice.

55. On average, how long does a “cohort” last? What is the duration of the cohorts 2005-07 for which recent re-estimates have been provided by the United States?

134. The United States Office of Management and Budget (OMB) Circular A-11 (2008)\(^{129}\) sets forth in section 185.3(c) the definition of “cohort” applicable to all United States federal direct loans and loan guarantees:

“**Cohort** means all direct loans or loan guarantees of a program for which a subsidy appropriation is provided for a given fiscal year (except as provided

\(^{127}\) Exhibit US-52.

\(^{128}\) Exhibit US-53.

\(^{129}\) Exhibit US-8.
below for pre-1992 direct loans and loan guarantees that are modified). For direct loans and loan guarantees for which a subsidy appropriation is provided for one fiscal year, the cohort will be defined by that fiscal year. For direct loans and loan guarantees for which multi-year or no-year appropriations are provided, the cohort is defined by the year of obligation. Direct loans and loan guarantees that are made from supplemental appropriations will be recorded in the same cohort as those that are funded in annual appropriations acts. These rules apply even if the direct loans or guaranteed loans are disbursed in subsequent years.

“Cohort accounting applies to post–1991 direct loans and loan guarantees and pre–1992 direct loans and loan guarantees that have been modified. Post–1991 direct loans or loan guarantees remain with their original cohort throughout the life of the loans, even if they are modified. Pre–1992 direct and guaranteed loans are assigned to a single cohort by program and credit instrument regardless of the fiscal year of the subsidy appropriation. For purposes of budget presentation, cohorts will be aggregated. However, accounting and other records must be maintained separately for each cohort.”

135. Section 185.6(a) further provides:

“(a) General.

Subsidy reestimates are made on direct loans and loan guarantees that have been disbursed. They are recorded in the current year column of the budget. (For example, the subsidy for direct or guaranteed loans disbursed during 2006 would be reestimated during 2007 and would be recorded in the 2007 column of the FY 2008 Budget.) A closing reestimate should be made once all the loans in the cohort have been repaid or written off.”

136. Section 185.6(g) states:

“(g) Closing reestimates.

Agencies will make a closing technical reestimate once all of the loans in a cohort have been either repaid or written off. This reestimate will be based on actual accounting systems data and will be used in closing the accounting books for the cohort. All the procedures that are described above for the technical reestimate and interest on reestimates are applied. Closing entries will be made in the accounting records.”

137. As a result, if payment of a claim under a federal loan guarantee program such as GSM 102 occurs with respect to a particular cohort of guarantees, then a debt to the U.S. government arises. In the case of GSM 102, the Commodity Credit Corporation takes a subrogated position with respect to the debt of the defaulting obligor (a foreign bank). Each such guarantee is issued
in a particular fiscal year. The group of guarantees issued in a particular fiscal year is a cohort of guarantees. Coverage under a particular GSM 102 guarantee does not commence until shipment occurs. In some cases, shipment may not occur until months after issuance of a guarantee.

138. A guaranteed lender must file a notice of default within 10 days following a default and must file a claim within 180 days following such a default. Therefore, since the maximum tenor of a GSM 102 guarantee is three years, the cohort can be closed at the end of three years plus 180 days from the date of the last shipment covered under a guarantee, if no claims are filed. The cohort of guarantees will remain open until such time as all of the debt owed CCC for all guarantees in the cohort is repaid or written off. Even if CCC has an outstanding subrogated position to collect only with respect to one transaction, the entire cohort remains open. If a claim results in a rescheduling of debt, the cohort will remain open until repayment of the rescheduled amount. Operationally, formal closing of cohorts occurs at the end of a fiscal year.

139. For the FY 2005-2007 cohorts, no claims under GSM 102 have been filed. The period of guarantee coverage for cohorts 2006 and 2007 remains open for some guarantees. With respect to cohort 2005, if no default claims are filed, the cohort should be eligible to close at the end of fiscal year 2009.

56. Paragraph 50 of the US Written Submission appears to indicate a different figure from those provided to the compliance panel for the years 2005 and 2006. What is the reason for the difference?

140. Paragraph 50 and Figure 1 of the U.S. Written Submission reflect the most recent re-estimate data from the Fiscal Year 2009 U.S. Government Budget. Figures previously provided to the compliance panel only reflected data through the Fiscal Year 2008 U.S. Government Budget, the most recent data at that time.

141. A comparison of Figure 1 with the table presented in response to compliance panel question 110 (para. 275) readily reveals this difference. In Figure 1 and that table, for each of cohorts (fiscal year) 2005 and 2006, the original subsidy estimates are the same ($142,000,000 and $71,000,000, respectively). Similarly, in Figure 1 and the table, the total subsidy re-estimates for each of cohorts 2005 and 2006, as published in the Fiscal Year 2008 U.S. Government Budget, are the same ($ -92,209,000 and -$18,324,000).

142. In the Fiscal Year 2009 U.S. Government Budget, however, negative re-estimates undertaken in fiscal year 2008 for each of the 2005 and 2006 cohorts are published for the first time. For the 2005 cohort, a negative subsidy re-estimate of $39,516,000 appears. For the 2006 cohort, a negative subsidy re-estimate of $37,463,000 appears. These are the precise numbers that appear in paragraph 50 of the U.S. Written Submission. These reflect additional negative subsidy re-estimates calculated in fiscal year 2008. As further reflected in Figure 1, the total lifetime negative subsidy re-estimates for the 2005 cohort, as of the Fiscal Year 2009 U.S. Government Budget, are $131,725,000. The corresponding total lifetime negative subsidy re-estimates for the 2006 cohort are $55,787,000. Further re-estimates reflecting calculations for
fiscal year 2009 will be presented in the Fiscal Year 2010 U.S. Government Budget, anticipated to be released in April 2009.

(proposed countermeasures for actionable subsidies)

57. Please respond to the argument made by Brazil that its simulation of the removal of marketing loan and countercyclical payments is conservative because it does not incorporate (i) the continuing effects from past marketing loan and countercyclical payments that increase the present US production of cotton and (ii) the market effects from the anticipated availability of Step 2 subsidies to promote sales of US cotton in MY 2005?

143. Brazil’s simulation is not “conservative,” and it would allow countermeasures that are not permitted under the DSU. In particular, with respect to any effects of past payments, countermeasures would be retroactive, which is not permitted under the prospective, forward-looking system of the DSU. This is particularly problematic with regard to any effects of past payments prior to the end of the implementation period, because up to the end of that period, the United States was not obligated to withdraw the subsidy or remove its effects.

144. Even more, the claim that Brazil is “conservative” in its approach because it did not include Step 2 in its calculations for actionable subsidies is false because there is no disagreement that the United States has already come into compliance with the rulings and recommendations of the DSB on Step 2 payments. Thus, lack of countermeasures on Step 2 is not “conservative;” rather, it is required under the DSU and the SCM Agreement.

145. Finally, Brazil’s approach is not “conservative,” because the model used to assess the counterfactual can be used to fully reflect the situation with no marketing loan or countercyclical payments. With the correct parameter adjustments, the model will show the difference between the situation where the payments are being made and the counterfactual, with producers adjusting for the change. There is no need to add on additional considerations such as “lingering” effects or producers’ expectations were the payments to continue – the model shows the producers’ adjustment to the situation without marketing loan and countercyclical payments, and the corresponding difference in price.

146. Moreover, the United States notes that Brazil offers this argument, in part, to respond to the U.S. argument that the calculation of “total” effects using the economic model must be adjusted downward to properly reflect the effects that caused “significant” price suppression resulting in adverse effects to Brazil and the standard under Article 7.9 of the SCM Agreement. But the two issues – correctly reflecting the “commensurate” standard and Brazil’s notion that it is “conservative” – are not related. Brazil’s argument that it is “conservative” tries to provide a reason to ignore the importance of what portion of the effects of marketing loan and countercyclical payments resulted in the DSB findings (claiming it does not matter because of the “conservative” approach) but it does not address the legal argument about the requirement that, under Article 7.9, the amount of countermeasures must be determined with respect to only the
amount of “significant” price suppression in order to be “commensurate with the degree and nature of the adverse effects determined to exist.”

147. Brazil also suggests that the Arbitrator need not take into account the extent to which the effect on price was “significant” because of statements by the original and compliance panels that even small changes could be significant. But, these observations do not change the fact that neither panel determined the extent to which price suppression was “significant” in this dispute. At this stage of the proceedings, this determination cannot be avoided. Even if significant price suppression could occur at a relatively small number, it is still important to determine the point at which the price suppression is “significant.” Even a small difference in degree can make a very large difference in the bottom line of proposed countermeasures, and so it must be taken into account to be sure that any countermeasures will be commensurate with the degree and nature of the adverse effects determined to exist.

58. Please respond to the argument made by Brazil in paragraph 349 of its submission that by advocating the use of long-run elasticities, the United States acknowledges that there are continuing effects from its marketing loan and countercyclical payments provided in prior years since the distortions created by these payments require a certain period of adjustment in order to cease affecting the decision-making of market participants?

148. The United States advocated the use of long-run elasticities to fully account for full adjustment by all participants to the policy change modeled. There may be factors which inhibit participants from fully adjusting to the announced policy change within the first year, Brazil’s period of modeling. The difference between short and long run elasticities is the difference between incomplete and complete adjustment to a policy change by markets and market participants. In an exercise designed to measure the cost of U.S. non-compliance, surely the point of comparison is to U.S. compliance, with all markets fully adjusted to the changes from compliance. Long run elasticities capture such adjustments; short run elasticities do not.

59. Please respond to Brazil’s argument that in choosing MY 2005 as its reference period, it is following the approach adopted by past arbitrators, the reference year chosen is the year straddling the end of the implementation period; and that moreover, past arbitrations have stressed that compliance must be assessed at the time of expiry of the implementation period?

149. Brazil’s argument involves two separate issues. First, there is the legal issue of when the United States was required to come into compliance with the recommendations and rulings of the DSB (the end of the implementation period), which Brazil claims is required to be the time at which compliance must be assessed. As discussed in the response to question 4 above, the relevant time period for purposes of assessing the “counterfactual” is the time period that forms the basis of the compliance recommendations and rulings. Second, there is a data issue regarding

130 U.S. Written Submission, para. 316.
what the Arbitrator should use to calculate the amount of countermeasures that Brazil may impose. In spite of Brazil’s assertions, the fact is that the date at the end of the period for implementation is not the date that governs – past arbitrators have chosen available data from other time periods. For example, even in *US-FSC*, where the Arbitrator used the year that included the end of the implementation period, the data it chose reflected what was available in the circumstances of that case. The data that were used included data from both before and after the date of the end of the implementation period, the data reflected the original measure for which historical data were available (even though a new measure had been implemented), and the arbitrator made certain adjustments to account for differences between the new measure and the old measure.\(^{131}\) Similarly, in *US–Gambling*, the arbitrator used data that predated the end of the implementation period by several years. The arbitrator there connected the two ideas of the timing for the counterfactual and the data availability issue: the “relevant point” for the counterfactual is the end of the implementation period or “the time period coming closest to that date for which statistical information is available.”\(^{132}\)

150. In addition, where it suited the circumstances of the case, as in *Brazil-Aircraft*, the arbitrators have also used multi-year reference periods.\(^{133}\) In *Brazil-Aircraft*, the arbitrator stated that it chose the six-year time period of 2000-2005 “essentially because it corresponds to the period in which [the production data used] can be assumed to be reasonably accurate.”\(^{134}\) A multi-year reference period is the correct approach here. The nature of marketing loan and countercyclical payments makes a longer-term analysis an important part of determining an amount of countermeasures commensurate with the adverse effects of payments pursuant to these programs. The data show that, over time, marketing loan and countercyclical payments vary and – separately – the effects of these payments vary depending on market conditions. In order to determine, on a prospective basis, countermeasures that would be commensurate with these effects, it is practical to take into account the circumstances of this particular dispute and use data reflecting several years of relevant experience under the marketing loan and countercyclical payment programs.

60. *The United States had argued that MY 2005 is not “representative” of the potential adverse effects to Brazil of the marketing loan and countercyclical payments. In response, Brazil has asserted that MY 2005 is, in fact, much more “representative” than is MY 2005-2007. Brazil then provides a table (Table 1 of its submission) which purports to show that prices in MY 2005 were close to the average of the nine-year period since*

\(^{131}\) *US-FSC (Article 22.6)*, paras. 2.14-2.15.

\(^{132}\) *US-Gambling (Article 22.6)*, para. 3.143.

\(^{133}\) *Brazil-Aircraft (Article 22.6)*, para. 3.66; see also *Canada-Aircraft II (Article 22.6)*, para. 3.85.

\(^{134}\) *Brazil-Aircraft (Article 22.6)*, para. 3.66.
1999, the first year covered by the findings of the original panel.

(a) Could the United States please respond to Brazil’s argument?

(b) The results of Brazil’s analysis that MY 2005 is more “representative” hinges on the period chosen for comparison (its chosen period begins with MY 1999, the first year covered by the findings of the original panel). Does the United States agree that this is the appropriate or relevant period for comparison? If not, what is the relevant period of comparison and what would be the basis for choosing it?

151. The United States disagrees with Brazil’s argument. The question is not whether the period selected is “representative” of any possible past harm, but does it accurately depict the effects of the measures subject to the compliance recommendations and rulings. The compliance panel was established on September 28, 2006.

152. Brazil argues against the inclusion of MY2006 and MY2007, especially MY2007, because Brazil does not like the results. Brazil believes MY2007 could not be representative because prices during this marketing year were the highest during the period MY1999-MY2007. Brazil has provided no justification as to why the benchmark for comparison of prices to determine “representativeness” is limited to the period starting with MY1999 other than this is the beginning of the period in which the original panel based its determinations. Of course, the measures in existence in MY1999 were not the measures that are the subject of the compliance recommendations and rulings and there is no basis for concluding that the situation in MY1999 accurately depicts the effects of the measures that the DSB found to be inconsistent in the compliance recommendations and rulings.

153. In Figure 1, the United States has graphed the A-index from MY1971 through MY2007 as an illustration of price movements. As can be seen, the MY2007 A-index is in line with historical A-index values. In fact, the period MY1999-MY2002 represents a period in which the A-index is extremely low from a historical perspective. As the figure demonstrates, prices vary from year to year. For this reason, the United States advocated the averaging of three years to smooth out the ups and downs to provide a middle ground instead of relying on any single year. The United States would also note that Brazil has no problems including MY2001 in its calculations to determine representativeness. As the Figure shows, MY2001 had the lowest A-index value since 1971.

154. However, as explained above, the Arbitrator is to determine the likely harm to Brazil from significant price suppression resulting in adverse effects to the interests of Brazil. Taking an average from the last three marketing years is the most representative way to determine the likely harm to Brazil from the inconsistency found in the compliance recommendations and rulings.
61. In theory, the futures market incorporates the latest information available to market participants for forecasting prices.

(a) Can the United States confirm whether, at the time the futures price is set, market participants will already know the lagged price, i.e., the lagged price is a subset of market participants’ information set.

(b) What other information will market participants have that might be relevant in predicting prices in the future and which presumably will be incorporated in the futures price?

155. The lagged price would not be known either at the time the futures price is set or when U.S. farmers begin their planting intentions or planting. This is due to the mismatch between the marketing year period and the planting time for cotton. Although the marketing year starts on August 1 and goes through July 31, U.S. farmers actually plant in April, during the previous marketing year. Therefore, the lagged price constructed for modeling purposes includes information after U.S. farmers have planted. Farmers and futures market participants will, however, be cognizant of current spot market prices.

156. Other information available to futures market participants that may be incorporated into futures prices includes historic market conditions, USDA/NASS planting intentions for U.S. farmers published in March, USDA monthly Production, Supply and Demand estimates for the cotton market, industry newsletters that may provide forecasts U.S. and global market and weather conditions, FAPRI baseline projections, and general forecasts about the global economy.

62. Brazil has argued that the United States implicitly acknowledges that Brazil’s model is adequate for the question before the Arbitrators since it does not detail the alleged “serious flaws” of the model, does not argue why the model is “inadequate”, does not provide its own model, and adopts the model for use with its own set of parameters. Noting that the United States has re-submitted US Annex I (originally submitted to the compliance panel), does the United States accept this characterisation of its position with regards to Brazil’s model?

157. The United States disagrees with Brazil’s characterization. First, it is important to recall that the model measures total effects from removal of certain subsidy payments. The legal conclusions (e.g., how these total effects relate to the effects resulting in significant price suppression within the meaning of Article 6 of the SCM Agreement) are a separate matter.

158. At the same time, the calculation of total effects is a ceiling for “adverse effects,” because the adverse effects could not be greater than the total effects caused by marketing loan and countercyclical payments. As a result, if the model overestimates total effects, it is not “adequate” because any countermeasures based on the model will be too high, and so not commensurate with the “degree and nature of the adverse effects determined to exist” under Article 7.9.
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The United States believes that the results of the model (with the corrections it recommends) do not show a level of price suppression that is significant, but recognizes that the compliance panel drew a different conclusion.

159. The United States in its Written Submission described various problems with the model, including flaws in the choice of elasticities and parameter values. Because of these problems, the model is not adequate to measure total effects or adverse effects. With the corrections, the model, while far from perfect, could be used to estimate “total effects,” and the United States has not provided its own model.135

160. The United States emphasizes that the question of whether the model is “adequate” is more sensitive at this stage of the dispute. The compliance panel did not need to determine what parameters should be used in the model for it to be “adequate” to use as the starting point to determine the countermeasures commensurate with the adverse effects of marketing loan and countercyclical payments. It only needed to determine whether the price suppression indicated by the model was “significant.” The Arbitrator’s question is more precise, and requires that the flawed parameters be corrected so that the model is adequate for the task of determining “total” effects, which can in turn be used to determine countermeasures under the legal standard of Article 7.9 of the SCM Agreement.

161. In addition, the United States would like to offer clarification regarding two “Annex I” documents. The first “Annex I” is to the U.S. First Submission to the compliance panel. It is the U.S. critique of the Sumner model used during the compliance panel proceedings. In this annex, the United States discusses appropriate parameters for the model and re-runs the simulation with these parameters. The second “Annex I” was first submitted with the U.S. Rebuttal Submission to the compliance panel, and included rebuttal to arguments made by Dr. Sumner regarding the modeling in Brazil’s rebuttal submission. Both were re-submitted by Brazil with its methodology paper.

63. Please respond to the argument made by Brazil that a short-term analysis is necessary for the Arbitrators to examine a counterfactual involving the withdrawal of marketing loan and countercyclical payments?

162. Brazil’s argument that a short-term analysis is necessary confuses two issues: time for compliance and assessment thereof and the proper analysis of the counterfactual in the arbitration. As discussed in the response to questions 3 and 4 above, the relevant period for assessing countermeasures is not the situation at the end of the implementation period. Here, the compliance recommendations and rulings determine the correct measures at issue and time period for the counterfactual. And a compliance panel assesses compliance by looking at the measure taken to comply itself, not simply by checking whether a subsidy has been withdrawn and all adverse effects removed within six months.

163. In terms of the proper analysis of the counterfactual, the fact is that the modeling will

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135 The United States believes that the results of the model (with the corrections it recommends) do not show a level of price suppression that is significant, but recognizes that the compliance panel drew a different conclusion.
only fully reflect the response of market participants to the situation where the U.S. adjusted the marketing loan rates for cotton if a long-run analysis is used, because in a short run analysis, market participants will not fully adjust. If only short-run modeling were permitted to assess the difference between the measure at issue and the counterfactual, the full effect of the difference between the two situations would simply not be accounted for in the modeling and any less than full adjustment might appear simply because the modeling did not provide for the full adjustment that would take place in a real-world scenario where a subsidy is permanently withdrawn.

64. Please comment on Brazil's arguments in paragraphs 437 to 446 concerning the change in legal basis of the marketing loan and counter-cyclical payments since the expiry of the 2002 Farm Bill. Please comment specifically, in this context, on the statement of the Appellate Body in US – Hormones Suspension, referred to in para. 444 of Brazil's Written Submission.

164. In paragraphs 437-441, Brazil uses a comparison of the provisions of the 2002 and 2008 Farm Bills to argue that the change “did not reduce, or otherwise impact in any significant way” marketing loan or countercyclical payments for cotton. But, because the 2008 Farm Bill is only recently put into effect, it is difficult to make any such conclusion on the basis of actual data, and so this conclusion is only speculation that reflects Brazil’s assumptions regarding how the marketing loan and countercyclical payments will be made in the future. Over time, this will be affected by many factors other than the farm bill, including farmers’ decisions in the United States and worldwide, the state of industries that use cotton as an input, etc. In addition, even if future payments were certain, the effects of those payments on price would still be a matter of speculation.

165. What Brazil’s analysis cannot escape is that the 2002 Farm Bill, which served as the basis for findings with respect to marketing loan and countercyclical payments, no longer exists.

166. Brazil’s reliance on US-Hormones Suspension is misplaced. Brazil suggests that it can continue to pursue countermeasures regardless of whether the United States adopts new measures or otherwise comes into compliance, based on the idea of “substantive compliance” in that dispute. However, the situation in Hormones Suspension is completely different from the situation facing Brazil: in Hormones Suspension, countermeasures had been authorized by the DSB and were already in place. Here, no countermeasures have been authorized, and there are no countermeasures for Brazil to continue to impose on any basis.

65. In light of the fact that, in the underlying proceedings, findings were made in relation to the impact of the subsidies at issue on "world" prices, please elaborate on the reasons why you consider that only the adverse effects "to the interests of Brazil" should form the basis of an assessment of countermeasures "commensurate with" the adverse effects determined to exist (see paras. 242 and 243 of your FS).

136 US-Hormones Suspension (AB), paras. 304-305.
167. The original panel used a world market and world prices to determine whether United States marketing loan and countercyclical payments caused significant price suppression “in the same market” and “serious prejudice to the interests of” Brazil. This was upheld by the Appellate Body on appeal.\textsuperscript{137} As the panel stated, “Article 6.3(c) of the SCM Agreement provides that serious prejudice within the meaning of Article 5(c) may arise in any case where the effect of the subsidy is ‘significant price suppression . . . in the same market.’”\textsuperscript{138}

168. In this statement, the panel correctly took account of the two different provisions of the SCM Agreement that are most of concern here. First, there is Article 5(c), which is the basis for the “adverse effects” finding, and is recalled by the term “adverse effects” in the “commensurate” standard under Article 7.9 of the SCM Agreement. Second, there is the finding of significant price suppression in Article 6.3(c), which is where the choice of market is made.

169. In the compliance proceedings, the panel again correctly placed the “world market” issue within Article 6.3(c) of the SCM Agreement. That is, the compliance panel examined world prices on the basis that the relevant “same market” in which significant price suppression was alleged was the world market for cotton.\textsuperscript{139} The use of the term “in the same market” makes clear that the products of both the Member providing the subsidy and the other Member must be present in that “same” market. That the other Member’s products must be present in the same market reflects that under Articles 5 and 6, it is adverse effects “to the interests of another Member” that is of concern.

170. The panel and the Appellate Body both observed that the use of a “world market” for the analysis was not the only possibility under Article 6.3(c).\textsuperscript{140} Thus, under different circumstances, a “world market” or a regional market or a national market might be used to evaluate significant price suppression. But in any case, the finding under Article 6.3(c) would simply be a step toward meeting the test under Article 5(c) with respect to “adverse effects” on the Member bringing the dispute. The parameters of Article 5(c) do not change from commodity to commodity.

171. The finding of significant price suppression in the world market, the “same market” in which U.S. and Brazilian cotton competed, was a step toward finding “adverse effects to the interests of” Brazil.\textsuperscript{141} This is further clarified in the discussion of world price in the Appellate

\textsuperscript{137} US-Upland Cotton (AB), paras. 414 and 418.

\textsuperscript{138} US-Upland Cotton (Panel), para. 7.1235.

\textsuperscript{139} US-Upland Cotton (Article 21.5) (Panel), para. 10.43.

\textsuperscript{140} US-Upland Cotton (Panel), para. 7.1247, US-Upland Cotton (AB), para. 408.

\textsuperscript{141} US-Upland Cotton (Panel), para. 7.1388.
Body report, which stated that because Brazil would be affected by the world upland cotton price, it was not necessary to do a separate analysis of the Brazilian market.142

172. The original panel’s conclusions with respect to interests of other Members underscore that the panel’s findings under Article 5(c) are in relation to Brazil. While the panel observed that it could take into account interests of other Members, the panel was clear that allegations of serious prejudice to other Members were taken into account “to the extent these constitute evidentiary support of the effect of the subsidy borne by Brazil as a Member whose producers are involved in the production and trade in upland cotton in the world market.”143

173. In other words, regardless of whether the underlying analysis of significant price suppression includes specific findings on effects to Brazil alone, includes consideration of worldwide market conditions, or a combination, the ultimate legal conclusion of “adverse effects” is governed by Article 5(c) and is limited to “adverse effects to the interests of” Brazil.

66. Please clarify what you understand the terms the "nature of the adverse effects determined to exist" (emphasis added) to refer to, in Articles 7.9 and 7.10 of the SCM Agreement.

174. First of all, these terms only apply with respect to possible countermeasures for actionable subsidies, and they must be understood in that context. Although certain disciplines apply, actionable subsidies are permitted. The standard in Articles 7.9 and 7.10 serves to narrow countermeasures so that they only apply to the extent that these disciplines are breached and do not limit otherwise permitted subsidies. Thus, the “nature” of the adverse effects is first that they are caused by subsidies which are, in themselves, permissible. This is underscored by the modification of the term “effects” with “adverse.” Countermeasures may not be commensurate with all effects of a subsidy, but are limited to what is commensurate with the adverse effects.

175. Second, the nature of the adverse effects can be understood on the basis of the findings in the particular dispute. Here, the findings of “adverse effects” are under Article 5(c) of the SCM Agreement, “serious prejudice to the interests of another Member” (Brazil), based on a finding of “significant price suppression” under Article 6.3(c). Thus, the finding of “significant price suppression” indicates that the “nature” of the effects on Brazil in this particular case are not simply price suppression, but significant price suppression. As a result, part of the “nature” of the “adverse” effects here is that they are limited to those causing price suppression in the same market that reaches the level of “significant.”

176. Finally, details of the particular measure at issue may bear on the “nature” of the adverse effects. In this particular dispute, the variability of marketing loan and countercyclical payments

142 US-Upland Cotton (AB), para. 417.

143 US-Upland Cotton (Panel), para. 7.1415 (emphasis added).
from year to year is such a factor. As a factual matter, this is part of the data underlying the “adverse effects determined to exist,” but the United States notes it separately because the variability affects what can be considered “commensurate” going forward, if the DSB authorizes countermeasures by Brazil.

67. Please respond to Brazil’s arguments, in paras. 454 to 472, that there are no restrictions on the types of countermeasures that may be taken pursuant to the SCM Agreement.

177. Brazil’s argument comes too late. Brazil conceded at the outset of this process that Article 22.3 applies to its request for authorization for countermeasures. Indeed, in its requests for authorization, Brazil explicitly invoked Article 22.3 of the DSU (including the heading: “Suspension of concessions and obligations under Article 22.3(c) of the DSU”) and asserted that it met the criteria laid out therein. In both the request for suspension of concessions under Article 4.10 and under Article 7.9, Brazil referred to Article 22.3 of the DSU (and the “practicable or effective” and “circumstances are serious enough” terms of art in Article 22.3) when it set out its request for suspension of concessions under TRIPS and GATS. Therefore, having conceded the application of Article 22.3 of the DSU, Brazil is in no position to now claim that Article 22.3 does not apply to Brazil’s requests, or that there is no restriction on the “types” of countermeasures that may be taken pursuant to the SCM Agreement, with the implication that there are no limits on countermeasures in terms of sector or agreement.

178. Indeed, the United States is quite surprised to find such a belated attempt by Brazil to alter unilaterally the terms of these proceedings and to circumscribe the terms of reference of the Arbitrators. The United States referred the matter under each request to arbitration under Article 22.6 of the DSU, and in each case the “matter” included Brazil’s claim to be justified under Article 22.3. The DSB explicitly agreed that the “matter” that was referred to arbitration included the U.S. claims that Brazil had failed to follow the principles and procedures set forth in Article 22.3. Brazil is not now entitled to seek to amend the Arbitrators’ terms of reference.

179. Furthermore, under Article 1.2 of the DSU, the special or additional rules for subsidies, including articles 4.10 and 7.9 of the SCM Agreement, only displace the otherwise applicable rules of the DSU to the extent that there is a difference, and there is no such difference here.

180. In Guatemala-Cement, at issue was what is required under DSU Article 1.2 in terms of a “difference” in order for a DSU rule to be displaced by a special or additional rule. The Appellate Body Report concluded that this should occur only where there is an inconsistency between two provisions that results in an actual conflict. Otherwise, provisions should be interpreted to be complementary. The Appellate Body stated:

144 WT/DS267/21; WT/DS/267/26.

145 WT/DS267/23 and WT/DS267/27. Minutes of the DSB meetings of July 15, 2005 (WT/DSB/M/193, para. 11), and of October 18, 2005 (WT/DSB/M/199, para. 44).
“it is only where the provisions of the DSU and the special or additional rules and procedures of a covered agreement cannot be read as complementing each other that the special or additional provisions are to prevail. A special or additional provision should only be found to prevail over a provision of the DSU in a situation where adherence to the one provision will lead to a violation of the other provision, that is, in the case of a conflict between them. An interpreter must, therefore, identify an inconsistency or a difference between a provision of the DSU and a special or additional provision of a covered agreement before concluding that the latter prevails and that the provision of the DSU does not apply.”

181. As an initial matter, it is clear from the terms of Article 22.3 that it applies to the SCM Agreement. Article 22.3(g) states that “agreement” for the purposes of Article 22.3 means “with respect to goods, the agreements listed in Annex 1A of the WTO Agreement, taken as a whole as well as the Plurilateral Trade Agreements in so far as the relevant parties to the dispute are parties to these agreements.” The list in Annex 1A includes the SCM Agreement.

182. It is plain that the disciplines of Article 22.3 apply to countermeasures with respect to subsidies. Brazil’s arguments on the silence of the SCM Agreement on “type” of countermeasures, on the significance of the term “countermeasure,” and the interpretation of the ILC Articles and Commentaries cannot change this fact.

183. Brazil’s interpretation would require assuming the special or additional rules under Article 4.10 and 7.9 of the SCM Agreement speak to amount of countermeasures, but are silent on “type” and that this silence is a “blank check” that would allow countermeasures under any sector and under any agreement. But this would mean that the special or additional rules – which allow for countermeasures specifically tailored to different types of subsidies – would be entirely

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146 Guatemala Cement I (AB), para. 65.
147 DSU Article 22.3(g).
148 Finally, Brazil’s reliance, in paragraph 466 of its submission, on the quotation from Canada-Aircraft is misplaced. In that context, there was no question of countermeasures outside the sector, and the flexibility with respect to type is only within the boundaries of where countermeasures were sought in that dispute (the same sector). “Type,” in this context, is similar to “form” or “nature” (see Written Submission of Brazil, para. 28, arguing that 4.10 does not include rules that “countermeasures must be of a particular form or type”) as used by the arbitrator in US-Gambling, when it said that it would not be examining the “nature” or “form” of proposed suspension of concessions, even though the question of the sector and Agreement under which the suspension of concessions would take place was squarely before it under Article 22.3. US-Gambling (Article 22.6), para. 5.9
permissive and free of restriction with respect to sector and agreement. Such a conclusion is difficult to reconcile with the fact that the drafters obviously were concerned with issues relating to cross-sectoral suspension of concessions or other obligations. The text of Article 22.3 is a testament to this fact. In light of this, as well as the Appellate Body’s admonition that the special or additional rules and procedures and the other provisions of the DSU be interpreted in a complementary matter, it simply is not credible to contest, as does Brazil, that the drafters intended *sub silentio* to permit cross-sectoral retaliation in prohibited subsidy disputes without any rules. Indeed, if anything, the existence of detailed rules in Article 22.3 and the absence of any reference to cross-sectoral suspension in Articles 4.10 and 7.9 would suggest that, if these rules are not meant to be read together, cross-sectoral suspension is not permitted under Articles 4.10 and 7.9.

184. The general rule (as stated in DSU Article 22.3) is for suspension of concessions within the same sector and agreement – indeed, Members are required to seek it. Suspension of concessions outside the same sector/agreement of the WTO-inconsistent measure is the exception to the rule. Members must meet additional requirements in order to impose them, and under the hierarchy of Article 22.3, such suspension of concession is clearly disfavored.

185. Given the general rule for suspension of concessions within the same agreement/sector, and the absence of any rule to the contrary in Articles 4.10 and 7.9, there is no conflict in applying both the special or additional rules of the SCM Agreement and Article 22.3 of the DSU. Thus, the better interpretation – and one that allows Articles 4.10/7.9 and 22.3 to be applied in a complementary fashion – is that Articles 4.10 and 7.9 deal with the amount of countermeasures, while Article 22.3 sets forth rules for determining when countermeasures can be applied on cross-sectoral basis. To the extent there is a conflict between them, it is in regard to assessment of quantity, or amount, of suspension of concessions. With regard to “type” or “form,” the silence of the SCM Agreement as to cross-agreement or cross-sector countermeasures means that there is no “difference” in the meaning of DSU Article 1.2 that would require ignoring the carefully articulated, hierarchical test under Article 22.3.

186. Brazil’s interpretation requires reading the silence on the subject of cross-sectoral suspension of concessions in Articles 4.10 and 7.9 of the SCM Agreement as meaning there are no rules governing such countermeasures and a conflict with the rules under Article 22.3. But this type of interpretation finds a conflict where, as described in the paragraph above, there is no conflict. By Brazil’s logic, would any of Article 22 apply (except Article 22.6, due to its mention in Article 4.11 and 7.10)? For example, Article 22.8 affirms the temporary nature of suspension of concessions. Without explicitly being incorporated into the SCM Agreement, would this apply to countermeasures?

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149 DSU Article 22.3(a).

150 *EC-Bananas III (US) (Article 22.6)*, para. 3.7.
187. Brazil’s reliance on the term “countermeasure” and its appearance in the ILC Articles and Commentaries cannot change any of this. Brazil argues that the use of the term “countermeasures” in the SCM Agreement and the ILC Articles should be read, along with the idea of inducing compliance with international obligations (present in Article 49 of the ILC Articles) to create a reading of the actual standards for assessing countermeasures for subsidies that would essentially be any measure that Brazil finds “reasonable” to induce compliance.

188. First, the ILC Articles Brazil cites do not apply. They are not “covered agreements” set forth in Appendix 1 to the DSU, nor do they set forth “customary rules of interpretation of public international law,” the rules by which WTO dispute settlement adjudicative bodies are to clarify existing provisions of the covered agreements pursuant to Article 3.2 of the DSU.

189. Even aside from this, the Draft Articles per se are irrelevant to the issues raised in this proceeding because they do not constitute law in their own right. Rather, the Draft Articles include provisions that reflect customary international law, others that explicitly do not, and still others the status of which is unclear. Therefore, as a general matter outside the context of this proceeding, before the Draft Articles could be applied, a determination would have to be made that a particular provision of the Draft Articles constituted customary international law.

190. Furthermore, the Draft Articles themselves make clear that they could not be relevant to this proceeding. Article 55 of the Draft Articles states:

*Lex specialis*

These articles do not apply where and to the extent that the conditions for the existence of an internationally wrongful act or the content or implementation of the international responsibility of a State are governed by special rules of international law.

191. The provisions of the WTO agreements fully govern the conditions for the existence of an internationally wrongful act and the content or implementation of the international responsibility of Members. Accordingly, the Draft Articles would not apply by virtue of Article 55 to these arbitrations.

192. Significantly, the International Law Commission itself has agreed with this assessment. In its commentary accompanying the Draft Articles, the Commission has stated as follows:151

Article 55 provides that the Articles do not apply where and to the extent that the conditions for the existence of an internationally wrongful act or its legal

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consequences are determined by special rules of international law. It reflects the maxim of *lex specialis derogat legi generali* ... Thus, the assumption of article 55 is that the special rules in question have at least the same legal rank as those expressed in the Articles. On that basis, article 55 makes it clear that the present articles operate in a residual way.

It will depend on the special rule to establish the extent to which the more general rules on State responsibility set out in the present articles are displaced by that rule. In some cases it will be clear from the language of a treaty or other text that only the consequences specified are to flow. Where that is so, the consequence will be “determined” by the special rule and the principle embodied in article 56 will apply. In other cases, one aspect of the general law may be modified, leaving other aspects still applicable. An example of the former is the World Trade Organization Dispute Settlement Understanding as it relates to certain remedies.

193. Second, Brazil makes too much of the term “countermeasures,” which happens to occur in both the SCM Agreement and the ILC Articles. The term was present in the Tokyo Round Subsidies Code, and its continued use with respect to subsidies simply reflects continuity with respect to subsidies. It does not, through the operation of the ILC articles, change the *lex specialis* legal standard for imposing countermeasures under the SCM Agreement and the DSU.

194. Moreover, the use of the term “countermeasures” does not support Brazil’s reliance on the idea of “inducing compliance” (as provided in the ILC Articles) compared to the terms the United States used in its submission, “rebalancing of concessions.” “Rebalancing” also contemplates a “countermeasure” opposite (or counter) to the measure determined to be inconsistent with the SCM Agreement, but it also acknowledges that there is a check in the system to be sure that the “countermeasure” does not exceed what is permitted.

195. The definitions for “balance” are instructive to show that there is a “counter” or “offset” component to “rebalancing,” as well as a “proportion” and “equilibrium” component. The New Shorter Oxford dictionary defines “balance” as “equal in weight; neutralize the weight; make up for; counterbalance or match against another; bring into or keep in equilibrium.” Similarly, the American Heritage Dictionary defines “balance” as “to act as an equalizing weight or force; to offset; to counterbalance; to bring into or maintain a state of equilibrium; to bring into or keep in equal or satisfying proportion or harmony.”

196. The “check” that countermeasures are to provide is a “check” against the inconsistency found with respect to the SCM Agreement.

68. Please respond to Brazil’s arguments, in paras. 510 to 535, that it has in fact followed the principles of Article 22.3 of the DSU.

197. Brazil’s arguments in support of cross-agreement retaliation under Article 22.3 of the
DSU fall short. Brazil’s arguments underestimate the significance of the hurdles to cross-agreement retaliation, and resort to several criteria that should not be relied upon in this dispute.

198. Brazil describes the standard for Article 22.3 as “plausibility.” But “plausibility” is only part of what was required when the arbitrators in EC-Bananas III (Ecuador) and US-Gambling analyzed proposed suspension of concessions under Article 22.3. Not only must Brazil have plausibly arrived at its conclusion, but it must have done so objectively, considering the necessary facts. As the US–Gambling Arbitrator articulated:

“We have determined in the previous section that our task is to examine whether, in making a determination in this case, Antigua, as the complaining party, has considered the necessary facts objectively and whether, on the basis of these facts, it could plausibly arrive at the conclusion that it was not practicable or effective to seek suspension with respect to the same sector within the same agreement.”

199. Brazil attempts to dismiss the U.S. argument that the standard for cross-agreement countermeasures is a high bar, but Brazil’s arguments are belied by the structure of the DSU. First, the possibility of cross-agreement countermeasures is exceptional. “The basic rationale of these disciplines is to ensure that the suspension of concessions or other obligations across sectors or across agreements . . . remains the exception and does not become the rule.” Article 22.3(a) includes an explicit reminder that the default rule for suspension of concessions is same sector/agreement, when it describes it as the “general principle.” The detailed, hierarchical disciplines in Article 22.3 further bear this out.

200. Brazil emphasizes the idea of inducing compliance to support its request to take countermeasures in other sectors and under other agreements. But, carried to its logical conclusion, emphasis on this notion would threaten the way in which the standards in the SCM Agreement and Article 22.3 of the DSU govern the amount and type of countermeasures that can be imposed. An “induce compliance” standard could permit ever-increasing amounts of countermeasure and ever-changing type of countermeasure (in any sector or under any agreement) until the goal of the Member imposing countermeasures was achieved. In terms of amount, this could be far more than “commensurate” within the meaning of Article 7.9 and may be disproportionate within the meaning of Article 4.10, footnote 9. In terms of “type,” it would ignore the hierarchical, structured standard of Article 22.3 in favor of reducing all of Article 22.3 to a particular reading of the term “effective.”

201. Countermeasures, it should be recalled, are WTO-inconsistent measures that are permitted because they meet certain legal standards. There is a need for a certain structure and disciplines on these WTO-inconsistent measures, and Brazil’s approach would reject these

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152US–Gambling (Article 22.6), para. 4.27.

153EC-Bananas III (U.S.) (Article 22.6), para. 3.7.
disciplines.

202. Brazil’s arguments emphasize its status as a developing country and the purported narrow scope of goods. In setting out these arguments, Brazil overestimates the barriers to practicable and effective countermeasures that these issues present. For example, Brazil points to the difference between the percent of trade to Brazil from the United States compared to the United States-Brazil trade to show a “dependence” on U.S. goods that would make countermeasures with respect to goods not practical or effective. But, the relative trade is not the question – rather, the question is whether, within the trade from the United States that does occur, would it be practicable or effective to impose countermeasures in goods?

203. Brazil suggests that the range of goods on which countermeasures could be imposed is actually quite small, claiming that almost all of Brazil’s imports from the United States are essentials. But another look shows that the United States accounts for only a small share of Brazil’s imports under virtually every HS chapter.\textsuperscript{154} Brazil has imports in all these areas from other sources, and the possibility of substituting goods from other sources for U.S. goods would mitigate any welfare effect. To the extent certain goods are more difficult to substitute, Brazil could take that into account in fashioning countermeasures (e.g., focusing on luxury goods to the extent possible, where increased costs would have little impact,\textsuperscript{155} and then exploring other goods where substitute goods are available.)

204. The impressive diversity and development of the Brazilian economy is also important. Although Brazil emphasizes the difficulties it faces as a developing country, in fact Brazil’s position is much different than Ecuador or Antigua. Brazil far surpasses both in GDP, population, exports, and diversity of industry.

\textsuperscript{154}Exhibit US-109. Only Machinery (15.52%), Organic Chemicals (23.84%), and Mineral Fuel, Oil, Etc. (10.17%) were above 10% in 2007 as a percentage of imports to Brazil.

\textsuperscript{155}Written Submission of Brazil, para. 523.
Table 5: Comparison of Antigua, Brazil, and Ecuador

<table>
<thead>
<tr>
<th></th>
<th>Antigua</th>
<th>Brazil</th>
<th>Ecuador</th>
</tr>
</thead>
<tbody>
<tr>
<td>Population (July 2008 est)</td>
<td>84.5 thousand</td>
<td>196.3 million</td>
<td>13.9 million</td>
</tr>
<tr>
<td>GDP (PPP) (2008est)</td>
<td>$1.1 billion</td>
<td>$2 trillion</td>
<td>$107 billion</td>
</tr>
<tr>
<td>Industries</td>
<td>tourism, construction, light manufacturing (clothing, alcohol, and household appliances)</td>
<td>textiles, shoes, chemicals, cement, lumber, iron ore, tin, steel, aircraft, motor vehicles and parts, other machinery and equipment</td>
<td>petroleum, food processing, textiles, wood products, chemicals</td>
</tr>
<tr>
<td>Exports</td>
<td>$84.3 million (2007 est)</td>
<td>$200 billion (2008 est)</td>
<td>$19.4 billion (2008 est)</td>
</tr>
</tbody>
</table>

source: CIA World Factbook

205. In fact, Brazil itself has identified many of the economic strengths that would increase the number of options available to it – even within the goods sector – for possible imposition of countermeasures. The Brazilian Government describes itself as an “advanced developing country” with, as “its most outstanding feature . . . a widely diversified economy makeup an impressive output in farming and livestock, a broad range of industries and a dynamic strong tertiary sector of enormous potential of expansion.”

206. Brazil also asks the Arbitrators to consider the costs of imposing countermeasures, including market distortion, risk of inflation, and potential welfare effects. As the United States observed in its submission, countermeasures are by definition counter to WTO disciplines. The Arbitrator is not asked to ensure that imposition of countermeasures will be without any such effects. Rather, the Arbitrators are asked to determine whether Brazil has satisfied the requirements of Article 22.3. Given the size and diversity of Brazil’s economy, and the availability of goods from other sources or from Brazil itself, it is evident that Brazil has many tools at its disposal to apply countermeasures within the goods sector.

207. Finally, Brazil’s arguments also fall short with respect to seriousness of the circumstances and the consideration of Article 22.3(d), which it discusses in paragraphs 528-535. For “seriousness of the circumstances,” Brazil emphasizes the characteristics of the U.S. subsidies with respect to which the DSB has made findings of inconsistency. But, the subsidy findings are

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156US-Exhibit 110, “Welcome to the Embassy of Brazil in Port-of-Spain.”
taken into account in the findings with regard to the amount of countermeasures. Furthermore, in this dispute, the amount of countermeasures is evaluated under standards specifically suited to the subsidies at issue (prohibited or actionable). The amount of the subsidies and the fact that the DSB made findings of inconsistency are part of the history and circumstances of the case, but they do not show that exceptional, out-of-sector countermeasures should be permitted. In addition, Brazil’s discussion of the trade relations between the United States and Brazil (with respect to both Articles 22.3(c) and 22.3(d)) does not make it possible to ignore the fact that given the size and diversity of this trade, Brazil could impose countermeasures within the goods sector (and in fact, cannot reach the further steps under Article 22.3(d)).