

BEFORE THE
WORLD TRADE ORGANIZATION
APPELLATE BODY

*United States – Subsidies on Upland Cotton:
Recourse to Article 21.5 of the DSU by Brazil*

(AB-2008-2)

Appellant Submission of the United States of America

February 19, 2008

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Short Form	Full Citation
<i>Australia – Leather (Article 21.5)</i>	Panel Report, <i>Australia – Subsidies Provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the United States</i> , WT/DS126/RW and Corr.1, adopted 11 February 2000
<i>Australia – Salmon (Article 21.5)</i>	Panel Report, <i>Australia – Measures Affecting Importation of Salmon – Recourse to Article 21.5 of the DSU by Canada</i> , WT/DS18/RW, adopted 20 March 2000
<i>Canada – Aircraft (Article 21.5) (AB)</i>	Appellate Body Report, <i>Canada – Measures Affecting the Export of Civilian Aircraft – Recourse by Brazil to Article 21.5 of the DSU</i> , WT/DS70/AB/RW, adopted 4 August 2000
<i>EC – Bed Linen (Article 21.5) (AB)</i>	Appellate Body Report, <i>European Communities – Anti-Dumping Duties on Imports of Cotton-Type Bed Linen from India – Recourse to Article 21.5 of the DSU by India</i> , WT/DS141/AB/RW, adopted 24 April 2003
<i>EC – Hormones (AB)</i>	Appellate Body Report, <i>EC Measures Concerning Meat and Meat Products (Hormones)</i> , WT/DS26/AB/R, WT/DS48/AB/R, adopted 13 February 1998
<i>Korea – Commercial Vessels</i>	Panel Report, <i>Korea – Measures Affecting Trade in Commercial Vessels</i> , WT/DS273/R, adopted 11 April 2005
<i>US – German Steel (AB)</i>	Appellate Body Report, <i>United States – Countervailing Duties on Certain Corrosion-Resistant Carbon Steel Flat Products from Germany</i> , WT/DS213/AB/R, adopted 19 December 2002
<i>US – Cotton Subsidies (Panel)</i>	Panel Report, <i>United States – Subsidies on Upland Cotton</i> , WT/DS267/R, adopted 21 March 2005, as modified by the Appellate Body Report, WT/DS267/AB/R
<i>US – Cotton Subsidies (AB)</i>	Appellate Body Report, <i>United States – Subsidies on Upland Cotton</i> , WT/DS267/AB/R, adopted 21 March 2005
<i>US – Oil Country Tubular Goods Sunset Reviews (Article 21.5) (AB)</i>	Appellate Body Report, <i>United States – Sunset Reviews of Anti-Dumping Measures on Oil Country Tubular Goods from Argentina – Recourse to Article 21.5 of the DSU by Argentina</i> , WT/DS268/AB/RW, adopted 11 May 2007

<p><i>US – Softwood Lumber IV (Article 21.5) (AB)</i></p>	<p>Appellate Body Report, <i>United States – Final Countervailing Duty Determination with Respect to Certain Softwood Lumber from Canada – Recourse to Article 21.5 of the DSU by Canada</i>, WT/DS257/AB/RW, adopted 20 December 2005</p>
<p><i>US – Softwood Lumber VI (Article 21.5) (AB)</i></p>	<p>Appellate Body Report, <i>United States – Investigation of the International Trade Commission in Softwood Lumber From Canada – Recourse to Article 21.5 of the DSU by Canada</i>, WT/DS277/AB/RW, adopted 9 May 2006</p>
<p><i>US – Wheat Gluten (AB)</i></p>	<p>Appellate Body Report, <i>United States – Definitive Safeguard Measures on Imports of Wheat Gluten from the European Communities</i>, WT/DS166/AB/R, adopted 19 January 2001</p>

I. Introduction and Executive Summary

1. The United States took several actions to comply with the Dispute Settlement Body's ("DSB") recommendations and rulings in *United States – Subsidies on Upland Cotton* (WT/DS267). Effective August 1, 2006, the United States repealed the Step 2 program, which had been found to be a prohibited export subsidy and a prohibited import substitution subsidy in the original proceeding. Payments under the Step 2 program were also part of a basket of payments made in marketing year ("MY") 1999-2002 whose effect was found to be significant price suppression in the market for upland cotton, thereby causing serious prejudice to the interests of Brazil. Moreover, in 2005 the United States ceased to operate the CCC Intermediate Export Credit Guarantee Program ("GSM 103") and the Supplier Credit Guarantee Program ("SCGP"), and substantially reformed the fee structure of the CCC Export Credit Guarantee Program ("GSM 102") to ensure that premia were adequate to meet the long-term operating costs and losses of the program. In the underlying proceeding, all three of these export credit guarantee programs were found to have constituted prohibited export subsidies under the *Agreement on Agriculture* and the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement").

2. Despite all of these changes, which brought the United States fully into compliance with the DSB's recommendations and rulings, Brazil requested on August 18, 2006 the establishment of a panel under Article 21.5 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"). The Panel, after erroneously concluding that certain claims were properly within the scope of the compliance proceeding, found that the United States was not in compliance with the DSB's recommendations and rulings concerning export credit

guarantees and serious prejudice. The Panel's conclusions lack analytical rigor, contain inherent contradictions, and misinterpret the relevant provisions of the covered agreements. The Panel also failed to undertake an objective assessment of the matter before it, as required by Article 11 of the DSU. All of these errors compel a reversal of the Panel's legal conclusions. The U.S. appeal focuses on three main issues.

A. Proper Scope of the DSU Article 21.5 Proceeding

3. The United States asked for a preliminary ruling that Brazil's claims regarding the GSM 102 export credit guarantees with respect to exports of pig meat and poultry meat were not within the scope of the compliance proceeding under DSU Article 21.5. The United States further objected to the Panel's consideration of serious prejudice claims concerning marketing loan and counter-cyclical payments made after September 21, 2005, which was the expiration of the period to comply with the DSB's recommendations and rulings concerning serious prejudice. The Panel, however, erroneously found that these claims were within the scope of the compliance proceeding.

4. Under Article 21.5, a panel may examine disagreements as to the existence of, or consistency with the covered agreements, of measures taken to comply with *the recommendations and rulings of the DSB*. A complaining member may thus claim either that measures taken to comply with the recommendations or rulings of the DSB do not exist, or that the measures taken to comply with those recommendations and rulings of the DSB are not consistent with a covered agreement. In either case, the DSB recommendations and rulings shape the scope of a compliance proceeding.

1. GSM 102 Guarantees for Pig Meat and Poultry Meat Were Not

Within the Scope of the Proceeding

5. The GSM 102 export credit guarantees with respect to exports of pig meat and poultry meat were separate measures from those GSM 102 guarantees extended to other products. They were not subject to the DSB recommendation and rulings in the original proceeding, and there logically could be no disagreement about the existence of measures taken to comply regarding them. Nor were the revised GSM 102 guarantees for pig meat and poultry meat measures taken to comply with any other recommendations and rulings. The Panel, however, improperly found that the claims regarding those guarantees were within the scope of the compliance proceeding.

6. The Panel’s finding rested on a what the Panel saw as a “close relationship” between the GSM 102 guarantees for pig meat and poultry meat, the declared measures taken to comply, and the recommendations and rulings of the DSB. However, what governs here is the text of Article 21.5. Claims against measures that were not subject to the DSB’s recommendations and rulings cannot properly fall within the scope of a compliance proceeding.

2. Marketing Loan and Counter-Cyclical Payments Made After September 21, 2005, Were Not Within the Scope of the Proceeding

7. The only measures subject to the DSB’s recommendations and rulings concerning present serious prejudice were payments made under the Step 2, market loss assistance, marketing loan and counter-cyclical payment programs in MY 1999-2002 (i.e., through July 31, 2003). The marketing loan and counter-cyclical payments made after September 21, 2005 were not subject to the DSB’s recommendations and rulings, nor were payments made after September 21, 2005 in any way U.S. measures taken to comply with other recommendations and rulings of the DSB. These payments were outside the scope of the compliance proceeding under Article 21.5, but the

Panel nevertheless considered the serious prejudice claims related to them.

8. The Panel's finding rested on a fundamental misinterpretation of the U.S. obligation to withdraw the subsidy, or remove its adverse effects, under Article 7.8 of the SCM Agreement. According to the Panel, the United States did not take appropriate steps to remove adverse effects of a subsidy because it continued to provide marketing loan and counter-cyclical payments under the same conditions and the same criteria as the original payments in a manner that caused adverse effects. However, the provisions of Article 7.8 extend only so far as the DSB's recommendations and rulings. In this dispute, the DSB's recommendations and rulings applied only to the Step 2, market loss assistance, marketing loan, and counter-cyclical payments made during MY 1999-2002, and did not cover either future payments, such as those made after September 21, 2005, or the subsidy programs themselves.

9. The Panel also disregarded the proper relationship between Article 7.8 of the SCM Agreement and Article 21.5 of the DSU. The Panel viewed Article 21.5 as giving a compliance panel jurisdiction over payments similar to those that were found to have caused adverse effects in the original proceeding and that were subject to the Article 7.8 obligation. The text of Article 21.5, however, determines what is properly within the scope of a compliance proceeding when compliance with a Member's obligations under the covered agreements is at issue. Under Article 21.5, a panel may only review disagreements as to the existence or consistency with the covered agreements of measures taken to comply with the recommendations and rulings of the DSB. The recommendations and rulings of the DSB (and the measures taken to comply with them) establish the scope of a compliance proceeding, and here were limited to marketing loan and counter-cyclical payments made during MY1999-MY2002. Any payments made after September

21, 2005 were not properly before the Panel.

B. Export Credit Guarantees

1. Panel’s “Quantitative” Analysis Under Item (j) and the Failure of Brazil to Make a *Prima Facie* Case

10. The Panel’s determination that GSM 102 export credit guarantees constituted export subsidies rested entirely on its conclusion that they were provided at premia which were inadequate to cover the GSM 102 program’s long-term operating costs and losses under the terms of item (j) of the Illustrative List of Export Subsidies in Annex I of the SCM Agreement. The Panel’s “quantitative analysis” under item (j) focused on budgetary data concerning the CCC’s export credit guarantee programs. Brazil relied on initial budgetary estimates showing a loss under the GSM 102 program for fiscal years 2006-08, and the Panel erroneously concluded that these estimates were sufficient to support a *prima facie* case under item (j).

11. The United States explained that U.S. Government budget re-estimates made since the time of the original proceeding demonstrated that even before the changes to the CCC’s export credit guarantee programs, the programs were running at a long-term profit. Moreover, the United States elaborated on the inherent shortcomings in the initial estimates data. Brazil, however, never accounted for the significance of the new re-estimate data, nor the flaws in the initial budget projections. Nevertheless, the Panel considered that Brazil had put forth evidence to satisfy its burden of proof under item (j).

2. Reliance on Incorrect Fee Comparisons

12. Even though it recognized that Minimum Premium Rates (“MPRs”) under the OECD Arrangement on Officially Supported Export Credits (“OECD Arrangement”) have no legal

status under item (j) and provide no benchmark for agricultural export credit guarantees, it still made determinations under item (j) based on a comparison of GSM 102 program fees to MPRs. In addition, the Panel erroneously interpreted item (j) to require a relative “scaling” of fees between highest risk obligors and lowest risk obligors under an export credit guarantee program. In so doing, the Panel made improper comparisons between the GSM 102 program and wholly dissimilar programs of the Export-Import Bank of the United States (“Ex-Im Bank”).

3. Reliance on the One Percent Fee Cap

13. The Panel assumed that the continuing existence of a statutory one-percent fee cap under the GSM 102 program necessarily meant that the program was not designed to cover long-term operating costs and losses. Nothing in item (j), however, precludes the imposition of a fee cap for an export credit guarantee program, like GSM 102, as long as the program is designed to meet its long-term operating costs and losses. In this case, the fee structure of the GSM 102 export credit guarantees was drastically overhauled to take into account risk and to ensure that the program met its long-term operating costs and losses.

4. Reliance on Other Factors not Properly Part of an Item (j) Analysis

14. The Panel fundamentally misinterpreted item (j) in relying on other factors as part of its analysis of the structure, design, and operation of GSM 102 export credit guarantees. The Panel considered the fact that the CCC has access to funds from the U.S. Treasury as meaning that the GSM 102 program was not designed to cover its long-term costs and losses. The Panel also concluded that U.S. limits on foreign bank obligors were insufficient to take into account risk and ensure that the GSM 102 program met its long-term operating costs and losses. Neither of these factors is mandated by the terms of item (j), and neither properly supported the Panel’s

finding

5. Failure to Undertake an Objective Assessment

15. Article 11 of the DSU required the Panel to undertake an objective assessment of the export credit guarantee claims, but the Panel failed to do so. The United States demonstrates that the Panel (a) disregarded and misconstrued the import of the GSM 102 export credit guarantee budgetary re-estimates data submitted by the United States; and (b) relied on assumptions not supported by evidence on the record and on inappropriate comparisons of fees when conducting its assessment under item (j).

6. The Panel’s Finding that the United States Failed to Comply with the DSB’s Recommendations and Rulings as to Prohibited Subsidies Cannot Stand

16. The United States has demonstrated that the Panel’s findings as to GSM 102 export credit guarantees fail as a matter of law. Therefore, the Panel’s finding as to the United States’ non-compliance with the DSB’s recommendations and rulings concerning export credit guarantees cannot stand.

C. Present Serious Prejudice/Significant Price Suppression

1. The Panel’s Conclusion on Market Insulation Was Erroneous and Fails as a Matter of Law

17. The Panel’s finding that the “effect” of U.S. marketing loan and counter-cyclical payments “is” significant price suppression on the world market for upland cotton rested in large part on the Panel’s conclusion that the U.S. payments “insulated” U.S. producers from market signals to such an extent that they had significant effects on planting, production, exports, and ultimately, price. The Panel’s analysis fails as a matter of law for several reasons.

18. First, the Panel conducted an improper analysis as to the extent to which the structure, design, and operation of marketing loan and counter-cyclical payments operated to insulate U.S. producers. It relied extensively on findings from the original *Cotton* proceeding, even though the current proceeding involves different payments made during a different time period and under different market conditions. Moreover, the Panel's analysis did not properly account for the multitude of other factors, including the prices of competing crops, that influenced planting decisions of U.S. farmers. The Panel also relied on economic studies showing *minimal* effects of counter-cyclical payments on production, but these studies could not plausibly have supported a finding of significant price suppression. The Panel further considered it important that there was a relationship between recipients of counter-cyclical payments who hold base acres, and those who continue to plant cotton; however, the Panel did not account for the degree to which the receipt of those payments was actually inducing planting and production.

19. Second, the Panel contradicted its own findings as to market insulation. Chief among them was the fact that U.S. shares of world production and exports were stable over MY 2002-2005. This indicated that U.S. producers of upland cotton were responding to market signals just like their foreign counterparts. Therefore, there was no basis for the Panel's contradictory finding that U.S. marketing loan and counter-cyclical payments were cutting U.S. farmers off from market signals, and causing them to plant more cotton than they would have otherwise.

20. Third, the Panel never determined the degree of the alleged insulation from market signals, or the degree any of the production effects related to that insulation. It is not remarkable that support payments can have an effect on production, but the key question is the *degree* of the effect for purposes of a significant price suppression analysis. The Panel consistently failed to

make findings as to the degree of production and market-insulating effects of U.S. marketing loan and counter-cyclical payments.

2. Other Grounds Identified by the Panel in Support of its Finding of Present Serious Prejudice Fail as a Matter of Law

21. The Panel examined several other factors as part of its analysis of whether U.S. marketing loan and counter-cyclical payments caused significant price suppression on the world market for upland cotton, and relied on them in support of its ultimate finding on significant price suppression. None of the Panel’s conclusions regarding these factors can stand as a matter of law.

a. *Alleged Divergence between U.S. Total Costs and Market Revenue*

22. The Panel found an alleged “gap” between the total costs of production of U.S. upland cotton producers and their market revenue, and considered that this “gap” supported the proposition that the marketing loan and counter-cyclical payments were an important factor affecting the economic viability of U.S. upland cotton farming, and that but for the availability of those payments, farmers would produce less cotton. The Panel’s analysis erroneously relied on a total cost approach, inconsistent with the fact that U.S. farmers consider variable costs a determinative factor when deciding whether to plant cotton or some other crop.

23. The Panel’s analysis as to total costs and revenue also was flawed. By failing to take into account off-farm income, and other sources of on-farm income, the Panel essentially discounted the total amount of U.S. cotton farmers’ revenue. It also neglected to match up all on-farm and off-farm revenue against whole-farm total costs and inflated the overhead costs it did use by incorporating hypothetical opportunity costs. The net result was a “gap” that the Panel concluded

could only have been filled by marketing loan and counter-cyclical payments. This finding attributed effects to those payments that they were in fact not having. Such improper attribution is inconsistent with Article 6.3(c) of the SCM Agreement and cannot support a finding of significant price suppression.

b. *Economic Simulation Model*

24. Brazil submitted a highly flawed econometric model to the Panel in an attempt to demonstrate the price suppressing effects of U.S. marketing loan and counter-cyclical payments. The United States made certain adjustments to the model to correct for some of the flaws, and this revised model demonstrated only minimal effects on upland cotton prices. The Panel relied on both models in reaching its finding significant price suppression, merely because both of them showed price suppression. Article 6.3(c) of the SCM Agreement, however, required the Panel to determine whether the degree of suppression shown by the models was significant, something the Panel did not do.

c. *Impact of the Elimination of the Step 2 Program*

25. The Panel concluded that the impact of the repeal of the Step 2 program on U.S. exports and on the amounts of marketing loan and counter-cyclical payments suggested that the elimination of Step 2 did not affect the price suppressing effects of marketing loan and counter-cyclical payments. The Panel reached this finding, despite the fact that Brazil failed to meet its burden of demonstrating the allegedly modest effects of the elimination of Step 2 on level of U.S. exports, and despite the Panel's own conclusion that U.S. exports declined significantly in MY 2006. The Panel also fundamentally misconstrued the impact of the repeal on U.S. marketing loan and counter-cyclical payments. The United States showed that the repeal of Step 2 would

lead to a substantial decrease in marketing loan payments, and have a negligible impact on counter-cyclical payments in the “present” marketing year, and beyond.

d. *Other Factors Impacting the World Market for Upland Cotton*

26. Article 6.3(c) of the SCM Agreement requires that the effects of other factors on price are not improperly attributed to the challenged subsidies. Here, the United States explained the significant role of China in the world cotton market, but the Panel neglected to conduct a proper non-attribution analysis, and did not take into account China’s influence.

e. *Magnitude of the Subsidies*

27. The Panel’s conclusion that the magnitude of the U.S. marketing loan and counter-cyclical payments supported a finding of significant price suppression rested on its other conclusions as to the structure, design, and operation of those payments, and the role of those payments in bridging the alleged cost-revenue “gap.” Because the supporting conclusions were deficient, the Panel’s conclusion that the magnitude of the subsidies contributed to a finding that the effect of the challenged subsidies was serious prejudice cannot stand.

f. *Substantial Proportionate Influence*

28. The Panel’s finding as to the alleged substantial proportionate influence of the United States also does not support its conclusion that the effect of the challenged subsidies was serious prejudice. The relative size of U.S. shares of production and exports alone in a given marketing year does not explain price effects and cannot support a finding of significant price suppression. In addition, the Panel’s finding overlooked its own conclusion as to stable U.S. shares of production and exports, which indicated that U.S. producers respond to market signals like farmers in the rest of the world.

3. Failure to Determine What Degree of Price Suppression was “Significant”

29. The Panel found that the “effect” of U.S. marketing loan and counter-cyclical payments was “significant price suppression” within the meaning of Article 6.3(c) of the SCM Agreement. The Panel, however, never determined the *degree* of price suppression that it considered to be “significant,” as applied to the facts before it. Its finding essentially writes the word “significant” out of Article 6.3(c) of the SCM Agreement and would introduce uncertainty into the multilateral trading system if left to stand.

4. Failure to Undertake an Objective Assessment

30. DSU Article 11 required the Panel to undertake an objective assessment of the serious prejudice claims before it, but the Panel ignored and misconstrued evidence to find that the effect of U.S. marketing loan and counter-cyclical payments was significant price suppression. The United States demonstrates that the Panel: a) disregarded and misinterpreted evidence concerning the structure, design, and operation of marketing loan and counter-cyclical payments, including new studies on the minimal impact of counter-cyclical payments; b) ignored and misconstrued evidence on the record and its own finding that the U.S. share of world upland cotton production and exports was stable over MY 2002-2005; c) misconstrued the results of U.S. econometric modeling concerning the minimal effect of U.S. marketing loan and counter-cyclical payments on the world price for upland cotton; and d) ignored evidence relevant to ensuring that the effect of other factors on upland cotton prices was not improperly attributed to U.S. marketing loan and counter-cyclical payments.

5. The Panel’s Finding that the United States Failed to Comply with the DSB’s Recommendations and Rulings as to Serious Prejudice Cannot

Stand

31. Even assuming that the Panel had jurisdiction over Brazil’s serious prejudice claims, the United States has demonstrated that the Panel’s finding as to significant price suppression, constituting “present” present serious prejudice to Brazil, fails as a matter of law. Therefore, the Panel’s finding as to the United States’ non-compliance with the DSB’s recommendations and rulings on serious prejudice cannot stand.

32. The United States now turns to a more detailed examination of all of these errors by the Panel.

II. The Panel Improperly Examined Claims That Were not Within the Scope of the Article 21.5 Proceeding

A. The Panel Erred in Finding That Brazil’s Claims Concerning GSM 102 Guarantees for Exports of Pig Meat and Poultry Meat Were Within the Scope of the Compliance Panel Proceeding

33. The United States requested a preliminary ruling that Brazil’s claims regarding the GSM 102 guarantees in respect of exports of pig meat and poultry meat were not properly before the Panel. In paragraph 9.27 of its Report, however, the Panel concluded that “the claims of Brazil relating to export credit guarantees for exports of pig meat and poultry meat are within the scope of this proceeding under Article 21.5 of the DSU.” This finding fundamentally misinterprets the scope of a compliance proceeding under Article 21.5, and the United States respectfully requests that it be reversed.

34. The original panel recognized that export credit guarantees for pig meat and poultry meat

were separate measures from export credit guarantees extended to other products.¹ That finding was untouched on appeal.² Neither the original panel, nor the Appellate Body, made findings that export credit guarantees with respect to pig meat and poultry meat were inconsistent with the WTO obligations of the United States.³ Therefore, the DSB adopted no recommendations and rulings as to those measures, and hence, there could be no “measure taken to comply” with such non-existent recommendations and rulings. Nor were the modified GSM 102 export credit guarantees with respect to pig meat and poultry meat “measures taken to comply” with any other recommendations and rulings by the DSB. There was therefore no basis under Article 21.5 for a compliance panel to consider export credit guarantees with respect to pig meat and poultry meat, and the Panel’s finding here to the contrary is erroneous.

35. Article 21.5 of the DSU establishes the scope of a compliance proceeding conducted pursuant to that provision. It defines that scope as “disagreement as to the existence of or consistency with a covered agreement of measures taken to comply with the recommendations and rulings [of the DSB].” In an Article 21.5 proceeding, a complaining party may thus claim that (a) measures taken to comply with the recommendations and rulings of the DSB do not exist; or that (b) measures taken to comply with the recommendations and rulings of the DSB are not consistent with a covered agreement.⁴ In both cases, the DSB recommendations and rulings

¹*Upland Cotton (Panel)*, paras. 8.1(d)(i)-(ii).

² The Panel here reaffirmed that “the application of the [GSM 102] programme to an individual product constitutes a ‘measure.’” Panel Report, para. 9.25.

³Panel Report, para. 9.21.

⁴The fact that “compliance” proceedings deal with implementation of recommendations and rulings of the DSB is apparent not only from the text of Article 21.5 but also its context; for example, the fact that it is part of Article 21, which deals overall with “Surveillance of Implementation of Recommendations and Rulings.” The first

shape the possible scope of the proceedings.

36. Where a measure is not subject to any DSB recommendations and rulings because no finding of WTO-inconsistency has been found in respect of it, there is logically no basis for any claim that a Member has not implemented the DSB’s recommendations and rulings in respect of the measure. In short, the measure would not be the type of measure properly within the scope of Article 21.5 and the claims that could be made against it would not be the type of claims properly within the scope of that provision.

37. This reasoning is consistent with the reasoning in prior Appellate Body reports interpreting the scope of Article 21.5. For example, in *Canada – Aircraft (21.5)*, the Appellate Body clarified that:

[p]roceedings under Article 21.5 do not concern just any measure of a Member of the WTO; rather, Article 21.5 proceedings are limited to those “measures taken to comply with the recommendations and rulings” of the DSB. In our view, the phrase “*measures taken to comply*” refers to measures which have been, or which should be, adopted by a Member to bring about compliance with the recommendations and rulings of the DSB.⁵

38. The Appellate Body thus confirmed that the focus of compliance proceedings is on the DSB’s recommendations and rulings – whether they have been complied with and, if so, whether the compliance measures are themselves consistent with the covered agreement. The Panel

paragraph of DSU Article 21.1 provides that “prompt compliance with recommendations or rulings of the DSB is essential in order to ensure effective resolution of disputes to the benefit of all Members.” And the provisions that follow all relate to implementation. For example, Articles 21.3 and 21.4 of the DSU deal with rules and procedures for establishing a reasonable period of time to implement the recommendations and rulings of the DSB. Article 21.5 deals with the dispute settlement procedures available when there is a disagreement as to whether a Member has implemented DSB recommendations and rulings consistently with its WTO obligations. And Article 21.6 deals with surveillance by the DSB of implementation by Members.

⁵*Canada – Aircraft (21.5) (AB)*, para. 36 (emphasis added).

acknowledged as much,⁶ but went on to disregard the requirements of Article 21.5, and substituted a “particularly close relationship” test. In doing so, the Panel never explained how the text of Article 21.5 supported its approach.

39. The original panel in this dispute expressly found that GSM 102 guarantees in respect of “exports of unscheduled agricultural products not supported under the programmes and other scheduled agricultural products” – including pig meat and poultry meat – “have *not* been applied in a manner which either results in, or which threatens to lead to, circumvention of United States export subsidy commitments within the meaning of Article 10.1 and that they therefore are *not inconsistent* with Article 8 of the Agreement on Agriculture.”⁷ Accordingly, the panel made no recommendations regarding GSM 102 guarantees in respect of exports of pig meat and poultry meat. On appeal, the Appellate Body reversed the panel’s findings, but concluded that there were insufficient uncontested facts to permit it to “complete the legal analysis to determine whether the United States’ export credit guarantees to poultry meat and pig meat have been applied in a manner that ‘results in’ circumvention of the United States’ export subsidy commitments.”⁸

40. GSM 102 guarantees in respect of exports of pig meat and poultry meat have thus never been found to be WTO-inconsistent, nor have they been subject to any DSB recommendation, as even Brazil and the Panel have acknowledged.⁹ Article 21.5 simply does not apply in those

⁶Panel Report, para. 9.22.

⁷*Upland Cotton (Panel)*, para. 8.1(d)(ii) (emphasis added).

⁸*Upland Cotton (AB)*, para. 694.

⁹Brazil First Written Submission, para 331; Panel Report, paras. 9.21, 9.23.

circumstances. In particular, since there are no DSB recommendations or rulings with respect to those measures, then under Article 21.5, there can be no “measures taken to comply” with respect to those measures. Moreover, the guarantees for these products at issue in the Article 21.5 proceeding *were not measures taken to comply* with any other recommendations and rulings by the DSB. The Panel, however, disregarded these facts, and considered claims that were beyond the scope of the compliance proceeding under Article 21.5.

41. The Panel erroneously relied on *U.S. – Softwood Lumber IV (21.5)* in support of its finding that the GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat were within the scope of the compliance proceeding. Citing to the Appellate Body report in that dispute, the Panel concluded that the guarantees had a “particularly close relationship to the declared measures taken to comply and to the recommendations and rulings of the DSB.”¹⁰ However, the reasoning of the Appellate Body in that dispute does not support the Panel’s analysis in this one.

42. In particular, the Appellate Body in *U.S. – Softwood Lumber IV (21.5)* simply built on the reasoning in *Australia – Leather II (21.5)* and *Australia – Salmon (21.5)*, which addressed situations in which a compliance panel may examine a new measure that is issued at approximately the same time as the one that the Member concerned has declared to be the measure taken to comply and that is alleged to undo (i.e., “cause not to exist) the compliance achieved by the declared “measure taken to comply.”¹¹ Unlike each of these disputes, however,

¹⁰Panel Report, para. 9.24-9.26 (citing *U.S. – Softwood Lumber IV (21.5)*).

¹¹See e.g., *U.S. – Softwood Lumber IV (21.5)*, para. 74.

the question before *this* Panel was not whether a second measure had undone, superceded, or otherwise replaced compliance with DSB recommendations and rulings regarding export credit guarantees for pig meat and poultry: there were no such recommendations and rulings in the first place, and so the question that the *Softwood Lumber IV* panel (and Appellate Body) considered does not arise.

43. The Panel advanced several reasons for finding what it called a “close relationship” between the GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat and the measures taken to comply by the United States, but these reasons are irrelevant to the analysis that Article 21.5 required the Panel to undertake.¹² What governs here is the text of Article 21.5, which provides that a disagreement over measures to comply with *the recommendations and rulings of the DSB* forms the sole basis for the scope of an Article 21.5 proceeding.

44. The recommendations and rulings of the DSB distinguish between the different types of guarantees, and as the Panel itself recognized, the application of the GSM 102 guarantee to an individual product constitutes a measure.¹³ The United States was only required to “withdraw the subsidy” with respect to those measures that were found to be WTO-inconsistent (i.e., export credit guarantees as to unscheduled products, and one scheduled product, rice). The GSM 102 guarantees with respect to exports of pig meat and poultry meat were separate measures, and were not the subject of the DSB’s recommendations and rulings. They therefore cannot properly

¹²Panel Report, para. 9.25.

¹³Panel Report, para. 9.25.

fall within the scope of the Article 21.5 compliance proceeding.

45. The Panel also was mistaken to consider the Appellate Body report in *U.S. – Oil Country Tubular Goods Sunset Review (21.5)* as “significant” for purposes of making a finding on the U.S. preliminary objection.¹⁴ In that dispute, the original panel had concluded that a likelihood of dumping determination was inconsistent with Article 11.3 of the Antidumping Agreement. In reaching this finding, the panel exercised judicial economy and examined only the first of two bases in support of the sunset review determination. The administrative proceeding undertaken to comply with the DSB findings resulted in a determination that re-examined the first basis (that dumping continued above *de minimis* levels during the time the anti-dumping order was in place) and that incorporated the original analysis as to the second basis. In the compliance proceeding, Argentina claimed that both bases were properly before the compliance panel, even though the second factor had never been examined by the original panel. The Appellate Body upheld the compliance panel’s finding that it could examine both bases in the Article 21.5 proceeding. It reasoned that, in the specific circumstances presented (where both bases operated together to support the likelihood of dumping determination), the reincorporated second basis was “an integral part” of the measure taken to comply.¹⁵

46. The Appellate Body’s reasoning in *U.S. – Oil Country Tubular Goods Sunset Review (21.5)* is inapplicable to this dispute, and the Panel was mistaken to rely on it. The analysis in *U.S. – Oil Country Tubular Goods Sunset Review (21.5)* dealt with the revision to an

¹⁴Panel Report, para. 9.28.

¹⁵*U.S.–Oil Country Tubular Goods Sunset Review (21.5)*, para. 148.

administrative determination in an antidumping sunset review that had been found WTO-inconsistent. However, the revision to export credit guarantees cannot in any way be compared to a revision to an administrative determination. The latter is adjudicatory in nature and involves the application of statutory and regulatory law to a set of facts. The revision to the fee structure of the GSM 102 program involved a government agency's business decision to ensure that premia are adequate to cover long-term operating costs and losses. Moreover, unlike in *U.S. – Oil Country Tubular Goods Sunset Review (21.5)*, the GSM 102 export credit guarantees for pig meat and poultry meat cannot be considered a factual basis relating to the wholly separate export credit guarantees that were within the DSB's recommendations and rulings.

47. The Panel also erroneously concluded, based on what it deemed "significantly different" facts, that the Appellate Body and panel reports in *EC – Bed Linen (21.5)* were inapplicable to the present dispute.¹⁶ Quite the contrary, *EC – Bed Linen (21.5)* is highly instructive as to the proper scope of the Article 21.5 proceeding in this case. The Appellate Body in *EC – Bed Linen (21.5)* rejected India's attempt to reassert the same claim in a compliance proceeding against an aspect of an antidumping determination (the "other factors" analysis) that had been dismissed by the original panel for failure to make a *prima facie* case.¹⁷ Specifically, the Appellate Body concluded, first, that "the investigating authorities of the European Communities were not required to change the determination as it related to the 'effects of other factors' in this particular dispute."¹⁸ In other words, the Appellate Body recognized that there was no basis for a claim

¹⁶Panel Report, para. 9.26, n.113.

¹⁷*EC – Bed Linen (21.5) (AB)*, para. 87.

¹⁸*EC – Bed Linen (21.5) (AB)*, para. 86.

regarding the *non-existence* of measures taken to comply in respect of that aspect of the determination. Next, the Appellate Body noted that “we do not see why that part of the redetermination that merely incorporates elements of the original determination on ‘other factors’ would constitute an inseparable element of a measure taken to comply with the DSB rulings in the original dispute.”¹⁹ In other words, the Appellate Body determined that the “other factors” determination was not itself a measure taken to comply with any DSB recommendations and rulings.

48. Although admittedly *EC – Bed Linen (21.5)* involved slightly different facts than those at issue here – namely, there, the failure by the complaining party to make a *prima facie* case meant that no finding of WTO-inconsistency could be made, while here, the Appellate Body had insufficient facts before it to make a finding whether the measures at issue were WTO-inconsistent – the analysis in both cases is the same. Where there is neither a basis for a claim of *existence* of measures taken to comply (because there are no DSB recommendations and rulings that must be implemented with respect to the measure), nor a claim of *consistency with a covered agreement* (because the measure is not a measure taken to comply with other DSB recommendations and rulings), neither the measure nor any claims against it are properly within the scope of an Article 21.5 proceeding.

49. The Appellate Body in *EC – Bed Linen (21.5)* also acknowledged that the Article 21.5 panel proceeding was *not* intended to provide complaining parties with a “second chance” to

¹⁹*EC – Bed Linen (21.5) (AB)*, para. 86.

reassert claims that had been unsuccessful in the original proceeding.²⁰ Here, Brazil was looking for what amounts to a “second chance” to make claims as to GSM 102 guarantees in support of exports of pig meat and poultry meat.²¹ To allow Brazil’s claims here would essentially give Brazil another chance, this time before the compliance panel, to argue against GSM 102 guarantees with respect to exports of pig meat and poultry meat. Article 21.5 was never intended to have such a result.

50. It is possible that the Panel may have believed that in folding in the export credit guarantees on pig meat and poultry meat it was simply promoting efficiency – there would have been little purpose to requiring Brazil to pursue another, new dispute proceeding just on these export credit guarantees. However, there are two strong arguments against such “efficiency.”

51. First, as described above, the Panel was not adhering to the text of Article 21.5. For the Panel to exceed its authority in this way undermines the dispute settlement system and means that Members will be unable to explain how the Panel could have reached the result it did within the agreed dispute settlement rules. No matter how harmless the Panel may have believed the error to be in this dispute, panels are not free to disregard the agreed dispute settlement rules, and the precedent set in this dispute could have even more significant consequences in other disputes.

52. Second, the Panel’s finding raises serious systemic concerns. If left to stand, it would create a disincentive for WTO Members to extend the consequences of a finding beyond the DSB’s recommendations and rulings. Consider what the Panel’s approach would mean for a

²⁰*EC – Bed Linen (21.5) (AB)*, paras. 74, 87.

²¹Brazil’s First Written Submission, paras. 350, 459-60. Brazil even admitted that it was re-making its claims in respect of these GSM 102 guarantees. Brazil’s First Written Submission, para. 451, n. 623.

Member that changes a measure that was *not* subject to DSB recommendations and rulings at the same time as it takes a measure to comply. The Member would risk having the changed measure subjected to Article 21.5 proceedings – proceedings on an expedited basis with no reasonable period of time to come into compliance.

53. In other words, the Panel’s approach would tell Members to do the least possible changes to their measures around the time of taking different measures to comply in order to avoid the risk of Article 21.5 proceedings. For example, in the current dispute, the Panel’s approach is telling the United States it should not have changed the export credit guarantees for pig meat or poultry meat, even though the United States suspects that even Brazil would concede the changes the United States made were improvements. Perversely, Members should not apply changes on a program-wide basis for ease of administration and to improve the programs generally.

54. The Panel’s approach would create an incentive for a Member to create a tangle of separate regimes to address the application of a measure in different situations simply to avoid exposure to a dispute settlement challenge under the expedited procedures of an Article 21.5 proceeding with the accompanying disadvantages. Moreover, the incentive would be for Members to make the most limited changes possible and to retain the *status quo* – even at the cost of general improvements – because any broader approach would simply be rewarded with exposure to challenge in Article 21.5 proceedings. Nothing in the WTO agreement compels such a result.

55. The Panel in this dispute should never have found that Brazil’s claims concerning GSM 102 guarantees in respect of pig meat and poultry meat were within the scope of the compliance proceeding. The Panel’s interpretation of Article 21.5 is unsupported by the text of that

provision, misconstrues prior Appellate Body findings, and would have troublesome consequences for the WTO dispute settlement system if left to stand. The Appellate Body should reverse this error.

B. The Panel Erred in Finding That Brazil’s Claims Concerning Marketing Loan and Counter-Cyclical Payments Made After September 21, 2005 Were Within the Scope of the Compliance Panel Proceeding

56. The Panel found in paragraph 9.81 that “Brazil’s claim that the United States has failed to comply with its obligations under DSU Article 7.8 with respect to [marketing loan and counter-cyclical payments made after September 21, 2005] is properly before this Panel.” In other words, the Panel concluded that Brazil’s claims concerning serious prejudice arising from marketing loan and counter-cyclical payments made after the implementation deadline were within the scope of the compliance proceeding. This finding expanded the scope of the compliance proceeding beyond what was permitted under Article 21.5, and should be reversed.

57. The United States first notes that it objected to what it demonstrated was Brazil’s challenge to the “consistency with a covered agreement” of the marketing loan and counter-cyclical payment *programs*.²² These *programs* were not subject to the recommendations and rulings of the DSB – which only concerned *payments* made under the market loss assistance, Step 2, marketing loan, and counter-cyclical payment programs in MY 1999-MY 2002 – nor were they measures taken to comply with any such recommendations and rulings. Brazil attempted to clarify in its rebuttal to the U.S. preliminary objection that its claims covered not only the marketing loan and counter-cyclical payment programs, but the programs in addition to

²²U.S. First Submission, paras. 31-44.

the payments thereunder.²³ The United States explained that this distinction actually made Brazil’s claims even broader than they first appeared, and that they remained outside the scope of the proceeding.²⁴

58. The Panel found that Brazil was making an “as applied” claim – that is, that it was challenging only the payments, which could be considered the programs “as applied” – and declined to make findings on the U.S. preliminary objections related to the marketing loan and counter-cyclical payment *programs*.²⁵ However, the Panel agreed with the United States that:

. . .the original panel’s finding of ‘present’ serious prejudice did not apply to legal provisions or subsidy programmes in addition to subsidies and subsidy measures.²⁶

The Panel nevertheless proceeded to consider Brazil’s present serious prejudice claims as to marketing loan and counter-cyclical payments made after September 21, 2005, despite U.S. objections that they were beyond the scope of the proceeding under Article 21.5 of the DSU.²⁷ It is this finding that the United States now appeals.

59. As the United States has explained in Part II.A, the scope of a compliance proceeding is determined by Article 21.5 of the DSU. Under that provision, the only measures properly within the scope of a compliance proceeding are “measures taken to comply with the recommendations and rulings [of the DSB].” Article 21.5 also defines the claims that can be made in respect of

²³Brazil’s Submission Regarding U.S. Requests for Preliminary Rulings, para. 31.

²⁴U.S. Rebuttal Submission, para. 16.

²⁵Panel Report, paras. 9.53, 9.55.

²⁶Panel Report, para. 9.54.

²⁷As the Panel notes, the United States raised this objection during the course of the proceeding. See Panel Report, para. 9.8, n.93; U.S. Comments on Brazil’s Response to Panel Question 15; U.S. Response to Panel Question 47; U.S. Comments on Brazil’s Response to Panel’s Second Set of Questions, paras. 8-14.

such measures: a) that measures taken to comply with the recommendations and rulings of the DSB do not exist; and b) that measures taken to comply with the recommendations and rulings of the DSB are not consistent with a covered agreement. DSB recommendations and rulings are a necessary predicate to either claim.

60. In this dispute, the original panel (a) made a finding of “present” serious prejudice only with respect to payments made under the Step 2, market loss assistance, marketing loan and counter-cyclical payment programs in MY 1999-2002; (b) declined to make any finding of “threat” of serious prejudice with respect to payments allegedly “mandated” to be made in MY 2003-2007; and (c) declined to make any find of “threat” of serious prejudice with respect to the Step 2, marketing loan, and counter-cyclical payment programs themselves (which would have implicated *all* payments under the programs).²⁸ Upon appeal, the Appellate Body upheld the original panel’s finding “that the effect of marketing loan program payments, Step 2 payments, market loss assistance payments, and counter-cyclical payments is significant price suppression within the meaning of Article 6.3(c) of the SCM Agreement.”²⁹ Brazil did not appeal the original panel’s decisions to reject or decline to address its claims regarding “U.S. subsidies” allegedly “mandated” to be provided in MY 2003-2007 or the *per se* claims with respect to the programs.

ORIGINAL PANEL FINDINGS ON SERIOUS PREJUDICE

Measure Challenged	Claim Made	Resolution by Original Panel	Para. in Original Panel Report
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²⁸See chart below.

²⁹*Upland Cotton (AB)*, para. 496.

“U.S. subsidies provided during MY 1999-2002”	“Present” serious prejudice under Articles 5(c) and 6.3(c) of the SCM Agreement	Finding of WTO-inconsistency against Step 2, marketing loan, and counter-cyclical/market loss assistance payments	7.1416 8.1(g)(i)
“U.S. subsidies provided during MY 1999-2001”	“Present” serious prejudice under Articles 5(c) and 6.3(d) of the SCM Agreement	Rejected for failure to make <i>prima facie</i> case	7.1465 8.1(g)(ii)
“U.S. subsidies provided during MY 1999-2002”	“Present” serious prejudice under Articles XVI:1 and XVI:3 of the GATT 1994	Declined to address, <i>inter alia</i> , because of finding of inconsistency with Articles 5(c) and 6.3(c) of the SCM Agreement	7.1476
“U.S. subsidies” allegedly “mandated” to be provided during MY 2003-2007	“Threat” of serious prejudice under Articles 5(c) and 6.3(c) of the SCM Agreement	Declined to address in light of finding of inconsistency with Articles 5(c) and 6.3(c) and 3.1(a) and 3.2 of the SCM Agreement	7.1503
“U.S. subsidies” allegedly “mandated” to be provided during MY 2002-2007	“Threat” of serious prejudice under Articles 5(c) and 6.3(d) of the SCM Agreement	Rejected for failure to make <i>prima facie</i> case	7.1504
“U.S. subsidies” allegedly “mandated” to be provided during MY 2003-2007	“Threat” of serious prejudice under Articles XVI:1 and XVI:3 of the GATT 1994	Declined to address, <i>inter alia</i> , because of finding of inconsistency with Articles 5(c) and 6.3(c) of the SCM Agreement	7.1505
“selected provisions of the FSRI Act of 2002 and the ARP Act of 2000”	“Threat” of serious prejudice under Articles 5(c) and 6.3(c) of the SCM Agreement	Declined to address in light of findings regarding export subsidies, import subsidies, “present” serious prejudice, and “threat” of serious prejudice	7.1511
“selected provisions of the FSRI Act of 2002 and the ARP Act of 2000”	“Threat” of serious prejudice under Articles 5(c) and 6.3(d) of the SCM Agreement	Declined to address in light of findings regarding export subsidies, import subsidies, “present” serious prejudice, and “threat” of serious prejudice	7.1511
“selected provisions of the FSRI Act of 2002 and the ARP Act of 2000”	“Threat” of serious prejudice under Articles XVI:1 and XVI:3 of the GATT 1994	Declined to address in light of findings regarding export subsidies, import subsidies, “present” serious prejudice, and “threat” of serious prejudice	7.1511

61. On March 21, 2005, the DSB adopted the Appellate Body report and the original panel report, as modified by the Appellate Body report.³⁰ This included adoption of the single actionable-subsidy related finding that “the effect of the mandatory, price contingent United

³⁰United States – Subsidies on Upland Cotton, Action by the Dispute Settlement Body, WT/DS267/20.

States subsidies at issue – that is, marketing loan programme *payments*, user marketing (Step 2) *payments* and MLA *payments* and CCP *payments* – is significant price suppression in the same world market for upland cotton in the period MY 1999-2002 within the meaning of Articles 6.3(c) and 5(c) of the SCM Agreement.”³¹ As noted above, the panel in this proceeding confirmed that the “original panel’s finding of ‘present’ serious prejudice did not apply to legal provisions or subsidy programmes in addition to subsidies and subsidy measures.”³²

62. Under Article 21.5, the only measures subject to any finding of WTO-inconsistency, and the DSB’s recommendations and rulings based on them, or any implementation obligations, were payments made under the Step 2, marketing loan and counter-cyclical payment program in MY 1999-2002 (i.e., through July 31, 2003). The marketing loan and counter-cyclical payments made after September 21, 2005 were not subject to the DSB’s recommendations and rulings. Moreover, the payments made after September 21, 2005 were not in any way U.S. measures taken to comply with other recommendations and rulings of the DSB. Therefore, these payments were outside the scope of the compliance proceeding under Article 21.5, and the Panel should never have considered the serious prejudice claims related to them.

63. In reaching its conclusion, the Panel fundamentally misunderstood both the obligation of the United States under Article 7.8 of the SCM Agreement and the relationship between Article 7.8 of the SCM Agreement and Article 21.5 of the DSU.³³

³¹*Upland Cotton (Panel)*, para. 7.1416 (emphasis added).

³²Panel Report, para. 9.54.

³³Article 7.8 establishes the obligation of a responding Member “where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy [of the responding Member] has resulted in adverse effects to the interests of another Member within the meaning of Article 5.” In that situation, the responding

64. The Panel found that a “remedy under Article 7.8 must be viewed in relationship to the obligation under Article 5 [of the SCM Agreement] not to cause through the use of any subsidy referred to in Articles 1.1 and 1.2 of the *SCM Agreement* adverse effects to the interests of other Members” and that “[i]t must serve to restore conformity with the Member’s obligation to avoid causing adverse effects through the use of any subsidy.”³⁴ Here, withdrawal is one option, but so is taking appropriate steps to remove the adverse effects. The Panel concluded that “a Member does not take appropriate steps to remove adverse effects of a subsidy if it continues to provide payments under the same conditions and the same criteria as the original subsidy in a manner that causes adverse effects.”³⁵ The Panel used this conclusion to support its finding that the marketing loan and counter-cyclical payments made after September 21, 2005 were within the scope of the compliance proceeding.

65. The Panel’s reading of Article 7.8 of the SCM Agreement is overly broad and should be reversed. Article 7.8 provides that “[w]here a panel report or an Appellate Body report is adopted in which it is determined that *any subsidy* has resulted in adverse effects. . . , the Member granting or maintaining *such subsidy* shall take appropriate steps to remove the adverse effects or shall withdraw *the subsidy*.”³⁶ In other words, the obligation under Article 7.8 extends only as far as the DSB’s recommendations and rulings. In this dispute, the DSB’s

Member under Article 7.8 may either “take appropriate steps to remove the adverse effects” or may “withdraw the subsidy.” Article 21.5 of the DSU deals with the use of dispute settlement procedures to decide disagreements about the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings of the DSB.

³⁴Panel Report, para. 9.79.

³⁵Panel Report, para. 9.79.

³⁶Emphasis added.

recommendations and rulings applied only to the Step 2, market loss assistance, marketing loan, and counter-cyclical payments made during MY 1999-2002, and did not cover either future payments, or the subsidy programs themselves.³⁷ Although the United States had no compliance obligation concerning payments made after MY 2002, and the original panel had rejected or declined to reach Brazil’s claims regarding payments made after MY 2002, the Panel erroneously concluded that “to the extent marketing loan payments and counter-cyclical payments made by the United States after 21 September 2005 are provided under the same conditions and criteria as the marketing loan payments and counter-cyclical payments subject to the original panel’s finding of ‘present’ serious prejudice, they are subject to the obligation of the United States under Article 7.8 of the *SCM Agreement* to take appropriate steps to remove the adverse effects of the subsidy.”³⁸

66. The Panel went on to disregard the proper relationship between Article 7.8 of the *SCM Agreement* and Article 21.5 of the *DSU*. The Panel viewed Article 7.8 as somehow modifying Article 21.5 of the *DSU*. However, Article 7.8 is like other provisions of the covered agreements in that it informs the relevant DSB recommendations and rulings – it says nothing about modifying the terms of reference or the scope of compliance proceedings under Article 21.5 of the *DSU*. The Panel erred in concluding that “our interpretation of Article 7.8 implies that if a Member continues to make payments of a subsidy on the same legal basis and under the same conditions and criteria as the subsidy found to have caused serious prejudice in the original

³⁷*Upland Cotton (Panel)*, paras. 8.1(g)(1), 8.3(d).

³⁸Panel Report, para. 9.81.

proceeding, it must be possible for a panel in a proceeding under Article 21.5 of the DSU to examine a claim that the continued payment of that subsidy causes adverse effects within the meaning of Article 5 of the SCM Agreement.”³⁹ The Panel thus treated Article 7.8 as though it changed the nature of what is a “measure” in the phrase “taken to comply” rather than what is the nature of “compliance.” For the Panel, Article 7.8 set up an ongoing obligation with respect to subsidies that were not within the scope of the DSB’s recommendations and rulings. But nothing in Article 7.8 refers to such an ongoing, general obligation.

67. Furthermore, the text of Article 21.5 establishes what is within the scope of a compliance proceeding when a Member’s compliance with its obligation under Article 7.8, or any other provision of the covered agreements, is at issue. Under Article 21.5, a panel may only review disagreements as to the existence or consistency with the covered agreements of measures taken to comply with the recommendations and rulings of the DSB. The recommendations and rulings of the DSB (and the measures taken to comply with them) establish the scope of a compliance proceeding, and here were limited to certain payments made during MY 1999-2002. The Panel’s interpretation ignores the text of Article 21.5 and would expand a compliance panel’s jurisdiction into matters reserved for original proceedings.

68. Here, the DSB’s recommendations and rulings applied only to the combined effects of Step 2, market loss assistance, marketing loan, and counter-cyclical payments made during MY 1999-2002. The marketing loan and counter-cyclical payments made after September 21, 2005

³⁹Panel Report, para. 9.80. The Panel here referred to “subsidy” in the sense of “subsidy program.” (i.e., the phrase “continued payment of that subsidy” means “continued payments under a subsidy program.”) However, “that subsidy” for purposes of the DSB’s recommendations and rulings in the original proceeding was particular payments made during specific marketing years and not the subsidy programs themselves; “that subsidy” does not continue to get paid in the future.

were not the subject of the DSB’s recommendations and rulings, nor were they measures taken to comply with other recommendations and rulings. Under Article 21.5, they were not properly before the Panel.

69. The Panel erroneously found “further support” for its approach in *U.S. – Softwood Lumber IV (21.5)*.⁴⁰ However, the Appellate Body in that dispute did not find that a compliance panel could examine measures not found to be WTO-inconsistent just because they were similar to those that were found to be WTO-inconsistent. Rather, *U.S. – Softwood Lumber IV (21.5)* addressed the distinct issue of what measures could be considered to be part of the measures taken to comply. Future payments under the marketing loan and counter-cyclical payment programs made outside of the MY 1999-2002 period were not measures taken to comply with any recommendations and rulings of the DSB. Rather, they were original measures challenged by Brazil, and against which the original panel declined to make findings.

70. Further relying on *U.S. – Softwood Lumber IV (21.5)*, the Panel observed that “where payments of a subsidy have been found to cause serious prejudice and the Member in question continues to provide the same subsidy under the same conditions and criteria, there exists ‘a particularly close relationship’ between the subsidy that the Member continues to provide and the recommendations and rulings of the DSB in the original proceeding.”⁴¹ This statement is both wrong and irrelevant.⁴² The fact that two separate payments resemble one another may establish

⁴⁰Panel Report, para. 9.80.

⁴¹Panel Report, para. 9.80 (citing *U.S. – Softwood Lumber IV (21.5)*).

⁴²This statement is wrong and irrelevant for another reason as well. The subsidy here is not the “same subsidy” as that before the original panel. The original panel’s findings pertained to the collective effect of a basket of payments (i.e., Step 2, market loss assistance, marketing loan, and counter-cyclical payments). *Upland Cotton*

similarity; it does not establish a relationship between them, particularly not a relationship that has any legal relevance for the purposes of DSU Article 21.5. What matters for the purpose of an Article 21.5 compliance proceeding is whether the future payments were subject to the DSB's recommendations and rulings, or whether they were otherwise measures taken to comply. Here, the marketing loan and counter-cyclical payments made after September 21, 2005 were neither.

71. The Panel sought to avoid an interpretation of Article 21.5 whereby “a Member that considers itself to be adversely affected by the subsidy must initiate an entirely new proceeding under the DSU.”⁴³ It worried that such a finding “would. . .undermine the effectiveness of Article 7.8.”⁴⁴ However, Article 7.8 is fully effective, and is interpreted in a manner faithful to its text, when it is read to provide for expedited proceedings with respect to issues of compliance concerning exactly those measures that were the subject of the DSB's recommendations and rulings in the first place. It is the Panel's understanding of a Member's obligation under Article 7.8 of the SCM Agreement, and its interpretation of the scope of Article 21.5 of the DSU, that would undermine the proper functioning of the WTO dispute settlement system, as agreed upon by the Uruguay Round negotiators and reflected in the text of the WTO Agreement.

72. Disallowing Brazil's over-expansive claims in this proceeding would not mean that Members have no remedy to address the adverse effects of a subsidy. Under the reasoning of the original panel, nothing prevents Members from challenging the present adverse effects of past or

(Panel), para. 8.1(g)(i). When the United States repealed the Step 2 program, it eliminated a major part of that basket. The subsidy here can not be considered in any way the “same,” let alone one provided under the “same conditions and criteria.”

⁴³Panel Report, para. 9.80.

⁴⁴Panel Report, para. 9.80.

current payments; the threat of serious prejudice of past, current, or future payments; or present adverse effects or threat of serious prejudice from payment programs “as such.” Indeed, Brazil availed itself of many of those opportunities in the present dispute. The obligations of a responding Member under Article 7.8 of the SCM Agreement depend on what the outcome is of those challenges. Where, as here, a complaining Member only *prevails* on one claim – that of “present” serious prejudice with respect to particular payments made in particular years – Article 7.8 applies with respect to that outcome only. A compliance panel cannot ignore that outcome by finding in a proceeding under Article 21.5 that other measures are like the ones subject to the original panel’s findings and that the proceedings should be extended to them.

73. The Panel apparently thought that if it refused to consider Brazil’s serious prejudice claims, the United States would be insulated from liability for subsidizing, since by the time a proceeding as to adverse effects arising from support payments was completed, and the reports were adopted, those support payments would already have been relegated to the past. Brazil, however, never attempted to demonstrate to this Panel that the United States failed to remove the adverse effects of the U.S. support payments made during MY 1999-2002. Those payments, by their nature, had already ceased to exist, and were no longer having any effects in the market for upland cotton. There may be payments for which that would not be the case, and the complaining party could go to a compliance panel and allege that those payments were continuing to have adverse effects. But in the circumstances of this case, Brazil chose not even to try to make that showing; the logical inference is that Brazil could *not* make that case. This Panel was wrong to use a convoluted reading of Article 21.5 of the DSU and Article 7.8 of the SCM Agreement to allow Brazil to make serious prejudice claims, wholly unrelated to the

payments that were the subject of the DSB’s recommendations and rulings. Moreover, the Panel’s approach ignored the fact that serious prejudice, by its nature, is fact-specific and depends on the situation in the market, a situation that may be constantly changing such that the terms and conditions for a subsidy that causes serious prejudice during one time period are not causing serious prejudice for another time period.

74. The Panel improperly found that it could consider Brazil’s claims regarding marketing loan and counter-cyclical payments made after September 21, 2005. This finding imposed on the United States an overly-broad obligation based on an erroneous understanding of Article 7.8 of the SCM Agreement and Article 21.5 of the DSU. The Appellate Body should reverse the Panel’s ruling and find that the marketing loans and counter-cyclical payments made after September 21, 2005, were not within the scope of the Article 21.5 proceeding.

III. The Panel Erred in Finding that GSM 102 Export Credit Guarantees Issued after July 1, 2005 are Inconsistent with Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the SCM Agreement

75. The Panel’s determination that the GSM 102 export credit guarantee program constituted an export subsidy rested entirely on its conclusion that “it is provided against premiums which are inadequate to cover its long term operating costs and losses under the terms of item (j) of the Illustrative List [of Export Subsidies under Annex I of the *Agreement on Subsidies and Countervailing Measures*].”⁴⁵ The Panel indicated that it reached this conclusion after determining that Brazil had satisfied its burden of proof with respect to three elements: (a) alleged U.S. Government projections that the current GSM 102 export credit guarantee program

⁴⁵Panel Report, paras. 14.133; *see also* Panel Report, paras. 14.47, 14.132, 14.134, 14.135.

would be provided at a net cost to the U.S. Government, even though U.S. budgetary figures in fact project a profit; (b) GSM 102 fees are not at a sufficient level, as compared to Minimum Premium Rates (“MPRs”) applicable only to industrial goods under the OECD Arrangement on Officially Supported Export Credits (“OECD Arrangement”), which even the Panel recognized has no legal effect under the WTO agreements and has no proper role in the examination of agricultural export credit guarantees; and (3) the structure, design and operation of the GSM 102 program indicated that the GSM 102 program is not designed to cover its long-term operating costs and losses, even though the Panel took into account factors that are wholly inappropriate to a proper analysis under item (j).⁴⁶ The United States now addresses the legal errors as to each of these findings by the Panel.

A. The Panel’s “Quantitative” Analysis under Item (j) Fails Because the Panel Erroneously Found that Brazil Produced Data Sufficient to Support a *Prima Facie* Case that GSM 102 Export Guarantees were Provided at Premiums Inadequate to Cover Long-Term Operating Costs and Losses

76. The first element on which the Panel based its conclusion under item (j) relates to what the Panel has described as the “‘quantitative’ analysis under item (j).”⁴⁷ As part of its item (j) argument, Brazil alleged that the U.S. Government continued to predict that the revised GSM 102 export credit guarantees for fiscal years 2006, 2007, and 2008 would be provided at a net cost in the long-term.⁴⁸ The Panel noted Brazil’s reliance on “initial or original ‘subsidy

⁴⁶Panel Report, para. 14.133.

⁴⁷Panel Report, section XIV.C.4(b).

⁴⁸Panel Report, paras. 14.65; First Written Submission of Brazil, paras. 433-437.

estimates’ reported in the U.S. Budget,”⁴⁹ and looked at this evidence to support its finding that Brazil had met its *prima facie* case under item (j). The United States explained to the Panel why this evidence did not, in fact, support such a finding, but the Panel did not accept those explanations. The Panel’s failure to do so was legal error, as this section of the U.S. Submission will demonstrate.

77. Upon closer examination, it is clear that Brazil acknowledged that such initial estimates are similar to, and of the same probative value as, such initial estimates for prior budget years, going back to 1992. Brazil asserted that U.S. attempts to discredit such evidence were nothing more than a reiteration of arguments rejected by the original panel.⁵⁰ This is not correct. What Brazil neglected to address, and the Panel improperly failed to take into account, was the undisputed evidence of profit reflected in U.S. budgetary data issued after the original panel had considered the matter, in marked contrast to the analogous figures considered by the original panel.

78. The initial estimate data that Brazil presented to the original panel to demonstrate an anticipated loss has proven, over time, not to be accurate. Brazil again presented similar “not exceptional” initial estimate data to the most recent Panel, this time for the GSM 102 program for fiscal years 2006-08. The Panel received from the United States, however, new re-estimate figures demonstrating an anticipated profit. As the Panel acknowledged, the United States submitted a table comprised of figures from the U.S. budget showing “for all three programs

⁴⁹Panel Report, paras. 14.69.

⁵⁰*See, e.g.*, Oral Statement of Brazil, para. 254.

[i.e., the GSM 102 program and the dormant GSM 103 program and SCGP], an aggregate overall negative ‘subsidy estimate net of reestimates’ (i.e. anticipated ‘profit’) of US\$926 million for the 1992-2002 cohorts (i.e. the cohorts examined by the original panel) and of US\$403 million for the 1992-2006 cohorts.”⁵¹ As the Panel noted, these re-estimates “indicate that the US Government now projects the cohorts of guarantees at issue to be profitable.”⁵²

79. Significantly, the re-estimate figures before the original panel did not indicate an expected profit, but instead showed a positive subsidy (or anticipated loss) of approximately \$230 million.⁵³ The conclusions of the original panel were specifically informed by that important fact: “We believe that it is relevant for our item (j) analysis that, netting re-estimates against original subsidy estimates on a cohort-specific basis yields a positive subsidy which reveals that over the long term the United States government anticipates that it may not break even with its export credit guarantee programs.”⁵⁴ For that reason, the original panel stated, it was not “persuaded that cohort reestimates over time, will necessarily not give rise to a net cost to the United States government.”⁵⁵

80. The new re-estimate budgetary data, which came into existence after the original

⁵¹Panel Report, para. 14.79; See Response to Panel Question 111 and US First Written Submission, paras. 87-89.

⁵²Panel Report, para. 14.81. The Panel itself recognized that a negative subsidy net of reestimates indicates profitability when it stated: “The original panel was not persuaded that cohort reestimates, over time, would necessarily not give rise to a net cost to the United States Government. Similarly, we are not convinced that the re-estimates data submitted by the United States establishes that all positive subsidy estimates – and in particular, those for cohorts 2006-2008 – will eventually turn into negative ones.” Panel Report, para. 14.80.

⁵³*Upland Cotton (Panel)*, para. 7.852.

⁵⁴*Upland Cotton (Panel)*, para. 7.854.

⁵⁵*Upland Cotton (Panel)*, para. 7.853.

proceeding, indicated the profitability of the GSM 102 program, as well as the other two programs which have been eliminated (GSM 103, SCGP), even before substantial revisions were undertaken to comply with the DSB’s recommendations and rulings.⁵⁶ Two of the cohorts – for 1994 and 1995 – had actually closed, and reflected *actual* experience with the programs.⁵⁷ Both of these cohorts were profitable for the U.S. Government.

81. The Panel, in completing its “quantitative” analysis under item (j) and finding that Brazil had met its burden of proof, reverted almost entirely to the initial estimate data presented by Brazil: “[t]he process by which the CCC arrives at initial estimates of long-term program performance has not changed since the original proceedings; nor have the criteria used by the CCC to make this assessment’. There are, in sum, *no changes in the underlying circumstances that would justify us revisiting the original panel’s reasoning in this respect.*”⁵⁸ The new re-estimate figures, however, constituted a manifest change in the underlying circumstances, but the Panel never required Brazil to explain this salient fact.

82. The United States also explained to the Panel the problems inherent in using initial estimates submitted by Brazil. First, the estimates were calculated before any use of the program in the year the estimate was made.⁵⁹ Second, they were derived using government-wide estimation rules, without regard to the actual experience specific to CCC’s export credit

⁵⁶U.S. First Written Submission, paras. 83, 86-90, 96; Panel Report, para. 14.78.

⁵⁷U.S. First Written Submission, para. 94; Panel Report, para. 14.81.

⁵⁸Panel Report, para. 14.75 (emphasis added).

⁵⁹Panel Report, paras. 14.72, 14.76; U.S. Rebuttal Submission, paras. 108 *ff*; Exhibit US-73; US First Written Submission, paras. 100-104.

guarantee programs.⁶⁰ These government-wide rules impose assumptions about default and recovery rates as a component of the initial subsidy calculation, irrespective of the specific experience of the CCC program.⁶¹ At the time of calculation of the original subsidy estimates, therefore, these factors result in an exaggerated projection of losses in the initial subsidy estimate. In light of the profitability of the programs ultimately reflected in the negative subsidy net of re-estimates, it bears repeating that Brazil previously acknowledged that in the U.S. budget such “original estimates were too high.”⁶²

83. In addition to ignoring the data indicating profitability, Brazil’s budgetary evidence was limited to initial estimates in the U.S. budget for three specific fiscal years only: 2006, 2007, and 2008. Item (j), however, imposes no requirement with respect to individual program years or even a particular series of years. The question under item (j) is whether premia charged under an export credit guarantee program are adequate to cover the long-term operating costs and losses of that program. By not accounting for the data reflecting long-term profitability even before reform of the structure of the GSM 102 program, the Panel misapprehended and misapplied the item (j) standard in conducting its quantitative analysis.

84. The Panel, despite Brazil’s failure to address the re-estimates showing program profitability and the flaws inherent in the initial subsidy estimates, nevertheless found that the initial subsidy estimates provided a “strong indication” that GSM 102 export credit guarantees

⁶⁰Panel Report, para. 14.72; U.S. Rebuttal Submission, paras. 108 *ff*; Exhibit US-73; US First Written Submission, paras. 100-104.

⁶¹U.S. Rebuttal Submission, paras. 111-126; Exhibit US-73.

⁶²*Upland Cotton*, Second Oral Statement of Brazil (7 October 2003), para. 70; Brazil Comments on U.S. Rebuttal Submission (27 August 2003), para. 60.

are provided against premiums which are inadequate to cover the long-term operating costs and losses of the program.⁶³ The Panel considered that this evidence supported a finding that Brazil made a *prima facie* case that the GSM 102 program was an export subsidy under item (j).⁶⁴ But it did not, because it failed to account for re-estimates showing profitability, and the deficiencies in the initial estimates themselves.⁶⁵

85. Much of Brazil's other alleged quantitative evidence was outside the government-wide U.S. budget. Brazil submitted its own independent cash-basis accounting methodology, separate and apart from the U.S. budget accounting approach.⁶⁶ Brazil similarly went outside the U.S. budget to assert that the "credit guarantee liability" figure in CCC financial statements portrayed a different result of the re-estimate process.⁶⁷

86. The Panel noted that "the original panel took into consideration 'cash accounting' evidence submitted by Brazil and the 'credit guarantee liability' figure reported in the CCC's Financial Statements."⁶⁸ With respect to the latter, the United States demonstrated that the credit guarantee liability figure is merely a balance sheet entry of a liability for which an offsetting entry of an asset exists and that the CCC has an expectation of recovery associated with the

⁶³Panel Report, paras. 14.89.

⁶⁴Panel Report, paras. 14.89-14.90; 14.133-14.134.

⁶⁵As the Appellate Body said, "a *prima facie* case is one which, in the absence of effective refutation by the defending party, requires a panel, as a matter of law, to rule in favour of the complaining party presenting the *prima facie* case." *EC – Hormones (AB)*, para. 104.

⁶⁶Panel Report, para. 14.84.

⁶⁷Rebuttal Submission of Brazil, para. 483.

⁶⁸Panel Report, paras. 14.81.

payment for default on the guaranteed loan. Consequently, the figure is not a “loss.”⁶⁹ Brazil had also presented its cash-basis accounting methodology to the original panel, which did not adopt it, as the Panel seems to imply.⁷⁰

87. The Panel ultimately stated that “the ‘credit guarantee liability’ figure reported in the CCC’s Financial Statements and the cash accounting basis data submitted by Brazil at the very least *raise questions* as to whether subsequent subsidy reestimates indeed establish that the programs at issue in the original proceeding were not provided at a net cost to the US Government.”⁷¹ Merely to “raise questions,” however, is not sufficient to satisfy a burden of putting forward a *prima facie* case.

88. Although the Panel has professed that “we have conducted our analysis under the general rules of the burden of proof [and therefore] assumed that it was for Brazil to establish that GSM 102 export credit guarantees constitute export subsidies because they fall within the terms of item (j) of the Illustrative List,”⁷² the Panel stated only that the evidence of Brazil has “raised questions” or provided an “indication.” The Panel has erred as a matter of law in finding that Brazil’s budgetary and other quantitative evidence satisfied the requisite burden of proof placed on Brazil to demonstrate that the GSM 102 program charged fees inadequate to cover long-term operating costs and losses, and the Panel’s conclusion in respect of the “quantitative” analysis for purposes of item (j) therefore fails as a matter of law.

⁶⁹Panel Report, paras. 14.82.

⁷⁰See U.S. Rebuttal Submission, paras. 91-94.

⁷¹Panel Report, paras. 14.88 (emphasis added).

⁷²Panel Report, paras. 14.132.

B. The Panel Misconstrued the Requirements of Item (j) of the Illustrative List in Comparing GSM 102 Fees to MPRs under the OECD Arrangement and in Making Findings as to the Structure, Design, and Operation of the GSM 102 Program

89. The Panel has fundamentally misinterpreted the requirements of item (j) of the Illustrative List to the SCM Agreement. Even though it recognized that MPRs under the OECD Arrangement have no legal status under item (j) and provide no benchmark for agricultural export credit guarantees, it nevertheless made determinations under item (j) based on a comparison of GSM 102 program fees to MPRs. In addition, the Panel erroneously interpreted item (j) to require a relative “scaling” of fees between highest risk obligors and lowest risk obligors under an export credit guarantee program. In so doing, the Panel made improper comparisons between the GSM 102 program and wholly dissimilar programs of the Export-Import Bank of the United States (“Ex-Im Bank”), which are themselves subject to OECD MPR requirements.

90. The Panel also assumed that the continuing existence of a statutory one-percent fee cap under the GSM 102 program necessarily meant that the program was not designed to cover long-term operating costs and losses. The Panel professed an inability to evaluate whether a 46 percent average fee increase was sufficient to ensure that the GSM 102 program was provided at no net cost to the U.S. Government, even with the existence of the one percent fee cap, yet ruled against the United States. Nothing in item (j), however, precludes the imposition of a fee cap for an export credit guarantee program, like GSM 102, as long as the program meets long-term operating costs and losses.

91. Lastly, the Panel also took into account several other factors that have no place in a

proper analysis under item (j).

1. The Panel Incorrectly Relied on Comparisons of GSM 102 Premiums to the OECD Arrangement and Ex-Im Bank Programs

a. *MPRs and the OECD Arrangement*

92. In finding that Brazil has met its burden of proof with respect to item (j) of the Illustrative List, the Panel took into consideration that: “GSM 102 fees are well below the OECD MPRs, which we consider to provide an informed appraisal of the level of fees necessary to cover the long-term operating costs and losses of an export credit guarantee program.”⁷³ However, the MPRs under the OECD Arrangement are not appropriate for inclusion in a proper analysis under item (j), and the Panel’s comparison of GSM 102 fees to MPRs fails as a matter of law.

93. As the Panel itself recognized, the text of item (j) does not refer to any international agreement, including the OECD Arrangement, as a basis for determining whether premium rates are adequate to cover long-term operating costs and losses.⁷⁴ In contrast, item (k) of the Illustrative List does specifically mention the OECD Arrangement. The Panel also noted that “GSM 102 fees are not subject to the Arrangement – and therefore to the MPRs – because the Arrangement does not apply to exports of agricultural commodities.”⁷⁵ In addition, as to the terms of coverage, “the Arrangement only applies to official support for terms of two years or more, while GSM 102 guarantees, which are provided for tenors up to three years, are also

⁷³Panel Report, para. 14.133.

⁷⁴Panel Report, para. 14.94.

⁷⁵Panel Report, para. 14.94.

provided for tenors of less than two years.”⁷⁶

94. Despite its recognition of the inapplicability of the OECD Arrangement and MPRs and the explicit admission that “the MPRs have no legal status in the context of an analysis under item (j),”⁷⁷ the Panel nevertheless compared OECD MPRs to fees charged under the GSM 102 program, and found that comparison dispositive for purposes of the item (j) analysis. Although it first stated that there is “no basis to treat the OECD MPRs as providing a legally binding benchmark to determine whether an export credit guarantee falls within the scope of item(j),”⁷⁸ the Panel stated that “the MPRs may thus be regarded as representing an assessment, developed by and agreed upon by the export credit experts of the Participants to the Arrangement, of the premia levels that are necessary to ensure that export credit guarantee programs cover their long-term operating costs and losses.”⁷⁹ Neither the OECD Arrangement nor the MPRs, however, are referenced in item (j), and MPRs, promulgated by OECD members, do not explain how the sufficiency of export credit guarantee premia should be judged.⁸⁰

95. In light of Article 10.2 of the *Agreement on Agriculture*, it was erroneous for the Panel to permit any application of MPRs, designed for industrial goods, to the GSM 102 program, an agricultural export credit guarantee program. The Panel’s characterization, in the context of an

⁷⁶Panel Report, para. 14.94.

⁷⁷Panel Report, para. 14.95.

⁷⁸Panel Report, para. 14.94

⁷⁹Panel Report, para. 14.96.

⁸⁰Even were the comparison to MPRs somehow valid, the Panel also seems to confuse “necessary” with “sufficient.” To the extent that adhering to MPRs is a form of safe harbor, such that compliance with them would insulate one from liability, no inference can be drawn from the failure to take advantage of the safe harbor under the Arrangement.

agricultural export credit guarantee program, that MPRs are “agreed upon ... premia levels that are necessary to ensure that export credit guarantee programs cover their long-term operating costs and losses” is wrong.

96. Article 10.2 provides:

Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith.

97. The Appellate Body will recall that in the original dispute the United States argued that “during the Uruguay Round, WTO Members did not agree on disciplines to be applied to agricultural export credits, export credit guarantees, and insurance programs, opting instead to continue discussions, deferring the imposition of substantive disciplines until a consensus was achieved.”⁸¹ The Appellate Body further noted that “there is no dispute between the parties that, to date, no disciplines have been agreed internationally pursuant to Article 10.2.”⁸²

98. Indeed, one Member of the Appellate Body went so far as to state that “the negotiating history supports an interpretation that Article 10.2 was inserted to commit WTO Members to continue negotiating on the disciplines that would apply, in the future, and that no disciplines would apply to such measures until such time as disciplines were internationally agreed upon.”⁸³

99. To this day, no disciplines have been agreed under Article 10.2. Moreover, as the

⁸¹*Upland Cotton (AB)*, para. 598.

⁸²*Upland Cotton (AB)*, para. 607.

⁸³*Upland Cotton (AB)*, para. 636

Panel acknowledged, the MPRs were not even developed with agricultural trade in mind.⁸⁴ The application of the OECD MPRs to an agricultural export credit guarantee program is therefore wholly improper. Despite the absence of any such multilaterally agreed disciplines under Article 10.2, the Panel would now impose on agricultural export credit guarantees criteria applicable only to *industrial* goods. Such a result would render Article 10.2 a nullity. It therefore constitutes legal error for the Panel to have relied in any way on a comparison of GSM 102 fees with MPRs when undertaking an item (j) analysis.

100. Seemingly aware of the misapplication of MPRs to an item (j) analysis in an agricultural context, the Panel hastened to note its agreement that “with respect to product coverage, Brazil submits that, if anything, the MPRs would increase if agricultural products were made subject to it.”⁸⁵ In support of its concurrence with Brazil’s argument, the Panel cited only Brazil’s unsupported assertion that “industrial products are more durable and offer a better security to the guarantor”⁸⁶ and “there is in our view no reason why the MPRs should be lowered were agricultural products to fall under its product coverage.”⁸⁷ The Panel’s attempt to explain MPRs in the context of agricultural trade only further affirms their inapplicability to an item (j) analysis of the GSM 102 program.⁸⁸

b. *Ex-Im Bank Programs*

⁸⁴Panel Report, para. 14.94.

⁸⁵Panel Report, para. 14.101.

⁸⁶Panel Report, paras. 14.101 & n.714.

⁸⁷Panel Report, para. 14.101.

⁸⁸The Panel could just have easily found that because food is a necessity, it would get priority for repayment and so MPRs would be lower for agricultural goods.

101. In its assessment of whether fees charged under the GSM 102 program are sufficiently “risk-based” the Panel evaluated evidence to determine whether the program reflected “insufficient ‘scaling’” of fees.⁸⁹ In conducting such assessment, the Panel examined evidence purporting to compare with the GSM 102 program “the rate of increase, with risk, of fees charged by the Ex-Im Bank (the US export credit agency) for two of its products, the Letter of Credit Insurance (LCI) and the Medium-Term Export Credit Insurance (MTI).”⁹⁰ As the United States pointed out, however, MTI is not available for agricultural products, and MTI fees themselves are subject to MPRs.⁹¹ The Panel, however, took into account “the significant difference between the rates of increase for, on the one hand, GSM 102 fees and, on the other hand, the ExIm Bank’s . . . products” to conclude that the GSM 102 program did not have a “truly risk-based fee structure.”⁹² Compounding the error of its improper analysis, as an “additional element lend[ing] further support to our conclusion that the rate of increase of GSM 102 fees is insufficient to meaningfully account for increased risks,” the Panel “recall[ed] our finding above concerning the increasing difference between GSM 102 fees and the OECD MPRs as risk increases.”⁹³

102. Brazil did not even offer its comparison of fees to Ex-Im Bank products for the purpose of an item (j) analysis. Instead, the comparison was offered almost exclusively in support of its

⁸⁹Panel Report, para. 14.121.

⁹⁰Panel Report, para. 14.122.

⁹¹Panel Report, para. 14.124; US Response to Panel Question 98, para. 223.

⁹²Panel Report, para. 14.128.

⁹³Panel Report, para. 14.129.

argument that GSM 102 guarantees are financial contributions that confer a benefit, and therefore constitute an export subsidy.⁹⁴ The Panel, however, did not examine this question and made no findings in this regard,⁹⁵ but used the evidence on Ex-Im Bank fees as part of its item (j) analysis.

103. In any event, the Ex-Im Bank products are fundamentally dissimilar to the GSM 102 program. In addition to the fact that they are subject to MPRs, and that MTI is not available for agricultural goods, those products differ significantly in terms of interest and principal cover, as well the availability of recourse to a third party for uninsured amounts.⁹⁶ Nevertheless, the Panel acceded to Brazil’s proffered adjustments to take into account these differences and force a scaling comparison.⁹⁷

104. The Panel’s legal error in relying on a comparison with Ex-Im Bank programs was compounded by its improper understanding of scaling as part of an item (j) analysis. Item (j) does not even impose a “risk-based” condition, so the Panel erred in imputing one in the first place and conducting a scaling analysis. The only condition that must be met is whether the premia under an export credit guarantee program are adequate to cover long-term operating costs and losses of that program. Even were a risk-based standard relevant, item (j) does not dictate any specific standards as to scaling. Scaling is only relevant with respect to a comparison of those transactions that are *eligible* under the program. Ineligible transactions have no fee – and

⁹⁴First Written Submission of Brazil, paras. 381-406; Rebuttal Submission of Brazil, paras. 433-436; Oral Statement of Brazil, paras. 174-180.

⁹⁵Panel Report, para. 14.135.

⁹⁶Panel Report, para. 14.124 and fn. 752; US Response to Panel Question 98, paras. 226-31; Exhibit US-155; Exhibits Bra-531 and Bra-535.

⁹⁷Panel Report, para. 14.125.

therefore no scaling – associated with them. A full examination of whether a program is risk-based would also take into account those transactions that are wholly ineligible. Upon adoption of the reformed GSM 102 program the United States reclassified as ineligible 22 countries that were previously eligible.⁹⁸ For those countries, the current fee is effectively infinite, but the Panel never recognized this fact.

2. The Panel Erroneously Found that the Continued Existence of the One Percent Fee Cap Prevented the Adoption of Risk-Based Fees Despite Certain Changes Made to the Fee Structure of the GSM 102 Program

105. The United States fundamentally revised the GSM 102 program to comply with the recommendations and rulings of the DSB. In addition to wholesale changes in the eligibility criteria for country risk, which led the United States to reclassify 22 previously eligible countries into an ineligible risk category, the United States adopted substantially increased fees based on risk for all eligible countries.⁹⁹ The United States also increased fees based on repayment term and repayment frequency. Overall, GSM 102 program fees increased on average by 46 percent.¹⁰⁰ Brazil nevertheless emphasized that a statutory one per cent fee cap on the program remained in place and highlighted a statement of the USDA made *before* the overhaul of the fee structure and taken into consideration by the original panel that “moving to a risk-based system would raise fees to a level that ‘would most likely exceed 1 per cent’”¹⁰¹

⁹⁸U.S. First Written Submission, para. 7.

⁹⁹U.S. First Written Submission, para. 7.

¹⁰⁰Panel Report, para. 14.105; U.S. First Written Submission, paras. 7, 74.

¹⁰¹Panel Report, paras. 14.116-14.117.

106. Brazil never mentioned that item (j) does not specify how a program should be structured and designed so that premiums are adequate to cover long-term operating costs and losses. Nothing in item (j) says that just because a program has a fee cap, it cannot satisfy the test that premium rates indeed cover long-term operating costs and losses. As long as fees are structured in such a way as to cover long-term operating costs and losses of a program, that program is not an export subsidy.¹⁰²

107. Noting only that the original panel did not quantify the margin by which fees in the unmodified GSM 102 program failed to cover long-term operating costs and losses, the Panel neglected its responsibility to evaluate the new fee structure and stated only that *because* of the original panel’s failure to provide a margin, the Panel was “unable to assess whether a 46 per cent average fee increase (23 per cent trade-weighted increase) is sufficient to ensure that the GSM 102 program is provided at a net cost to the US Government.”¹⁰³ The Panel also found that it “[could not] rule out” that revisions to the GSM 102 program “may affect the USDA’s evaluation of whether the one percent fee cap still remains a constraint on the adoption of risk-based fees.”¹⁰⁴

108. Despite its own uncertainty as to the effect of the changes to the GSM 102 program’s fee structure, the Panel nevertheless “regard[ed] the non-repeal of the one percent fee cap as an

¹⁰²The Panel erroneously implied that item (j) *requires* a difference in fees of greater than 100 percent between the lowest and highest country risk categories, when it declared, without support, that “an increase in fees of, at most, 100 percent suggests that fees insufficiently take account” differences in risk among eligible countries. Panel Report, para. 14.129.

¹⁰³Panel Report, para. 14.120.

¹⁰⁴Panel Report, para. 14.119.

indication that the fees charged for GSM 102 export credit guarantees are still not ‘risk-based.’”¹⁰⁵ In apparent support of this conclusion, the Panel stated: “[W]e consider that the evidence submitted by Brazil concerning outstanding guarantees with respect to countries that have now been made ineligible suggest that the factual context in which the USDA’s statement was made has not been altered fundamentally.”¹⁰⁶ The factual context, however, was indeed altered fundamentally, as the fee structure was completely restructured, and the data on budget estimates net of re-estimates reflected a profit even under the antecedent fee structure. Moreover, substantially increased fees and the elimination of previously eligible participants could only have improved the financial picture of the program.

109. The Panel erred as a matter of law in relying on the existence of the one percent cap as proof that the revised GSM 102 program was not risk-based. Nothing in item (j) mandated such a conclusion. The Panel compounded its error even further by concluding that its “assessment of the effects of the remaining presence of the one percent fee cap is confirmed by” Brazil’s Ex-Im Bank fee scaling analysis.¹⁰⁷

3. The Panel Erroneously Took into Account Other Factors that are Not Part of a Proper Analysis under Item (j)

110. The text of item (j) only asks whether the premia under an export credit guarantee program are adequate to cover long-term operating costs and losses of that program. In reaching its conclusion that GSM 102 program was not designed to cover its long-term operating costs

¹⁰⁵Panel Report, para. 14.120.

¹⁰⁶Panel Report, para. 14.120.

¹⁰⁷The United States demonstrated in Part III.B.1, *supra*, the problems inherent in that analysis.

and losses, the Panel improperly took into consideration other factors which were not germane to an analysis under item (j).¹⁰⁸ The Panel’s fundamental misinterpretation of item (j) cannot stand as a matter of law.

111. The Panel first considered the fact that the CCC has access to funds from the U.S. Treasury and that it also benefits from the full faith and credit of the US Government.¹⁰⁹ The Panel relied on these factors to support its finding that the GSM 102 program was not designed to cover its long-term operating costs and losses.¹¹⁰ Such considerations, however, are irrelevant under item (j). According to the Panel’s overly-broad approach, a government-backed export credit, guarantee, or insurance program could *never* satisfy the item (j) test because under the Panel’s theory, the unlimited access to government funds discourages the design of a program that meets long-term operating costs and losses. The WTO Agreements set forth no such absolute rule, and the Panel’s interpretation would render item (j) *inutile* since a government export guarantee program would always be an export subsidy.¹¹¹

112. The Panel also concluded that “the fact that the United States sets bank limits with respect to each foreign bank obligor does not, in our view, alter the fact that foreign obligor risk is not reflected in GSM 102 fees.” Item (j), however, does not dictate how foreign obligor risk should be taken into account by the government extending the export credit guarantees.

Managing such risk is an important way of ensuring the adequacy of premia to cover long-term

¹⁰⁸Panel Report, paras. 14.110-14.115.

¹⁰⁹Panel Report, paras. 14.110, 14.131.

¹¹⁰Panel Report, para. 14.131.

¹¹¹U.S. Rebuttal Submission, para. 104.

operating costs and losses. The United States argued that the CCC's strict bank exposure limits were a means of addressing foreign obligor risk, and that Brazil was incorrect to assert that the CCC should also assess fees based on the level of risk associated with each foreign bank.¹¹²

113. The Panel's interpretation of item (j) should be reversed. No WTO rule governs how a government program shall be designed to ensure that its premia are adequate to cover long-term operating costs and losses. The question under item (j) is whether premia are adequate to cover long-term operating costs and losses. Foreign obligor risk is in effect a way of describing the potential for loss as a result of the default of such an obligor. This risk can be mitigated in several ways. One way is to charge premia rates that are sufficiently high that usage is relatively low and exposure to the risk of default is commensurately low, but at all times, including in times of economic duress, the applicant can still obtain a guarantee of such bank's obligation by paying the fee. Alternatively, as CCC does, a guarantor can set a maximum exposure to debt of a particular foreign bank obligor. Under such a system, after that maximum point, a guarantee cannot be obtained at any price. As is the case for ineligible participants, at that point the fee required is essentially infinite. Under either method, the program as a whole charges premia that are adequate to cover its long-term operating costs and losses, because it truncates its exposure to such losses at the applicable exposure limit. The United States elected to impose exposure limits, and the Panel erred in concluding that fees were the only proper way to deal with foreign obligor risk.

C. The Panel Failed to Undertake an "Objective Assessment" of the Export Credit Guarantee Claims as Required by DSU Article 11

¹¹²U.S. First Written Submission, para. 79; U.S. Rebuttal Submission, para. 107.

114. Article 11 of the DSU provides that “a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements.” The Appellate Body has articulated the standard for determination of when a panel has failed to discharge its responsibility under DSU Article 11:

The duty to make an objective assessment of the facts is, among other things, an obligation to consider the evidence presented to a panel and to make factual findings on the basis of that evidence. The deliberate disregard of, or refusal to consider, the evidence submitted to a panel is incompatible with a panel’s duty to make an objective assessment of the facts. The willful distortion or misrepresentation of the evidence put before a panel is similarly inconsistent with an objective assessment of the facts. “Disregard” and “distortion” and “misrepresentation” of the evidence, in their ordinary signification in judicial and quasi-judicial processes, imply not simply an error of judgment in the appreciation of evidence but rather an egregious error that calls into question the good faith of a panel. A claim that a panel disregarded or distorted the evidence submitted to it is, in effect, a claim that the panel, to a greater or lesser degree, denied the party submitting the evidence fundamental fairness, or what in many jurisdictions is known as due process of law or natural justice.¹¹³

Moreover, the Appellate Body has stated that under Article 11, panels may not make affirmative findings that “lack a basis in the evidence contained in the panel record.”¹¹⁴

115. In *U.S. – Softwood Lumber VI (21.5)*, the Appellate Body further articulated the requirements of Article 11 of the DSU in the context of the review by a panel of determinations made by domestic investigating authorities.¹¹⁵ The Appellate Body noted that “[t]he panel’s scrutiny should test whether the reasoning of the authority is coherent and internally

¹¹³*EC – Hormones (AB)*, para. 133.

¹¹⁴*U.S. – German Steel (AB)*, para. 142.

¹¹⁵*U.S. – Softwood Lumber VI (21.5) (AB)*, para. 93.

consistent.”¹¹⁶ Moreover, “the panel must examine whether the explanations provided demonstrate that the investigating authority took proper account of the complexities of the data before it, and that it explained why it rejected or discounted alternative explanations and interpretations of the record evidence. A panel must be open to the possibility that the explanations given by the authority are not reasoned or adequate in the light of other plausible alternative explanations.”¹¹⁷ Clearly, the Appellate Body expects a panel to hold an investigating authority to a high standard of care in reaching its conclusions. A WTO panel, as the initial trier of fact, should be held to the same standard by the Appellate Body. In particular, under Article 5 of the SCM Agreement, a panel is fulfilling the same function as an investigating authority. For example, a panel may be examining whether there is material injury, the same question as for investigating authorities. A panel should conduct that analysis with the same care. This Panel, however, failed to do so.

116. In this matter, the Panel failed to undertake an objective assessment of Brazil’s claims concerning the GSM 102 export credit guarantee program.

1. Quantitative Analysis Under Item (j)

117. Conducting its “quantitative” analysis under item (j), the Panel disregarded the import of the budgetary re-estimates data submitted by the United States.¹¹⁸ The re-estimates data demonstrated that the export credit guarantee programs in the aggregate – even before the adoption of the new fee structure for the GSM 102 program and the elimination of the longer-

¹¹⁶*U.S. – Softwood Lumber VI (21.5) (AB)*, para. 93.

¹¹⁷*U.S. – Softwood Lumber VI (21.5) (AB)*, para. 93.

¹¹⁸Panel Report, paras. 14.73, 14.78-14.81.

term GSM 103 export credit guarantee program and the riskier SCGP – charged premium rates more than adequate to cover long-term operating costs and losses of the three programs.¹¹⁹ These re-estimates indicated the *U.S. Government’s view* of the profitability of the export credit guarantee programs. Two cohorts, for 1994 and 1995, had also closed by the time of the compliance proceeding, and reflected *actual* experience with the programs.

118. The Panel dismissed this highly probative evidence by noting that the United States had made similar arguments about re-estimates before the original panel and concluding that it was “not convinced” that the positive subsidy estimates, including those for 2006-2008, would “eventually turn” into negative ones.¹²⁰ The U.S. arguments, however, could not have been the same, as the re-estimates data, and the two closed cohorts, were not before the original panel. Moreover, unlike in the original proceeding, the re-estimates also showed a negative subsidy, which reflected the profitability of the export credit guarantee programs over the 1992-2005 period. This profitability existed *even before* the elimination of the GSM 103 program and SCGP and the changes to the GSM 102 program.¹²¹

119. This new information undermined the initial subsidy estimates submitted by Brazil, which the Panel relied on to find that the premia under the GSM 102 program were inadequate to cover the program’s long-term operating costs and losses. Like the initial estimates put forward by Brazil, the re-estimates data submitted by the United States also are set out in the U.S. Budget (the estimates and re-estimates are both calculated in accordance with a methodology prescribed

¹¹⁹Response to Panel Question 111; US First Written Submission, paras. 87-89.

¹²⁰Panel Report, para. 14.73, 14.78, 14.80.

¹²¹U.S. First Written Submission, paras. 85-86.

by the Office of Management and Budget within the U.S. Government and approved by that office), but reflect the overall profitability of the export credit guarantee programs based on actual experience of the programs. Instead of taking into account the new data submitted by the United States, the Panel ignored the import of the U.S. evidence, and relied on the initial subsidy estimates, among other factors, to find that Brazil made a *prima facie* case under item (j). This disregard for the new re-estimates data demonstrates the Panel’s failure to conduct an objective assessment as required by Article 11 of the DSU.

2. Non-Quantitative Analysis Under Item (j), Including Structure, Design, and Operation

120. When undertaking its non-quantitative analysis of the GSM 102 program, the Panel also distorted the meaning of the evidence before it, and made unsubstantiated assumptions to support its findings. These errors demonstrate that the Panel failed to conduct an objective assessment of the matter, and constitute a grounds for reversal under Article 11.

121. As the United States has explained, Brazil made a flawed comparison of GSM 102 fees to MPRs under the OECD Arrangement. The Panel itself acknowledged that neither the Arrangement nor MPRs apply to export credits for agricultural goods.¹²² Indeed, the Panel even admitted that “the MPRs have no legal status” in the context of an item (j) analysis.¹²³ Yet the Panel disregarded the irrelevancy of the MPRs and relied on Brazil’s comparison to support its finding that the premia under the GSM 102 program were inadequate to cover that program’s

¹²²Panel Report, para. 14.94.

¹²³Panel Report, para. 14.95.

long-term operating costs and losses.¹²⁴

122. The Panel exacerbated its error by adopting Brazil’s unsupported assertion that “if anything, the MPRs would increase if agricultural products were made subject to it.”¹²⁵ Brazil offered as an explanation only its conjecture that industrial products “offer a better security” and the value of an agricultural “product sold holds little value to the guarantor.”¹²⁶ These conclusory observations were unsupported by evidence on the record, and the Panel was wrong to rely on them to justify its use of an improper comparison between GSM 102 program fees and MPRs.

123. The Panel also accepted Brazil’s suggestion that differences in the rate of increase of fees between Ex-Im Bank’s products and the GSM 102 program “may indicate” that GSM 102 fees “do not sufficiently increase with risk and, as a consequence, are not truly ‘risk-based.’”¹²⁷ As the Panel recognized, however, one of these products – Medium Term Export Credit Insurance (“MTI”) – is “not available for agricultural products.”¹²⁸ Despite this obvious factual distinction, the Panel concluded that it “does not, in our view fundamentally undermine the value of the comparison.”¹²⁹ The Panel offered no support for this conclusion, and simply relied on a scaling comparison of GSM 102 program fees to Ex-Im Bank fees to support its finding under item (j).¹³⁰

¹²⁴Panel Report, paras. 14.97-14.98, 14.33(b).

¹²⁵Panel Report, para. 14.101.

¹²⁶Panel Report, para. 14.101.

¹²⁷Panel Report, para. 14.125.

¹²⁸Panel Report, para. 14.125.

¹²⁹Panel Report, para. 14.125.

¹³⁰Panel Report, paras. 14.125-14.128, 14.131.

124. The Panel further asserted that the increase in fees under the modified GSM 102 program of a maximum 100 percent between the lowest and highest risk category “suggests that fees insufficiently take account of” risk.¹³¹ The Panel nowhere provided any basis in the evidence for this assumption, yet considered it in reaching a finding that the one percent fee cap prevented the adoption of risk-based fees for the GSM 102 program.¹³²

125. The Panel here relied on unsupported assumptions, disregarded probative new evidence, and distorted the value of comparisons advanced by Brazil. Article 11 of the DSU requires more, and the failure here to conduct an objective assessment mandates reversal of the Panel’s findings under item (j) of the Illustrative List.

D. The Panel’s Finding that the United States Failed to Bring its Measures into Conformity with the *Agreement on Agriculture* and Failed to “Withdraw the Subsidy” Cannot Stand

126. The Panel found that “[r]egarding GSM 102 export credit guarantees issued after 1 July 2005 the United States acts inconsistently with Article 10.1 of the *Agreement on Agriculture* by applying export subsidies in a manner which results in the circumvention of US export subsidy commitments with respect to certain unscheduled products and certain scheduled products, and as a result acts inconsistently with Article 8 of the *Agreement on Agriculture*.”¹³³ Further, “[r]egarding GSM 102 export credit guarantees issued after 1 July 2005 the United States also acts inconsistently with Articles 3.1(a) and 3.2 of the SCM Agreement by providing export subsidies to unscheduled products and by providing export subsidies to scheduled products in

¹³¹Panel Report, para. 14.129.

¹³²Panel Report, para. 14.129.

¹³³Panel Report, para. 15.1(c).

excess of the commitments of the United States under the Agreement on Agriculture.”¹³⁴ The Panel ultimately concluded that “[b]y acting inconsistently with Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the SCM Agreement the United States has failed to comply with the DSB recommendations and rulings. Specifically, the United States has failed to bring its measures into conformity with the *Agreement on Agriculture* and has failed ‘to withdraw the subsidy without delay.’”¹³⁵

127. As an initial matter, the United States has demonstrated that the GSM 102 export credit guarantees with respect to poultry meat and pig meat were not within the scope of the Article 21.5 proceeding.¹³⁶ Therefore, the Panel should never have reached Brazil’s prohibited subsidy claims concerning those two scheduled products.

128. Even aside from the fact that those claims were not properly before the Panel, as were the claims concerning rice and unscheduled products, the United States has shown in this submission that the Panel’s finding concerning Brazil’s claims as to the GSM 102 export credit guarantees made after July 1, 2005, fails as a matter of law. Consequently, the Panel’s finding as to non-compliance by the United States with the DSB’s recommendations and rulings relating to the original panel's findings of inconsistency with Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the SCM Agreement cannot stand. The United States has therefore brought its measures into conformity with the *Agreement on Agriculture* and has withdrawn the prohibited subsidy without delay.

¹³⁴Panel Report, para. 15.1(c).

¹³⁵Panel Report, para. 15.1(c).

¹³⁶See Part II.A, *supra*.

IV. The Panel Erred in Finding that the “Effect” of Certain U.S. Marketing Loan and Counter-Cyclical Payments is “Significant Price Suppression” Constituting Present “Serious Prejudice” Within the Meaning of Articles 5(c) and 6.3(c) of the SCM Agreement

129. As the United States explained, the Panel erred in examining Brazil’s serious prejudice claims relating to marketing loan and counter-cyclical payments made after September 21, 2005.¹³⁷ The Panel, however, erroneously found that those claims were within the scope of the Article 21.5 proceeding, and, after considering them, concluded that “[t]he United States acts inconsistently with its obligations under Articles 5(c) and 6.3(c) of the *SCM Agreement* in that the effect of marketing loan and counter-cyclical payments provided to US upland cotton producers pursuant to the FSRI Act of 2002 is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement* in the world market for upland cotton constituting ‘present’ serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*.”¹³⁸ For the reasons explained in Part IV below, the Panel’s finding as to serious prejudice fails as a matter of law and should be reversed.

130. The Panel’s report draws conclusions concerning upland cotton production in the United States that are contrary to facts found by the Panel itself and based on an analysis that is erroneous as a matter of law. The Panel concluded that U.S. cotton farmers are insulated from market signals by marketing loan and counter-cyclical payments, but the real facts, as the Panel itself found, are that U.S. production and exports varied in the same manner as other producers

¹³⁷See Part II.B, *supra*.

¹³⁸Panel Report, para. 15.1(a).

such that U.S. shares of world cotton production and exports remained stable over the period of time since the introduction of the 2002 Farm Act. As the Panel also found, Brazil had no convincing explanation for these facts, which demonstrate that U.S. producers have responded to the market just as their foreign counterparts. According to the Panel’s flawed analysis, U.S. cotton producers still depend on marketing loan and counter-cyclical payments to remain economically viable, despite the fact that the evidence showed that producers have other significant sources of income and that the Panel had before it plausible explanations relating to the role of such income it did not examine. The Panel also explicitly declined to consider other factors which greatly influence world upland cotton prices, including the critical role of China in the world’s cotton trade. Ultimately, the Panel found that *any* effects on production caused by the U.S. payments, however *minimal* they could be, would rise to a level that can “significantly” suppress world prices. Such a *per se* rule applicable to widely traded commodities is not found in the SCM Agreement.

131. The Panel’s treatment of U.S. marketing loans and counter-cyclical payments stands in stark contrast to what a proper analysis under Article 6.3(c) of the SCM Agreement should look like. As the United States demonstrates below, the Panel consistently misapplied the law to the facts, made inherently contradictory findings, and failed to make findings where they were required for a proper analysis of significant price suppression. Moreover, the Panel did not undertake an objective assessment of the matter before it as required by DSU Article 11. It failed to provide a reasoned and adequate explanation in the light of plausible alternative explanations, adopted reasoning that was not coherent and internally consistent, and deliberately disregarded or wilfully distorted the meaning of important evidence that the United States placed on the record

in the compliance proceeding. For all of these reasons, the United States respectfully requests the Appellate Body to reverse the Panel’s findings as to significant price suppression and present serious prejudice.

A. The Panel’s Finding that the “Effect” of Certain U.S. Payments is “Significant Price Suppression” Fails as a Matter of Law Because the Panel Erroneously Concluded that U.S. Producers of Upland Cotton are “Insulated” from Market Signals

132. The Panel’s finding that marketing loan and counter-cyclical payments caused present serious prejudice to Brazil by significantly suppressing the world price of upland cotton rested in large part on the Panel’s erroneous conclusion that the U.S. payments “insulated” U.S. producers from market signals to such an extent that the payments had significant effects on planting, production, exports, and ultimately, price. After examining the structure, design, and operation of the payments, the Panel “concur[red] with the view of the original panel that these subsidies protect or ‘insulate’ revenues of US upland cotton producers when prices are low.”¹³⁹ Viewing this finding together with other factors, such as the magnitude of marketing loan and counter-cyclical payments, the Panel noted that “it is reasonable to conclude that without these subsidies, the level of US upland cotton acreage and production would likely be significantly lower.”¹⁴⁰ Moreover, even though the Panel later determined that “the degree of price insulation that the original panel found is now weaker possibly because prices are not as depressed as during the period examined by the original panel,”¹⁴¹ it nevertheless found that the alleged market

¹³⁹Panel Report, para. 10.104; *see also* para. 10.248.

¹⁴⁰Panel Report, para. 10.104. These other factors are addressed in Part IV.B, *infra*.

¹⁴¹Panel Report, para. 10.127; *see also* para. 10.251.

insulation, along with other factors, was responsible for higher levels of U.S. cotton planting and production, and hence lower world market prices for cotton.¹⁴²

133. The Panel’s reliance on a theory of market insulation fails for several reasons. First, the Panel conducted an improper analysis of the extent to which the structure, design, and operation of the marketing loan and counter-cyclical payments allegedly operate to insulate U.S. producers of upland cotton. Second, the Panel ignored several of its own key findings demonstrating the absence of market insulation. In fact, the Panel itself found that U.S. shares of world cotton production and exports had been stable. This suggested to the Panel that U.S. producers had increased production and exports in much the same way as foreign producers. But the Panel failed to examine the “market insulation” hypothesis in light of these key facts, and the resulting conclusion by the Panel fails as a matter of law. Third, the Panel never determined the degree of insulation that was required to lead to significant price suppression, and instead concluded, in essence, that any degree of insulation was sufficient. The United States discusses each of these arguments in turn.

1. The Panel Improperly Analyzed the Structure, Design, and Operation of the Marketing Loan and Counter-Cyclical Payments in Reaching its Conclusion that U.S. Cotton Producers are Insulated from Market Signals

134. The Panel’s conclusion that U.S. producers were insulated from market signals, and that this insulation somehow contributed to significant price suppression even when the insulation was “weak,” fails as a matter of law because the Panel’s analysis did not adequately take into account all factors relevant to producers’ planting decisions. A proper analysis under Articles 5

¹⁴²Panel Report, para. 10.254.

and 6 of the SCM Agreement would have accounted for this information, which demonstrated that marketing loan and counter-cyclical payments did not insulate U.S. upland cotton producers in MY 2006, or in any prior marketing year under consideration. Instead, the Panel chose to rely on findings from the original panel and Appellate Body reports as to the structure, design, and operation of the marketing loan and counter-cyclical payments, and neglected to account for how farmers actually make production decisions.¹⁴³

135. As a threshold matter, the Panel’s excessive reliance on the original findings is misplaced. Although a compliance panel may consider the reasoning of the original panel or Appellate Body to be persuasive, the compliance panel is bound by Article 11 of the DSU to make an “objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability and conformity with the relevant covered agreements.”¹⁴⁴

This rule applies with particular force to a compliance panel examining claims of serious prejudice. By their very nature, serious prejudice claims will depend on the facts available as to a particular period, and a compliance panel will need to assess the facts applicable to that period in a compliance proceeding and will not necessarily be able to rely on the original panel’s finding.¹⁴⁵

136. The facts in the original proceeding and this compliance proceeding vary in fundamental ways which make unsupportable the Panel’s reliance on the original panel and Appellate Body reports on issues related to market insulation. Neither the original panel nor the Appellate Body

¹⁴³See, e.g., Panel Report, paras. 10.64-10.83; 10.100-10.102.

¹⁴⁴See Part IV.D, *infra*, for the separate U.S. claim under Article 11.

¹⁴⁵U.S. Comments on Brazil’s Answers to Panel Questions 1 & 2, para. 7.

addressed the precise serious prejudice claims that Brazil made before the Panel. The findings and recommendations of the original panel and Appellate Body, and the recommendations and rulings of the DSB, related to the package of Step 2, market loss assistance, marketing loan, and counter-cyclical payments made in MY 1999-2002.¹⁴⁶ The compliance proceeding pertained to marketing loan payments and counter-cyclical payments made in MY 2006.¹⁴⁷ Whether these payments insulated U.S. upland cotton producers, and ultimately, whether they caused significant price suppression, was a question of first impression, which involved the consideration of new evidence on market conditions and producers' expectations.

137. The United States demonstrated to the Panel that U.S. upland cotton producers were not insulated from market signals to any significant degree as a result of the marketing loan and counter-cyclical payments. As the United States explained,¹⁴⁸ a cotton farmer makes a single key production decision in each marketing year; that is, the decision to plant, whether cotton, a competing crop, some mix of crops, or nothing at all (for example, to put the farm to conserving uses).¹⁴⁹ At the time a farmer makes that decision (in January-March in the United States), the farmer cannot know what final prices and final costs will be at the time he harvests and markets

¹⁴⁶*Upland Cotton (Panel)*, para. 8.1(g)(i).

¹⁴⁷The United States considered that the "present" marketing year, MY 2006 at the time of the panel proceeding, was the relevant time period to consider whether the present "effect" of any subsidy "is...significant price suppression" within the meaning of Article 6.3(c) of the SCM Agreement. The United States noted that historical data could serve as a proxy for the present marketing year where data from MY 2006 were not available. *See* U.S. Answer to Panel Question 28, para. 12. The Panel largely agreed that MY 2006 data should be examined, but left open the possibility of looking at longer time frames. *See* Panel Report, paras. 10.18-10.19.

¹⁴⁸*See, e.g.*, U.S. First Written Submission, para. 255; U.S. Response to Panel Question 51, paras. 65-68.

¹⁴⁹The farmer may make further production decisions after planting, for example whether or not to harvest the crop. That decision will depend on factors such as whether the marginal cost of bringing the crop to harvest is greater than the price he expects to receive for the harvested crop.

his crop (towards the end of the year in the United States). Any number of factors – for example, future supply, demand, yields, weather, labor and input prices, changes in technology, government support, and marketing efforts – could have an impact on the farmer’s final revenue. The farmer needs to weigh, as best as possible, all of those various factors in making planting decisions. The evidence submitted by the United States showed that in making these planting decisions, U.S. upland cotton farmers responded in ways that were consistent with market forces, even though they were aware that they might receive marketing loan and counter-cyclical payments if actual prices were below trigger prices.

a. *Marketing Loan Payments*

138. The Panel’s conclusion that the structure, design, and operation of marketing loan payments supported a finding of significant price suppression is at odds with the facts. The Panel claimed that the United States made the “same arguments” concerning the structure, design, and operation of marketing loan payments as during the original proceeding.¹⁵⁰ It focused exclusively on the U.S. argument that because the expected price of upland cotton was above the marketing loan rate in MY 2006 and previous marketing years, U.S. producers’ planting decision were not influenced by the possibility of receiving marketing loan payments.¹⁵¹ After reviewing findings from the original proceeding, the Panel summarily dismissed the U.S. argument as one “rejected by the panel and the Appellate Body in the original proceeding.”¹⁵² The Panel concluded:

¹⁵⁰Panel Report, para. 10.74.

¹⁵¹Both the Panel and Brazil also recognized that cotton farmers have price expectations that drive planting decisions. Panel Report, paras. 10.77, n.315, 10.81.

¹⁵²*See, e.g.*, Panel Report, 10.77, 10.80-10.82.

. . . [T]he fact that US cotton producers know that they will receive marketing loan payments whenever the adjusted world price is below the marketing loan rate continues to be an important factor affecting the level of acreage planted to cotton (and thus the level of production), even when, as in MY 2006, the expected market price for upland cotton at the time of planting is higher than the marketing loan rate.¹⁵³

139. The Panel’s analysis and ultimate finding are premised on an erroneous assumption. The United States did not rely, as the Panel claimed, on the “same arguments,” nor could it have – the evidence before the Panel was not identical to that before the original panel, and it pertained to an entirely different time period. For example, in MY 2005, the expected price of upland cotton, as measured by the New York futures price, was lower than the marketing loan rate, but the United States explained that other factors aside from the availability of marketing loan payments, including the prevalence of Asian soybean rust, drove planting decisions that year.¹⁵⁴ None of this evidence was before the original panel, which considered only MY 1999-2002, and the Panel was incorrect as a matter of law to reject the U.S. argument on the grounds that it was the same as that rejected in the original proceeding.

140. By focusing almost exclusively on the U.S. argument as to producers’ price expectations, the Panel also failed to take into account the fact that U.S. producers looked to other factors, aside from the expected price of upland cotton, and responded to them as the market would predict.¹⁵⁵ The United States, for example, explained that in MY 2003-2007, producers’ decisions on planting cotton were consistent with expectations concerning the costs and revenues

¹⁵³Panel Report, para. 10.81.

¹⁵⁴U.S. First Written Submission, para. 234.

¹⁵⁵*See, e.g.*, U.S. First Written Submission, paras. 259-61. These factors also are relevant to whether counter-cyclical payments have insulated U.S. upland cotton producers from market signals.

of competing crops. Compared to the key crops of corn and soybeans, upland cotton was the most attractive option from the standpoint of costs and revenue in at least three of the years under review (MY 2003, MY 2004, and MY 2006). In two of the other three years (MY 2002 and 2007), where cotton was not the most attractive option, upland cotton plantings declined *substantially* consistent with the signals from the market. And in the single year (MY 2005) in which acreage shifts did not line up with the different relative attractiveness of cotton and competing crops, other factors were clearly responsible (most importantly, a shift away from soybean acreage due to concerns about an outbreak of Asian soybean rust at the end of MY 2004).¹⁵⁶ Thus, U.S. upland cotton farmers' planting decisions were entirely consistent with the decisions that they would have made had there been no marketing loan and counter-cyclical payments, and were fully consistent with both market signals and other planting and production considerations.¹⁵⁷

141. The United States also submitted survey evidence of MY 2007 upland cotton planting intentions, showing that U.S. producers intended to pull back on their upland cotton plantings in MY 2007 by approximately 14 percent in response to such factors as the relatively more attractive expected prices for corn and the poor performance of U.S. exports since August 2006

¹⁵⁶U.S. Response to Panel Question 51, para. 71; *see also* U.S. Comments on Brazil's "Oral" Presentation, paras. 70-72.

¹⁵⁷The United States also used a comparison of U.S. planted upland cotton acreage to the ratio of soybean futures prices and cotton futures prices to demonstrate how U.S. producers reacted to price expectations regarding competing crops. The Panel considered that this evidence did not adequately explain producer decisions. Panel Report, para. 10.124. However, as the Panel noted, in MY 2006 – the relevant year for an analysis of "present" price suppression – the relationship of U.S. planted acreage to the soybean and cotton futures ratio did move in the same direction, consistent with market signals. In addition, even the United States explained that the comparison was a "simplified analysis," and that "other crops," and "other extraneous factors" could, and did, influence farmers' decisions. U.S. First Written Submission, paras. 260-61.

(at which time the Step 2 program was eliminated).¹⁵⁸ The Panel examined this survey in connection with its analysis on the absence of a discernible temporal coincidence,¹⁵⁹ but also should have examined it in connection with the structure, design, and operation of the marketing loan payments. This survey evidence is clearly inconsistent with the Panel’s conclusion that U.S. farmers did not respond to market signals and continued to plant upland cotton in situations where they would not do so without subsidies.¹⁶⁰

142. The Panel’s analysis also relied on unsupported findings concerning the impact of the availability of marketing loan payments on the expectations of cotton farmers. It concluded that:

even if expected market prices at the time of planting are higher than the marketing loan rate and producers do not expect to receive marketing payments at that time, the availability of marketing loan payments can be considered to influence planting decisions. While US upland cotton producers may be uncertain at the time of planting as to whether actual harvest prices will be below the marketing loan rate, there is no uncertainty as to the fact that, if actual harvest prices are below the marketing loan rate, they will receive marketing loan payments.¹⁶¹

The Panel also found that since farmers know that they have access to marketing loan payments, “the marketing loan rate continues to be an important factor affecting the level of acreage planted

¹⁵⁸U.S. Answer to Second Set of Panel Questions, para. 1; U.S. Opening Statement, para. 12.

¹⁵⁹Panel Report, para. 10.230.

¹⁶⁰The United States also produced other evidence as to the absence of market insulation – U.S. shares of world production and exports were stable over MY 2002-05, and U.S. producers were able to cover their costs of production from revenues generated from the sale of cotton, and were not dependent upon support payments to do so. This information, which was considered by the Panel outside of the context of the structure, design, and operation of marketing loan and counter-cyclical payments, is discussed more fully below. *See* Part IV.A.2 & IV.B.2.

¹⁶¹Panel Report, para. 10.77.

to cotton,” even when the expected price is above the marketing loan rate.¹⁶² These findings were used to support the Panel’s conclusion that U.S. cotton farmers were insulated from market signals due to marketing loan payments. The Panel, however, made no evaluation of producers’ expectations that “actual harvest prices [would be] below the marketing loan rate” in MY 2006 or any other year examined. That is, if producers had not expected actual harvest prices to fall below the loan rate, then despite that “there is no uncertainty as to the fact that, if actual harvest prices are below the marketing loan rate, they will receive marketing loan payments,” the influence of the availability of marketing loan payments on producers *in that year* would have been non-existent or negligible. The Panel simply failed to examine this crucial question and that omission vitiates its conclusion.

143. If producers value the income guarantee provided by the availability of marketing loan payments in the face of uncertainty about future prices, to conclude that the availability of such payments influences production decisions, the Panel would have had to analyze whether removing that support influenced planting decisions in the year examined. The Panel did not undertake this analysis or any other analysis, whether qualitative or quantitative, as to effects on production due to the availability of marketing loan payments, and its conclusion therefore fails a matter of law.

b. Counter-Cyclical Payments

144. The Panel’s conclusion with respect to the market-insulating effect of counter-cyclical payments is also deficient as a matter of law. As the United States pointed out, useful economic

¹⁶²Panel Report, para. 10.81.

research about counter-cyclical payments has been conducted since the time of the original proceeding.¹⁶³ The United States submitted numerous studies demonstrating the minimal impact that counter-cyclical payments have on production.¹⁶⁴ The Panel first downplayed the studies' relevance,¹⁶⁵ and then improperly relied on them to support its flawed conclusion that the structure, design, and operation of U.S. counter-cyclical payments had a revenue-insulating effect on U.S. upland cotton producers, that they led to increased acreage and production, and that the "effect" of the payments was significant price suppression.¹⁶⁶

145. The Panel considered it important that all of the academic research, including studies submitted by Brazil that were discredited by the United States, showed that "counter-cyclical

¹⁶³U.S. First Written Submission, para. 205. The Panel recognized this fact when noting the relevance of the new research. Panel Report, para. 10.90.

¹⁶⁴U.S. First Written Submission, paras. 204-19; U.S. Rebuttal Submission, paras. 224-40, 253-62.

¹⁶⁵The United States explained that even though the studies it submitted did not pertain directly to counter-cyclical payments paid to producers of upland cotton – as the Panel itself noted – they were still *highly relevant* to the Panel's analysis of the structure, design, and operation of counter-cyclical payments. U.S. Response to Panel Question 56. There is no reason to believe that the payments under the counter-cyclical program in respect of upland cotton base acres would affect planting incentives in any materially different way than would counter-cyclical payments in respect of other base acres. To the contrary, the 2005 Westcott study explained that "cross-commodity effect[s] suggest[] that CCPs may provide a general reduction in revenue risks rather than a crop-specific effect." Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 204 (Exhibit US-35). This indicates that counter-cyclical payments may have general revenue risk effects regardless of the base acres in respect of which the payments are made and regardless of the crop that is ultimately selected for planting.

The Panel also seemed to downplay the studies because they were not "empirical studies of the effects of counter-cyclical payments," but rather "a survey of other studies," "a simulation of the effects of these payments," and "a conceptual analysis of the effects of counter-cyclical payments." Panel Report, para. 10.91. Regardless of how they are characterized, these studies were conducted by professionals, using widely-accepted research methodologies, and cannot be discounted merely because they are not what the Panel called "empirical studies."

In any event, the United States submitted this new research to provide a more robust basis – deriving from tested and reviewed economic methods – for understanding the operation of the counter-cyclical payment program and what the economic effects on planting/production might be as a result of payments thereunder. Especially in the absence of any specific analysis on counter-cyclical payments made with respect to upland cotton base acres and upland cotton production, this research was important in providing context and guidance for assessing the effects of counter-cyclical payments.

¹⁶⁶Panel Report, paras. 10.95, 10.104.

payments can increase production and these production effects occur because increased wealth reduces risk aversion, the availability of the payments relieves credit constraints and provides some insurance from fluctuations in revenues and the payments allow farmers to cover fixed costs of production.”¹⁶⁷ The Panel relied on this conclusion in support of its finding that counter-cyclical payments had market-insulating and production effects with respect to U.S. upland cotton producers and that they therefore had the “effect” of significantly suppressing cotton prices.¹⁶⁸ However, all the research submitted by the United States indicated *minimal* effects of counter-cyclical payments on plantings and production by U.S. producers, and could not reasonably lead to such findings by the Panel.

146. The 2005 study by Lin and Dismukes, which was noted by the Panel, examined possible production impacts of counter-cyclical payments, specifically through an analysis of risk and wealth effects, and found only minimal effects.¹⁶⁹ The study investigated the role of risk in farmers’ acreage decisions for major field crops in the North Central region by revisiting an earlier study and testing the effects of wealth and revenue risk on supply response. The study found limited effects on supply response. While an increase in initial wealth would lead to greater crop acreage, consistent with decreasing absolute risk aversion, the resulting increase in the acreage of the crops was estimated at less than 1 percent.

¹⁶⁷Panel Report, para. 10.95.

¹⁶⁸Panel Report, paras. 10.104, 10.248, 10.254.

¹⁶⁹Lin, William and Robert Dismukes, “Supply Response Under Risk: Implications for Counter-Cyclical Payments’ Production Impact,” *Review of Agricultural Economics*, forthcoming. An earlier version of the paper can be found at “Risk Considerations in Supply Response: Implications for Counter-Cyclical Payments’ Production Impact,” Selected Paper, American Agricultural Economics Association (July 2005) (Exhibit US-34).

147. The United States submitted a follow-up 2007 study by Lin and Dismukes looking at the same crops in the North Central region. The Panel did not specifically mention this study as part of its substantive analysis. The 2007 Lin and Dismukes study found that “[t]he effect of CCPs on producers’ planting decisions . . . appears to be *very negligible* – an increase in the acreage of major field crops of less than 1%”¹⁷⁰ The study found acreage effects with respect to corn and wheat that are not statistically significant. In the case of soybeans, in the 2005 version of the study, the authors found a 2.94 percent increase in soybean acreage where counter-cyclical payments were introduced.¹⁷¹ In the 2007 study, the authors updated their analysis to include both yield and price variability in the acreage response model. The updated results for soybeans shows no effect on soybean acreage from the introduction of counter-cyclical payments. The Lin and Dismukes studies from both 2005 and 2007 simply cannot support the Panel’s finding that counter-cyclical payments insulated U.S. upland cotton producers from market signals when making planting decisions.

148. The Panel also took note of a 2005 study by Paul Westcott that was submitted by the United States. That study, like others, concluded that the effects of counter-cyclical payments on production are likely limited. Westcott noted that in the case where the expected season average price is below loan rates (i.e., the counter-cyclical payment is expected to be at the maximum), counter-cyclical payments operate no differently than fixed payments (like direct payments):

¹⁷⁰Lin, William and Dismukes, Robert. “Supply Response Under Risk: Implications for Counter- cyclical Payments’ Production Impacts,” *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 83 (Exhibit US-85) (emphasis added).

¹⁷¹Lin, William and Dismukes, Robert. “Supply Response Under Risk: Implications for Counter-Cyclical Payments’ Production Impact,” Selected Paper, American Agricultural Economics Association, July 2005, p. 23.

If farmers expect prices to be below loan rates (as occurred for rice and cotton in 2002/03), the CCP's are at their maximum levels and become more like "fixed" payments. Research has shown that fixed payments act like general income transfers to farm household and have only small effects on output.¹⁷²

At the time of planting from 2002 to 2008, the Food and Agricultural Policy Research Institute ("FAPRI") was projecting in every year except 2004 that the expected counter-cyclical payment rate for upland cotton would be at the maximum level. Moreover, the expected value for counter-cyclical payments was at the maximum payment rate for most of the out years (i.e., future marketing years) as well. Thus, the payments effectively operated much like fixed direct payments over this period, and had minimal effects on output.¹⁷³ The Panel nevertheless found that U.S. counter-cyclical payments insulated U.S. upland cotton producers and led to increased acreage and production.

149. The United States further explained that much of the increase in wealth from farm payments accrues to non-operator landlords and can have no effect on production.¹⁷⁴ Where land is rented, some amount of the value of decoupled payments is transferred from operators to the owners of base acres in the form of higher rents and sales values. The panel in the original proceeding specifically agreed that the benefits of some of the payments – specifically, the decoupled production flexibility contract, direct, market loss assistance and counter-cyclical payments – had been "captured" by land-owners and, thus, not "passed-through," to producers.¹⁷⁵

¹⁷²Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" (3rd Quarter 2005) (Exhibit US-35).

¹⁷³U.S. First Written Submission, para. 211.

¹⁷⁴U.S. First Written Submission, paras. 215-19.

¹⁷⁵*Upland Cotton (Panel)*, para. 7.1226.

150. This fact was confirmed in a 2005 review of the effects of decoupled payments on land values by Abler and Blandford (“OECD study”):

Empirical work suggests that PFC and MLA payments had a significant effect on land values and rental rates. Given the importance of the rental market for land in the United States, it appears that there was a relatively high “pass-through” of the additional income generated by the payments to landowners, many of whom are not the actual operators of the land. It appears that the payments primarily had the effect of increasing the value of the principal fixed asset in agriculture—land.¹⁷⁶

151. What this passage indicates, in other words, is that a substantial portion of decoupled payments are being disposed of in a way that cannot have any effect on production. Thus, to the extent that counter-cyclical payments could in theory have any effects on production during the present – and the recent empirical evidence indicates that they do not – these effects were minimized by the fact that a large part of the payments is not going to producers, but rather to non-operator landlords.

152. The Panel considered the OECD study and acknowledged implicitly that counter-cyclical payments could be capitalized into land values.¹⁷⁷ It then speculated that “enough seems to have been left in the hands of farm operators to create a modest production effect,” and stated, without providing any citation to economic literature, that “there is a presumption that the output effect of counter-cyclical payments will be higher than that of the production flexibility payments.”¹⁷⁸ The Panel thus construed the OECD study in such a way so as to support its conclusion that counter-

¹⁷⁶Abler, David, and David Blandford. A Review Of Empirical Studies Of The Acreage And Production Response To US Production Flexibility Contract Payments Under The Fair Act And Related Payments Under Supplementary Legislation, Directorate For Food, Agriculture And Fisheries Committee For Agriculture, OECD, Paris, AGR/CA/APM(2004)21/FINAL (March 25, 2005) (Exhibit US-32).

¹⁷⁷Panel Report, para. 10.94.

¹⁷⁸Panel Report, para. 10.94.

cyclical payments insulated U.S. producers and thereby had important production effects. That study, however, could not, on its face, contribute to a finding that counter-cyclical payments were having a significant enough of an effect on production to influence prices to any significant degree.

153. The United States also demonstrated before the Panel that the studies provided by Brazil did not show any significant effects of counter-cyclical payments on production. These studies were inapposite, or were marked by numerous analytical deficiencies.¹⁷⁹ Yet the Panel did not even address the shortcomings of the research submitted by Brazil, and merely grouped Brazil's studies together with those of the United States to find that counter-cyclical payments insulated U.S. producers and caused production effects leading to significant price suppression within the meaning of Articles 5(c) and 6.3(c) of the SCM Agreement. The Panel's legal finding was based on a flawed conclusion as to the effects of counter-cyclical payments on production, which was at most minimal.

154. The Panel's analysis as to the effects of counter-cyclical payments also rested on its finding that the "relationship between upland cotton base acre holders and upland cotton production is significant in that it suggests that cotton counter-cyclical payments play a role in maintaining the level of acreage and production at a higher level than would otherwise be the case."¹⁸⁰ The Panel concluded that "a strongly positive relationship exists between recipients of upland cotton counter-cyclical payments who hold upland cotton base acres and those who

¹⁷⁹U.S. Rebuttal Submission, paras. 242-62.

¹⁸⁰Panel Report, para. 10.102.

continue to plant upland cotton and that this factor is an element that provides support for a finding that the counter-cyclical payments, because of their structure, design and operation, have price-suppressing effects.”¹⁸¹ In making this finding, however, the Panel did not analyze the degree to which counter-cyclical payments received by holders of upland cotton base acres allegedly influenced the level of cotton planted by those holders. In other words, the Panel never actually tested the strength of the alleged relationship between payments and plantings in order to conclude that the former was driving the latter. In fact, the mere fact that 95 percent of U.S. upland cotton acreage was on farms that held upland cotton base acreage tells nothing about the planting/production effects due to counter-cyclical payments, and whether they were significant.¹⁸²

155. As the United States explained, it is not remarkable that some producers who farmed cotton in the past, at the time base acres were fixed, continue to farm cotton today, especially in the United States, where certain parts of the country – many southern States, for example – have a strong tradition of growing cotton due to such factors as favorable weather and natural endowments. There is nothing surprising, therefore, about the existence of some overlap between current and historic upland cotton production.¹⁸³ What is remarkable, however, is that the data¹⁸⁴ showed that a significant portion of U.S. upland cotton planted acreage (over MY 2002-2005, average of about 17 percent) was on farms with cotton planted acreage that exceeded

¹⁸¹Panel Report, para. 10.103.

¹⁸²U.S. Rebuttal Submission, para. 266.

¹⁸³U.S. First Written Submission, para. 221.

¹⁸⁴From individual farms reporting acreage to the Farm Service Agency.

cotton base acres, or, indeed, on farms with no cotton base acres at all – undermining the idea that counter-cyclical payments were significantly influencing planting decisions. Moreover, traditional U.S. cotton farms receiving cotton counter-cyclical payments planted approximately 40 percent fewer cotton acres over MY 2002-2005 than they had in the period used to calculate cotton base acres. This decline in cotton planted acres on traditional U.S. cotton farms reflects the fact that other factors, such as weather and competing crops, drive planting. It is also significant that the holders of base acres do not even have to plant cotton to receive those payments,¹⁸⁵ so production effects cannot merely be assumed because a farmer holds upland cotton base acres.

156. The Panel’s finding as to the relationship between recipients of counter-cyclical payments who hold base acres and those who continue to plant cotton did not test the strength of that relationship and analyze the degree to which the receipt of those payments was actually inducing planting and production.¹⁸⁶ It assumed that which Brazil had to demonstrate as to the actual effects of counter-cyclical payments. And, the facts showed that the relationship between counter-cyclical payments and planting was weak – upland cotton farmers who also held cotton base acres were planting 40 percent less upland cotton than they had in the period when their collective base acres were established, and 17 percent of plantings was on farms with no base acres or on farms planting more than their base acres. The Panel therefore had no basis to conclude that counter-cyclical payments were “maintaining” the level of production and leading

¹⁸⁵U.S. Rebuttal Submission, para. 264.

¹⁸⁶That same relationship exists between upland cotton production and recipients of direct payments, yet this did not support a finding in the original proceeding that direct payments had any significant production effects. U.S. Rebuttal Submission, para. 266.

to “price-suppressing” effects, and its findings cannot stand.

2. The Panel Overlooked its own Findings as to Market Insulation

157. The Panel made several findings that contradict its ultimate conclusion that marketing loan and counter-cyclical payments insulated U.S. producers of upland cotton from market prices. These inconsistencies demonstrate the flawed nature of the Panel’s analysis. Had the Panel followed the logic of its own findings, it would have concluded that U.S. upland cotton producers responded to the market similarly as other producers, and that they were not insulated to any significant degree by marketing loan and counter-cyclical payments. Because it overlooked the import of its own findings, the Panel’s conclusion as to market insulation fails as a matter of law.

a. Stable U.S. Shares of World Production and Exports

158. As the United States argued before the Panel, the fact that U.S. upland cotton production during the existence of the FSRI Act was both economically rational and consistent with market and planting/production considerations was confirmed by the fact, as found by the Panel,¹⁸⁷ that U.S. production was generally stable as a percentage of world production and exports throughout the entire period that U.S. marketing loan and counter-cyclical payments were made.¹⁸⁸ The chart below illustrates this trend:

U.S. SHARE OF WORLD EXPORTS AND PRODUCTION

MY	Exports	Production
2002	39.2%	19.5%

¹⁸⁷Panel Report, para. 10.127.

¹⁸⁸U.S. First Written Submission, paras. 243-52; U.S. Rebuttal Submission, paras. 282-86.

2003	41.4%	19.2%
2004	41.2%	19.3%
2005	40.1%	20.9%
Average	40.5%	19.7%

Source: Panel Report, Table 3; Exhibit US-27.

159. The stable U.S. shares of production and exports show that – contrary to Brazil’s assertions – marketing loan and counter-cyclical payments were not inducing U.S. farmers to plant, produce, and export where market signals would have caused their foreign counterparts to pull back. This evidence indicates that whatever signal the “world market” was sending, U.S. producers were receiving it clearly and responding to it in much the same way as their foreign counterparts. Indeed, if U.S. producers *were* cut off from market signals, one would expect that in times of anticipated low prices, foreign production would fall off but U.S. producers – allegedly expecting large U.S. government payments under the marketing loan and counter-cyclical payments programs – would continue to plant, produce, and export at artificially high levels.

160. The Panel appeared to comprehend the significance of the U.S. evidence when it concluded that “[t]he fact that the US share of world cotton production and exports has remained relatively constant in MY 2002-2005 suggests to us that US producers have increased production and exports in proportionately the same way as foreign cotton producers.”¹⁸⁹ The Panel, however, disregarded this finding, and concluded, in support of its finding of significant price suppression, that U.S. marketing loan and counter-cyclical payments insulated U.S. producers

¹⁸⁹Panel Report, para. 10.127.

from price signals.¹⁹⁰ This finding on market insulation is contradictory, and cannot stand as a matter of law. If the U.S. share of world production and exports was stable, and if U.S. producers acted in much the same way as those in other countries, then the Panel could not rationally have found that U.S. payments insulated U.S. producers to any meaningful degree.

b. Expected Prices

161. The Panel also determined that “Brazil's claim of insulation of US producers from market price signals applies in particular when expected prices are below their intervention levels. . . . However, *the degree of insulation is less when expected cotton prices are above their intervention levels. In such a situation, US cotton producers should respond to higher expected cotton prices much in the same way as foreign cotton producers.*”¹⁹¹ The United States demonstrated that in MY 2006, the year relevant to the analysis of “present” significant price suppression, the expected market price of upland cotton was above the marketing loan rate.¹⁹² According to the Panel’s own logic, U.S. producers should have responded just as foreign producers did, a fact proven by the existence of stable U.S. shares of world upland cotton production and exports. U.S. farmers therefore were not insulated from market prices to any meaningful degree because of marketing loan and counter-cyclical payments; rather, they made economically rational decisions based on market considerations as did producers elsewhere. The Panel, however, reached the opposite, and unsupported, conclusion, and never explained how

¹⁹⁰Panel Report, paras. 10.127, 10.248, 10.251, 10.254.

¹⁹¹Panel Report, para. 10.127 (emphasis added).

¹⁹²U.S. First Written Submission, paras. 229-31. The United States also showed a similar pattern in MY 2003 and MY 2004. In MY 2005, where expected prices were below the marketing loan rate, the United States explained that other factors drove planting decisions. U.S. First Written Submission, paras. 232-35.

U.S. producers could be acting inconsistently with market signals to a significant extent if they were acting like producers in other countries.

c. “Discernible Temporal Coincidence.”

162. The original panel found a “discernible temporal coincidence” of suppressed world market prices for upland cotton and price-contingent U.S. subsidies.¹⁹³ In support of its claim of present significant price suppression, Brazil argued before the Panel that there remained a discernible temporal coincidence.¹⁹⁴ The Panel, however, concluded that “the data. . . indicates that with respect to several key factors relied upon by the original panel in finding ‘a discernible temporal coincidence’ of suppressed world market prices and the price-contingent US subsidies, the current situation is *significantly* different from the situation considered by the original panel.”¹⁹⁵ It determined that “two factors - first, that other major cotton producers were increasing their production and exports at the same time as US producers and second, that prices received by US cotton producers were not declining dramatically during this period - make it more difficult to discern a pronounced temporal coincidence between the US subsidies, the increase in US cotton exports and the drop in world market prices.”¹⁹⁶ Moreover, the Panel did not find a “similar broad decline” in the world price for upland cotton from MY 2002-05.¹⁹⁷

163. The absence of a discernible temporal coincidence reinforces what the United States has

¹⁹³*Upland Cotton (Panel)*, paras. 7.1351-7.1352.

¹⁹⁴First Written Submission of Brazil, paras. 151-55.

¹⁹⁵Panel Report, para. 10.133 (emphasis added).

¹⁹⁶Panel Report, para. 10.139. The Panel noted that the U.S. share of world exports and world production stayed at about 40 percent and 20 percent, respectively, during the period analyzed. Panel Report, para. 10.137.

¹⁹⁷Panel Report, para. 10.141.

demonstrated all along when responding to Brazil’s allegations – marketing loan and counter-cyclical payments did not insulate U.S. producers from market signals; did not lead to significantly higher U.S. plantings, production, and exports than would have been the case without such payments; and did not therefore cause significant price suppression. The Panel itself implicitly recognized that U.S. farmers could not have been insulated when it found that U.S. and foreign producers were increasing production and exports at the same time, and that this fact made it difficult to discern a pronounced temporal coincidence. The Panel nevertheless contradicted its own findings regarding the lack of a discernible temporal coincidence, and concluded that U.S. marketing loan and counter-cyclical payments insulated U.S. producers and ultimately caused significant present price suppression.

3. The Panel Failed to Determine the Degree of the Alleged Insulation from Market Signals

164. The United States noted throughout the compliance panel proceeding that marketing loan and counter-cyclical payments could have an effect on the production of upland cotton.¹⁹⁸ In fact, it is hardly remarkable that payments of any kind to a producer could have such effects. As the United States explained, the key legal question is whether the risk, wealth, and planting/production effects of the marketing loan and counter-cyclical payments rise to the level that they cause *significant* price suppression. In other words, the *degree* of the effect matters. Thus, the Panel, in reaching a finding of significant price suppression, was required to determine the *degree* of the effects, including the *degree* of alleged market insulation. The Panel, however, failed to make any findings as to the degree of market insulation, or the degree of the effects

¹⁹⁸U.S. Rebuttal Submission, paras. 222, 289-90; U.S. Answer to Panel Question 53, paras. 87-90.

related to that insulation:

- After examining the structure, design, and operation of marketing loan and counter-cyclical payments, the Panel determined that “these subsidies affect the level of US upland cotton acreage and production as a result of their mandatory and price-contingent nature and their revenue-stabilizing effect.”¹⁹⁹ The Panel also found that in conjunction with other evidence on the record, “it is reasonable to conclude that without these subsidies the level of US upland cotton acreage and production would likely be significantly lower.”²⁰⁰ Missing from the Panel’s findings was any mention of just *how much lower* was “significantly lower.” The generalized reference to “significantly” is insufficient for explaining the *degree* of production effects that could be considered as contributing to significant price suppression.
- The Panel reviewed the various studies submitted by the United States and Brazil concerning the structure, design, and operation of counter-cyclical payments and found that “in our assessment, the current state of this academic and policy research is such that even though the experts disagree among themselves about the exact magnitude of the production effects of counter-cyclical payments, there is no disagreement about the direction of those effects nor on the mechanisms by which the production effects are transmitted. Thus, counter-cyclical payments can increase production and these production effects occur because increased wealth reduces risk aversion, the availability of the payments relieves credit constraints and provides some insurance from fluctuations in revenues and the payments allow farmers to cover fixed costs of production.”²⁰¹ The Panel was required, however, to determine the *degree* of the production effects, and could not rely on its generalized conclusion about the direction of such effects to support its finding that counter-cyclical payments insulated U.S. producers to any significant extent when making planting decisions.
- After examining an OECD study submitted by the United States, the Panel found that “[w]hile the [study] concluded that most of the impact of production flexibility contract and market loss assistance payments pass-through to higher land values, enough seems to have been left in the hands of farm operators to create a modest production effect. Given that counter-cyclical payments, in contrast to production flexibility contract payments, are price-contingent, there is a presumption that the output effect of counter-cyclical payments will be higher than that of the production flexibility payments.”²⁰² Once again,

¹⁹⁹Panel Report, para. 10.104.

²⁰⁰Panel Report, para. 10.104.

²⁰¹Panel Report, para. 10.95.

²⁰²Panel Report, para. 10.94.

the Panel did not fulfil its responsibility. It was required to explain just *how modest* the production/output effects were, and *how much higher* the output effect of counter-cyclical payments was, before it could rely on the OECD study to support its apparent conclusion that despite any capitalization of counter-cyclical payments into land values, those payments still insulated U.S. producers of upland cotton from market signals.

- The Panel found that “that the stable US share of world production and exports does not mean an absence of insulation of US producers from market price signals. What it means is that the degree of price insulation that the original panel found is now weaker possibly because prices are not as depressed as during the period examined by the original panel.”²⁰³ The Panel, however, never determined *how much weaker* the insulation was. Nor did it conclude *how weak a degree of insulation* could support a finding of the supposed price-insulating effect of U.S. marketing loan and counter-cyclical payments. In fact, stable U.S. shares of world production and exports of upland cotton demonstrated that the U.S. payments did not insulate U.S. cotton farmers from market signals to any significant degree.

165. The Panel’s findings as to market insulation fail as a matter of law. The Panel did not reach any conclusions as to the *degree* of the market insulation, and the *degree* of the production effects related to that insulation. Rather, it erroneously assumed that the existence of *any* market-insulating effect, and *any* related production effect, due to U.S. marketing loan and counter-cyclical payments was sufficient to support a finding of significant price suppression.

166. The Panel’s conclusion on market insulation should be reversed. It is inconsistent with the requirement that the degree of effects attributable to support payments be determined before there can be a finding on significant price suppression. Moreover, if left to stand, the finding would leave little guidance to Members on how they should structure agricultural support payments so as to avoid liability for serious prejudice in the future.

B. The Other Grounds Identified by the Panel in Support of its Finding of Present Serious Prejudice Do not Withstand Scrutiny

²⁰³Panel Report, para. 10.127.

167. The Panel examined several other factors as part of its analysis of whether U.S. marketing loan and counter-cyclical payments caused significant price suppression on the world market for upland cotton, and relied on them in support of its ultimate finding of significant price suppression. The Panel’s findings as to each of these factors is deficient, and should be reversed as a matter of law.

1. Divergence Between U.S. Total Costs and Market Revenue

168. The Panel found “a significant gap between the total costs of production of US upland cotton producers and their market revenue” and considered that “this gap between costs and revenue, when analyzed in conjunction with the magnitude of the marketing loan and counter-cyclical subsidies and their importance as a share of the revenue of US cotton producers, supports the proposition that the marketing loan and counter-cyclical payments are an important factor affecting the economic viability of US upland cotton farming.”²⁰⁴ This reasoning led the Panel to conclude that “without these subsidies the level of US upland cotton acreage and production would be considerably lower.”²⁰⁵

169. As set out below, the United States does not believe the Panel’s decision to compare total costs and market returns was valid for purposes of determining whether U.S. farmers produced more cotton than they would have but for the U.S. subsidies. However, even if the total costs approach were somehow appropriate, the Panel adopted a distorted view of U.S. cotton farmers’ financial viability, and failed to establish that the “effect” of subsidies was to stimulate

²⁰⁴Panel Report, para. 10.196.

²⁰⁵Panel Report, para. 10.196.

production of upland cotton when it otherwise would not have occurred.

a. Total v. Variable Costs of Production

170. The United States demonstrated that producers make year-to-year planting decisions with reference primarily to *variable* costs of production (among other factors), while *total* costs (among other factors) are relevant with respect to longer-term decisions, such as whether to exit the cotton sector.²⁰⁶ The Appellate Body in the original proceeding expressly recognized that:

We agree with the general proposition of the United States that *variable costs may play a role in farmers' decision-making as to whether to plant upland cotton or some alternative crop, and how much of each crop to plant. From a short-term perspective, variable costs may be particularly important.*²⁰⁷

Thus, U.S. farmers consider variable costs a determinative factor when deciding whether to plant cotton, or some other crop like soybeans or corn, in a given year. The Panel, however, disregarded the U.S. argument, which was grounded in widely-accepted economic principles, and concluded that “a comparison of market returns with total costs, rather than only with variable costs, is the appropriate benchmark for assessing the effects of the subsidies.”²⁰⁸

171. As the United States demonstrated, it is well-accepted in agricultural economics that *variable* costs are the relevant consideration in year-to-year planting decisions. The United States noted that it had discussed the extensive literature concerning this issue in its submissions

²⁰⁶U.S. First Written Submission, paras. 293-99; U.S. Rebuttal Submission, paras. 322-23. Brazil, as the Panel noted, appeared to agree that short-term variable costs play a role in a producer's decision of whether to plant cotton or some other crop. Panel Report, para. 10.172. Brazil, however, ignored available economic evidence and argued that long-term total costs were most relevant.

²⁰⁷US – Upland Cotton (AB), para. 453.

²⁰⁸Panel Report, para. 10.176,

to the panel in the original proceeding.²⁰⁹ To supplement that discussion, the United States submitted two other studies in the compliance proceeding that confirmed that variable costs are the appropriate consideration in assessing year-to-year planting decisions.²¹⁰ Moreover, the United States explained to the Panel that there is *no economic model* of which the United States is aware that uses total costs in its supply response equations (that is, to examine the planting decision). Indeed, the Food and Agricultural Policy Research Institute (“FAPRI”) uses variable costs in its modeling framework.²¹¹

172. The United States articulated in its written submissions the key role that variable costs play in a producer’s planting decisions.²¹² A farmer might decide in January of a particular year whether to plant all soybeans, some soybeans and some cotton, all cotton, or to allow the land to sit idle. This farmer will consider, *inter alia*, the expected price of cotton at harvest, the expected price of soybeans at harvest, as well as the anticipated costs of growing each crop. In so doing, the farmer does not need to consider fixed asset and overhead costs. The farmer has already incurred those costs and they exist regardless; fixed costs will not differ based on whether the farmer plants soybeans, cotton, a mix, or nothing. Rather, the farmer will consider projected net revenues taking into account costs for such items as seed, fertilizer, chemicals, and other

²⁰⁹See e.g., U.S. Further Rebuttal Submission in the Original Proceeding, paras. 117-122 (18 November 2003).

²¹⁰See Cecil Davison and Brad Crowder, “Northeast Soybean Acreage Response Using Expected Net Returns” *Northeastern Journal of Agriculture and Resource Economics*, April 1991, pp. 33-41 (Exhibit US-137) and Duncan M. Chembezi and Abner W. Womack, “Regional Acreage Response for U.S. Corn and Wheat: The Effects of Government Programs,” *Southern Journal of Agricultural Economics*, July 1992, pp. 187-198 (Exhibit US-138).

²¹¹U.S. Comments on Brazil’s “Oral” Statement, para. 64.

²¹²U.S. Comments on Brazil’s “Oral” Presentation, para. 62; U.S. First Written Submission, para. 294.

expenses that are directly related to planting, harvesting, and marketing each crop. The economically rational decision for him will be to plant the crop, or mix of crops, that *both* covers his variable costs *and* maximizes his net revenue. In other words, the farmer will choose the option that gives him the largest margin above variable costs. This will not only allow him to cover his variable expenses, but will also give him the most revenue to pay down total costs.

173. The United States submitted evidence on the impact of variable costs and expected revenue on planting decisions.²¹³ Its analysis showed that for the entire period MY 2002-2007, U.S. farmers expected to meet or exceed their variable costs of planting cotton, corn, or soybeans. It was therefore rational to plant something, rather than leaving the fields sit idle. U.S. producers chose to plant more cotton where returns were most attractive from the standpoint of costs and revenue in MY 2003, 2004, and 2006. Where cotton was not the most attractive crop from the standpoint of variable costs and revenue, farmers reduced cotton plantings in favor of the more profitable crop (MY 2002, 2007) or chose cotton, the second most attractive crop after soybeans, due to concerns over soybean rust infestation (MY 2005).

174. The United States also demonstrated the complete absurdity of the total costs approach as advocated by Brazil.²¹⁴ In its “oral” presentation to the Panel, Brazil submitted charts comparing total costs of producing cotton, corn, and soybeans to total gross revenue earned in respect of the crop.²¹⁵ Brazil claimed that this proved the “economically irrational business of growing cotton

²¹³U.S. Response to Brazil’s “Oral” Presentation, paras. 66-72.

²¹⁴U.S. Answer to Panel Question 53(c), paras. 96-99.

²¹⁵Brazil Oral Statement, para. 57 and paras. 57-91.

in the United States without marketing loan and CCP subsidies.”²¹⁶ What the United States explained to the Panel, however, was the unreasonableness of Brazil’s analysis.

175. According to a total cost approach, U.S. farmers would have lost money *across the board* producing *any* of these crops (or would have expected to do so) in any of the years examined. In fact, if one were to apply such flawed reasoning more broadly, one would obtain similar results for virtually *all* major field crops in the United States. Thus, for example, according to the total costs theory, producers of every single major field crop except for soybeans would have lost money in MY 2005 and, even for soybeans, U.S. farmers would have eked out no more than \$1/acre.

**Total Gross Value of Production/Acre v. Total Costs/Acre
for Major Field Crops (MY 2005)**

	Cotton (USD)	Corn (USD)	Wheat (USD)	Rice (USD)	Sorghum (USD)	Barley (USD)	Oats (USD)	Sugarbeet (USD)	Peanut (USD)	Soybean (USD)
Total gross value of production	483	285	121	469	118	148	142	880	564	265
Total Costs	544	402	203	703	282	255	154	965	665	264
Total Value - Total Costs	-87	-117	-82	-235	-164	-107	-25	-85	-101	1

Source: U.S. Answer to Panel Question 53

176. In other words, the Panel adopted a total costs approach which leads to the unbelievable conclusion that *none* of the 434 million acres of cropland in the United States should have been planted to any major field crop in MY 2005. Under the total costs approach, no upland cotton, corn, wheat, rice, sorghum, barley, oats, sugarbeet, or peanuts should have been grown. And any evidence that they were in fact grown must be accepted as evidence of the production effects of

²¹⁶Brazil Oral Statement, para. 57 and paras. 57-91.

the marketing loan and counter-cyclical payments.²¹⁷

177. The unreasonableness of these results confirms that total costs is a fundamentally erroneous approach to assessing the planting decisions of U.S. farmers. Rather, as the United States argued before the Panel, any proper assessment of the “economic rationality” of upland cotton farming must look to, *inter alia*, the variable costs of production.

178. In short, the Panel failed to comprehend that variable costs should be used to properly assess the yearly planting/production effects, if any, attributable to marketing loan and counter-cyclical payments. Instead, it substituted findings from the original proceeding for its own analysis, and concluded that long-term total costs were more appropriate for measuring the effect of the U.S. support payments.²¹⁸ In doing so, the Panel misapplied economic theory and perpetuated the fallacy of using average total costs of production as the relevant measure farmers use when making production (that is, planting) decisions.

179. A proper analysis focused on variable costs disproves the Panel’s finding that *but for* marketing loan and counter-cyclical payments, U.S. cotton producers would have planted less. The United States showed that U.S. cotton farmers covered their variable costs in the period MY 2002-2005, as well as in almost all years, most if not all of their total costs.²¹⁹ The Panel even recognized this fact.²²⁰ Far from “skirt[ing] around the main issue,”²²¹ this information

²¹⁷Notably, almost no payments were made in respect of wheat or soybeans in MY 2005.

²¹⁸Panel Report, paras. 10.173-10.175.

²¹⁹U.S. First Written Submission, paras. 300-02.

²²⁰Panel Report, para. 10.193.

²²¹Panel Report, para. 10.195.

demonstrates the absence of a so-called “gap” between costs and revenues that marketing loan and counter-cyclical payments would have bridged. In other words, those payments did not somehow induce U.S. farmers to plant more cotton than they otherwise would have.

b. *The Alleged Gap Between Total Costs and Revenues*

180. The Panel also took an approach to total costs that was completely at odds with the economic realities faced by U.S. cotton growers. In doing so, the Panel determined that there was a “gap” between total costs and revenues, and found that the marketing loan and counter-cyclical payments filled this alleged gap, making upland cotton farming economically viable and leading to higher levels of cotton acreage and production than would otherwise have been the case.²²² The Panel’s analysis attributed effects to marketing loan and counter-cyclical payments that they simply were not having. Such improper attribution is inconsistent with Article 6.3(c) of the SCM Agreement and cannot support a finding of significant price suppression.

181. The United States explained to the Panel the flaws in using the crop-specific cost data published by USDA to reach conclusions about the financial viability of upland cotton farmers generally.²²³ The use of such data assumes in effect that all U.S. upland cotton farmers produce nothing but upland cotton. The fact is, however, that for agronomic and risk management reasons farmers in the United States would rarely, if ever, rely solely on the production of one crop, year after year. A farmer manages his farm in a manner to maximize net revenue from the entire operation, which could include producing various crops and livestock, and providing other

²²²Panel Report, paras. 10.195-10.196.

²²³U.S. Answer to Panel Question 59, paras. 143-46.

agricultural services (such as custom harvesting) to other producers. The USDA cost of production data – and other similar cost data – do not purport to show the financial viability of a farm growing upland cotton that also relies on many other sources of income and incurs other costs. Rather, it provides a stylized, abstract view of one single crop or livestock enterprise that an individual producer of upland cotton can look at as a kind of general benchmark to compare against his own costs and revenues. The Panel’s use of these data to extrapolate about the financial viability of upland cotton farmers generally or the entire U.S. upland cotton sector was not reasonable.

182. The “total” cost figures used by the Panel include all the items under “allocated overhead,” which were either not specific to upland cotton (in which case they are expenses that should be allocated over all the crops and enterprises on a farm) or were not actual cash outlays (in which case they are economic costs arrived at through imputed values).²²⁴ The American Agricultural Economics Association (“AAEA”) Handbook submitted by the United States explains at length the difficulties in concepts and methods of allocating costs such as general farm overhead. For example:

The third category [general farm overhead] is usually referred to as general farm or business overhead and typically includes items *for which it is difficult or impossible to determine the impact of the input on either output or cost for a specific enterprise*. For example, it is difficult to determine the impact of buying a new set of Allen wrenches on the average corn yield per acre or the impact of attending pesticide applicator training on cucumber gross returns.²²⁵

²²⁴U.S. Answer to Panel Question 59, paras. 143-46.

²²⁵*Commodity Costs and Returns Estimation Handbook*, updated 09/30/2005, A Report of the AAEA Task Force on Commodity Costs and Returns, p. 9-1 (Exhibit US-88).

183. While the USDA makes such allocations of whole-farm expenses for purposes of presenting the published costs and returns data for specific crops like cotton, there is no “allocation” of actual costs on farms. These costs are simply incurred and aggregated; and they must be paid in the long-term using whatever net aggregate revenue remains after variable/operating costs are paid. The assumption that U.S. farmers would close down their businesses based on a narrow crop-by-crop or enterprise-by-enterprise assessment of allocated overhead is unrealistic. Yet the Panel overlooked the characteristics and intended use of these data, considered them a reliable measurement of total costs of production for U.S. upland cotton farmers, and did not adequately explain how using them could be squared with economic reality.

184. The Panel’s conceptual flaw in using the total cost data published by USDA to assess financial viability of farms and – more generally the entire upland cotton sector – was magnified by the fact that the Panel found that “opportunity costs should be included in the total costs of production.”²²⁶ The U.S. argument against the inclusion of non-cash costs was completely consistent with the economic reality of how farmers take costs into account when making business decisions.

185. For the most part, opportunity costs are costs that have been calculated by USDA to attribute some value to unpaid labor and owned land. For example, if a farmer owns his own land, the “opportunity cost” of using the land may be the value of renting it to some other operator. As the United States demonstrated, there are inherent difficulties in valuing such items

²²⁶Panel Report, para. 10.170; *see also* U.S. Answer to Panel Question 59, paras. 147-50.

for which there is no market transaction or cash outlay.²²⁷ The Panel itself agreed that “imputing values to resources to which there are no market transactions is not as reliable as direct market valuation.”²²⁸

186. More importantly, however, opportunity costs are not necessarily costs that must be paid off in order for farmers to avoid having to shut down their business. A farmer who owns his land does not have to pay anybody an imputed economic cost to account for that fact. The United States submitted data from the USDA’s Agricultural Resource Management Survey showing that an estimated 66 percent of all farmland operated in 2003 was on owned land.²²⁹ This means that – for this percentage of farmland – the attribution of an imputed economic cost (and the treatment thereof as a kind of cash cost that must be paid on pains of closing down one’s business) is simply not accurate.

187. It is not consistent with the economics of farming in the United States to suggest that farmers are behaving in an economically irrational way if they do not choose to close down their businesses simply because total revenues, while meeting all the variable and fixed cash costs, do not meet hypothetical imputed economic costs. Such a view ignores important factors, including that farm owners may reasonably anticipate that their equity investment will gain in value and

²²⁷For example, the AAEA Handbook notes that “[w]hen a market transaction is not available to value a given expendable factor or capital service, methods that will approximate the opportunity cost of the service are used. *These methods are not as reliable as direct market valuation.*” *Commodity Costs and Returns Estimation Handbook*, updated 09/30/2005, A Report of the AAEA Task Force on Commodity Costs and Returns, p. 2-11 (Exhibit US-88).

²²⁸Panel Report, para. 10.169.

²²⁹Hoppe, Robert and David Banker. “Structure and Finances of US Farms: 2005 Family Farm Report.” Economic Research Service Economic Information Bulletin No.12, May 2006. (Exhibit US-67).

provide long-term returns.²³⁰ That equity investment, therefore, has a value in addition to the annual returns of the commodities planted on the farm.

188. From an economic standpoint, it was unsupportable for the Panel to suggest that a farmer will exit cotton farming altogether if the farmer were meeting variable costs and even total cash costs over the long-run but nonetheless could theoretically make more money by renting or selling the farmer's land or taking some odd job in a nearby town. From a legal standpoint, it was even more unsupportable to extend such reasoning to find that upland cotton production was not economically viable without marketing loan and counter-cyclical payments, and that *but for* these payments, upland cotton acreage and production would have been lower.

189. The Panel's legal error was compounded by its disregard of off-farm income – and income from other crops – that are an important part of cotton farmers' revenue.²³¹ For example, the United States provided data showing that in MY 2002-2005, on average, only 47% of total farm revenue on upland cotton farms was from cotton.²³² That is, the majority of farm revenue (not even taking off-farm revenue into account) was coming from other production. Off-farm revenue added substantially to that. The United States pointed out that farmers make long-term decisions, such as whether to exit cotton farming, by looking at all returns, including off-farm income, and comparing them to total cash costs for the farm as a whole.²³³ Thus, such off-farm income, and other on-farm income, should be taken into account when undertaking a cost-

²³⁰U.S. Answer to Panel Question 59, para. 149.

²³¹Panel Report, para. 10.184.

²³²U.S. Answer to Panel Question 59, para. 151.

²³³U.S. First Written Submission, para. 295.

revenue analysis and assessing the actual production effects of the marketing loan and counter-cyclical payments.

190. The Panel examined the two economic studies submitted by the United States that demonstrated the importance of off-farm income to producers' income.²³⁴ Both of these studies – Dimitri et al. (2005) and Hoppe & Korb (2006) – explained that a large and growing number of farmers earn off-farm income. For example, Hoppe & Korb showed that about one-third of farmers have worked off-farm at least 200 days a year since 1978.²³⁵

191. The Panel, however, viewed one of these studies, Hoppe & Korb, as “ambivalent” about the role of off-farm income, and on that basis failed to take into account altogether the influence that off-farm income has on the financial viability of farms.²³⁶ While the Hoppe & Korb study mentions that off-farm income “may be the first step in an exit from farming,” it also explains that “off-farm work might lower the probability of exit by providing farm operator households with another source of income.”²³⁷ The Panel was even “convinced that off-farm income has grown in importance in farm operators' income.”²³⁸

192. Given that the Panel recognized it had new evidence before it concerning the importance of both off-farm income, and other sources of on-farm income, the Panel erred in ignoring this

²³⁴Panel Report, paras. 10.180-10.183.

²³⁵Hoppe, Robert A. and Korb, Penni. Understanding U.S. Farm Exits. Economic Research Report 21. June 2006, p. 20 (Exhibit US-46).

²³⁶Panel Report, para. 10.183.

²³⁷Hoppe, Robert A. and Korb, Penni. Understanding U.S. Farm Exits. Economic Research Report 21. June 2006, p. 20 (Exhibit US-46).

²³⁸Panel Report, para. 10.184.

income in its (fundamentally flawed) total cost-revenue analysis. That is, the Panel had before it two plausible explanations for the role of off-farm (and other on-farm) income in farm exits, but it examined neither. On one hypothesis, other sources of revenue could permit uneconomic farmers to keep farming. The facts in this dispute showed precisely such significant sources of other revenue, such that producers were not dependent on U.S. support payments to cover the alleged cost-revenue gap and stay in business. Instead, the Panel never analyzed the extent and impact of off-farm income, and other on-farm income, which vitiates its conclusion that “there exists a significant gap between the total costs of production of US upland cotton producers and their market revenue,” and this gap indicates that “therefore. . .without these subsidies the level of US upland cotton acreage and production would be considerably lower.”²³⁹

193. The Panel sought to dismiss U.S. arguments regarding the role other sources of income could play in permitting uneconomic farmers to keep farming by pointing to a second hypothesis, that the growing importance of off-farm income might be the sign of the long-term exit of farmers from the agricultural sector.²⁴⁰ However, the Panel raised but never tested this hypothesis. That is, while asserting that increasing off-farm revenue could signal that farmers were exiting farming, the Panel never examined whether U.S. cotton producers *actually were* exiting cotton farming. The exit of producers from cotton farming would be inconsistent with the Panel’s conclusion that marketing loan payments and counter-cyclical payments induce farmers to continue producing by covering an alleged cost-revenue “gap,” but the Panel never

²³⁹Panel Report, para. 10.196.

²⁴⁰Panel Report, para. 10.182.

examined this potential consequence for the hypothesis that it raised.²⁴¹ Thus, the Panel’s analysis of the alleged cost-revenue “gap” was incomplete and could not support the conclusions it drew.

c. Conclusion as to Costs and Revenues

194. By failing to take into account off-farm income, and other sources of on-farm income, the Panel essentially discounted the total amount of U.S. cotton farmers’ revenue. It also neglected to match up all on-farm and off-farm revenue against whole-farm total costs and inflated the overhead costs it did use by incorporating hypothetical opportunity costs. The net result was a “gap” that the Panel concluded could only have been filled by marketing loan and counter-cyclical payments.²⁴² This finding attributed effects to those payments that they were in fact not having. Such improper attribution is inconsistent with Article 6.3(c) of the SCM Agreement and

²⁴¹The United States submitted data demonstrating that U.S. farmers were actually cutting back on cotton production. For example, survey evidence of MY 2007 upland cotton planting intentions, showing that U.S. producers intended to pull back on their upland cotton plantings in MY 2007 by approximately 14 percent. U.S. Answers to Second Set of Panel Questions, para. 1. In addition, traditional U.S. cotton farms receiving cotton counter-cyclical payments planted approximately 40 percent fewer cotton acres over MY 2002-2005 than they had in the period used to calculate cotton base acres. U.S. First Written Submission, para. 224.

²⁴²The United States showed that when looking at USDA survey data for high-, middle-, and low-cost producers in MY 2003, fully 92 percent of U.S. cotton production was on farms on which total revenue exceeded not only all variable costs actually reported in response to the survey, but also the cash costs allocated to upland cotton by USDA and – indeed – even the items of economic opportunity cost included in “total” costs published by USDA. U.S. Rebuttal Submission, para. 337; U.S. Response to Panel Question 59, paras. 140-4. Thus even under the Panel’s flawed analytical approach, nearly all U.S. cotton farmers were meeting both variable and fixed costs. The Panel attempted to dismiss these data by noting that cotton prices were at a record high in MY 2003. Panel Report, para. 10.194. While it is true that prices in MY 2003 were high, however, that does nothing to undermine either the validity or the usefulness of these data. Importantly, there is a substantial spread between the total cost figures and the market revenue figures for the low- and mid-cost producers that made up the 92 percent figure. In the case of the former, U.S. producers’ market revenue was almost double (or 29 cents/lb more than) the “total” costs reflected in the USDA data. For the mid-cost producers, the difference was almost 10 cents/lb. While prices did fall in MY 2004 and MY 2005, this would simply have had the effect of lowering or eliminating the excess above the “total” costs reflected in the USDA data. It does not mean that substantially less production would be shown to be meeting all possible costs. Moreover, the Panel failed to take into account that with yields increasing in later years, costs also were likely to have fallen for these producers in those years. Thus, there is no basis to assume that the results would have been substantially different in later years.

cannot support a finding of significant price suppression.

2. Economic Simulation Model

195. The United States demonstrated the flaws in Brazil’s econometric model, and submitted adjustments showing the minimal effect that U.S. marketing loan and counter-cyclical payments had on the price of upland cotton.²⁴³ And even these effects were overstated given the structural flaws in Brazil’s model for which the United States was unable to adjust, and in light of other evidence demonstrating the absence of significant price suppressing effects of marketing loan and counter-cyclical payments.²⁴⁴ The Panel, however, never determined which model or models were appropriate, even after extensive arguments by both parties, and merely found that it was “not in a position to judge the claims of the parties about the exact magnitude by which the world price would rise were marketing loan and counter-cyclical payments to cease entirely.”²⁴⁵ Nevertheless, the Panel found that “all the simulations conducted by the parties support the view that US marketing loan and counter-cyclical payments have led to an increase in US production and exports of cotton that have then suppressed world prices,” and “[took] note of the fact that price suppression has been the outcome of all the simulation results whether one uses the parameter values proposed by Brazil or the FAPRI and ATPSM parameter values proposed by

²⁴³U.S. First Written Submission, paras. 319-27 & Annex I; U.S. Rebuttal Submission, paras. 349-351 & Annex I. As re-calibrated, the new model showed complete removal of the marketing loan and counter-cyclical payment programs resulting in an increase in world prices of only 1.41 percent over baseline levels over the period MY 2002-2005 and of only 0.96 percent over the period MY 2006-2008. Using long-run values for supply and demand elasticities, complete removal of the two programs would only show an increase in world prices of 2.26 percent over the period MY 2002-2005 and 1.52 percent over the period MY2006-2008.

²⁴⁴U.S. Opening Statement, para. 85; Statement of Dr. Joseph W. Glauber, paras. 12-13; U.S. First Written Submission, para. 320.

²⁴⁵Panel Report, para. 10.221.

the United States.”²⁴⁶ The Panel then cited the results of the modeling as supporting its finding of significant price suppression.²⁴⁷

196. The Panel’s reliance on the parties’ econometric modeling cannot withstand scrutiny. Articles 5(c) and 6.3(c) of the SCM Agreement make actionable those subsidies that cause *significant* price suppression. It is not sufficient to support a finding of significant price suppression that both models showed what the Panel deemed to be “price suppression.” Rather, to rely on the results of modeling for its conclusion, the Panel would had to have concluded which model or models were appropriate, determined the level of price suppression resulting from that model, and found that such price suppression was *significant*. The Panel, however, overlooked the fundamental flaws of Brazil’s model, and the fact that even accounting for some of them, the effect on prices was minimal. Moreover, by its own admission, the Panel never assessed the likely magnitude of the price effects of marketing loan and counter-cyclical payments based on the economic models. Given these errors, the Panel’s conclusion concerning the modeling is insufficient to support a finding of significant price suppression.

3. Impact of the Elimination of Step 2 Payments

197. The Panel concluded that “the evidence before it on the effect of the elimination of [the Step 2 program] on US exports and on the amounts of marketing loan payments and counter-cyclical payments suggests that the elimination of this subsidy does not affect the price suppressing effects of the marketing loan payments and counter-cyclical payments in the world

²⁴⁶Panel Report, para. 10.221. The Panel later recalled that “all the simulations conducted by the parties support the view that US marketing loan and counter-cyclical payments have led to an increase in US production and exports of cotton that have then suppressed world prices.” Panel Report, para. 10.251.

²⁴⁷Panel Report, paras. 10.2251, 10.254.

market for upland cotton.”²⁴⁸ The Panel reached this finding, despite the fact that Brazil had not discharged its burden of demonstrating the allegedly modest effects of the elimination of Step 2 on levels of U.S. exports. The Panel also fundamentally misconstrued the impact of the elimination on U.S. marketing loan and counter-cyclical payments. For these reasons, the Panel’s finding fails as a matter of law.

a. *Effect on U.S. Cotton Exports*

198. The United States demonstrated that following the elimination of Step 2 payments, U.S. exports and export commitments were substantially below historic levels, and projected to decline.²⁴⁹ The United States explained that to the extent it was possible to draw conclusions from these partial-year data for MY 2006, the data did not support Brazil’s claim that the elimination of Step 2 payments had a modest impact on U.S. production, exports, and world prices. The Panel “concur[red] with the United States that the available evidence as of February 2007 suggests *significant* reductions in the volume of production and exports of US upland cotton in MY 2006.”²⁵⁰ Further, the Panel considered that “the data before it is certainly consistent with the argument that the elimination of Step 2 payments is having an effect on US export performance,” and that “some part of the decline in the US share of the export market reflects the effect of the elimination of Step 2 payments.”²⁵¹ Although the Panel acknowledged the impact of the repeal on exports, it nonetheless concluded:

²⁴⁸Panel Report, para. 10.253.

²⁴⁹U.S. First Written Submission, paras. 190-95; U.S. Rebuttal Submission, paras. 204-07.

²⁵⁰Panel Report, para. 10.230 (emphasis added).

²⁵¹Panel Report, para. 10.231.

[G]iven that we are not yet one calendar year removed from the elimination of Step 2 payments, and that the amount of Step 2 payments was much smaller than the amounts of payments made under either the marketing loan or counter-cyclical programmes, it is not possible for the Panel to determine with any great deal of precision or confidence just how much of the projected decline in US exports of upland cotton is due to the elimination of the Step 2 payments.²⁵²

199. In light of the above conclusions, it is astonishing that the Panel then found that “the evidence before it on the effect of the elimination of [the Step 2 program] *on US exports*. . . suggests that the elimination of this subsidy does not affect the price suppressing effects of the marketing loan payments and counter-cyclical payments in the world market for upland cotton.”²⁵³ This finding indicates that the Panel agreed with Brazil that the impact of the elimination of Step 2 on U.S. exports was modest, even though the Panel earlier determined that the elimination of Step 2 was responsible for at least some of the “significant” decline in U.S. exports, and even though it found that it was unable to determine with confidence or precision just how much of the decline was due to the elimination of Step 2. This finding is also inconsistent with the fact that the Panel found there to be a *significant* decline in U.S. production and exports of upland cotton, regardless of whether it was due to the repeal of Step 2, or some other source.

200. The Panel’s finding represents an improper application of the burden of proof. As the Panel recognized earlier in its Report, “[t]he general rules regarding the allocation of the burden of proof in WTO dispute settlement require that a party claiming a violation of a provision of a

²⁵²Panel Report, para. 10.231.

²⁵³Panel Report, para. 10.253 (emphasis added).

WTO agreement by another Member assert and prove its claim.”²⁵⁴ Therefore, Brazil had to prove its claim of significant price suppression under Articles 5(c) and 6.3(c) of the SCM Agreement, including its argument that the impact of the repeal of the Step 2 program on U.S. exports was modest. The Panel, however, ignored its own factual findings that the impact on exports was indeterminable, and that the decline in U.S. exports in MY 2006 was significant, and did not hold Brazil to the proper burden of proof. Instead, it found for Brazil, even though Brazil failed to make a *prima facie* case on the impact of the repeal of Step 2 on U.S. exports of cotton. The Panel’s finding therefore constitutes reversible error.

b. *Indirect Effect on Marketing Loan and Counter-Cyclical Payments*

201. The United States demonstrated that the repeal of the Step 2 program would have more than a “modest” impact on the market for upland cotton. Specifically, the United States introduced evidence showing that the repeal would lead to lower marketing loan payments and would likely not increase the amount of counter-cyclical payments.²⁵⁵ The Panel, however, concluded that “the indirect impacts on US production and exports are likely to be small, given the relatively modest changes projected in the amounts of marketing loan and counter-cyclical payments, and the fact that these changes run counter to one another.”²⁵⁶ The Panel’s finding misconstrued important facts and cannot, as a matter of law, support a finding that the “effect” of marketing loan and counter-cyclical payments is significant price suppression.

²⁵⁴Panel Report, para. 9.3.

²⁵⁵U.S. First Written Submission, paras. 157-78.

²⁵⁶Panel Report, para. 10.239.

202. The United States explained to the Panel the significant impact that the repeal of the Step 2 program would have on marketing loan payments. According to a study by the Food and Agricultural Policy Research Institute (“FAPRI”), the elimination of the Step 2 program results in an average increase of 0.4 cent/lb in the “adjusted world price” (“AWP) in MY 2006-2010 and a decline of the same amount in the marketing loan payment.²⁵⁷ As the Panel recognized, even Brazil did not dispute that the repeal of the Step 2 program was likely to reduce marketing loan payments.²⁵⁸ The chart below demonstrates the projected changes to the AWP and marketing loan payment, as well as the decline in marketing loan payments due to the repeal of Step 2, over the MY 2006-2010 period.

	MY2006 (cents/lb)	MY2007 (cents/lb)	MY2008 (cents/lb)	MY2009 (cents/lb)	MY2010 (cents/lb)	Average MY2006-10
Projected adjusted world price ²⁵⁹ (A)	48.30	51.40	52.80	53.70	53.40	51.90
Projected marketing loan payment (52 cents - (A))	3.70	0.60	0.00	0.00	0.00	0.86
Projected AWP increase and decline in marketing loan payment resulting from Step 2 elimination ²⁶⁰	0.41	0.50	0.38	0.31	0.34	0.39

²⁵⁷U.S. Rebuttal Submission, paras. 183-84. The marketing loan program makes loans available to producers after harvest to prevent market disruption caused by many producers selling immediately after harvest, when prices are typically lowest, for cash-flow reasons. Loans are made at a rate fixed by statute and are nonrecourse, such that if prices fall below the loan rate (52 cents) the producer may simply forfeit the crop or repay the loan at lower price, which is the AWP. The difference between the loan rate and the AWP is referred to as a “marketing loan gain.” Alternatively, a producer may forego the loan and choose to receive a “loan deficiency payment” in the amount of the difference between the loan rate and a lower AWP. “Marketing loan gains” and “loan deficiency payments” are collectively referred to herein as “marketing loan payments.”

An increase in world market prices will result in a corresponding increase in the AWP, which is calculated on the basis of the former. As marketing loan payments are equal to the difference between the marketing loan rate and the AWP, the effect of a rise in world market prices – and thus a consequent rise in the AWP – will be a corresponding decline in the amount of marketing loan payments.

²⁵⁸Panel Report, para. 10.235.

²⁵⁹FAPRI July 2006 Baseline Update for U.S. Agricultural Markets, at 6 (Exhibit BRA-479).

²⁶⁰FAPRI, “Impacts of Commodity and Conservation Reserve Program Provisions in House and Senate Reconciliation Bills,” FAPRI-UMC Report #15-05, December 2005 (Exhibit BRA-484).

Percentage decline in marketing loan payment due to Step 2 elimination	10%	45%	–	–	–	33%
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203. As shown above, the elimination of the Step 2 program was projected to result in substantial declines in marketing loan payments, including in MY 2006 – the “present” marketing year for purposes of the significant price suppression claim – and even more so (almost by half) in MY 2007. Moreover, *marketing loan payments* were not even projected to be made past MY 2007; any effects they may have can, therefore, hardly be expected to remain strong after then.

204. The Panel misconstrued the U.S. evidence and found that these projected changes in marketing loan payments were “modest,” particularly in light of the “scale of the annual payments made” and “the ten year horizon involved.”²⁶¹ However, a projected average decline of a one-third over ten years, with all of the decline concentrated in the first two years before the marketing loan payments are phased out, can hardly be considered “modest.” Moreover, as is evident from the price and payment projections above, the scale of the marketing loan payments themselves is projected to be small before the payments are eliminated altogether as of MY 2008.

205. The Panel also overlooked important evidence demonstrating that there was unlikely to be an increase in counter-cyclical payments as a result of elimination of the Step 2 program in the period that was relevant for Brazil’s claims of “present” serious prejudice (i.e., MY 2006).²⁶² Brazil could not – and, indeed, did not – contest this fact in rebuttal.²⁶³ As the United States

²⁶¹Panel Report, para. 10.239.

²⁶²U.S. First Written Submission, para. 160-170; U.S. Rebuttal Submission, para. 182.

²⁶³Brazil Rebuttal Submission, paras. 57-65.

explained, according to the formula for counter-cyclical payments, the season average farm price is part of the base used to determine counter-cyclical payments only if the average farm price is above the marketing loan rate (52 cents/lb).²⁶⁴ Thus, if U.S. prices are below the marketing loan rate, the elimination of the Step 2 program – and any consequent decline in farm prices – cannot have any effect on the level of counter-cyclical payments; the counter-cyclical payment rate remains fixed at the maximum level of 13.73 cents/lb. At the same time, the counter-cyclical payment rate is zero if the season average farm price is above 65.73 cents/lb. Therefore, if farm prices are above 65.73 cents/lb, and remain there after the repeal of Step 2, then the elimination of the program also will have no effect on counter-cyclical payments

206. Since MY 2003, the average farm price has been below the lower 52 cents/lb threshold.²⁶⁵ Under those conditions, there would be no effect on the counter-cyclical payment rate if farm prices were to decline; the rate would remain at 13.73 cents/lb. According to FAPRI projections – specifically, the July update to FAPRI’s 2006 baseline upon which Brazil’s economist relied for his own modeling – the season average farm price was similarly projected to be below the 52 cents/lb threshold in MY 2006. As the 2006 FAPRI baseline already accounted for the elimination of the Step 2 program, the United States had to adjust the price projections to account for the possibility that farm prices might have been higher if the Step 2 program were still in

²⁶⁴U.S. First Written Submission, paras. 161-62. Under the FSRI Act of 2002, counter-cyclical payments are calculated based on the difference between a 72.4 cent/lb “Target Price” and an “Effective Price” as follows: CCP = payment rate * 85% of base acres * payment yield, where:
payment rate = Target Price – Effective Price
= \$0.724 - (Direct Payment rate + higher of marketing loan rate or season average farm price)
= \$0.724 - (\$0.0667 + higher of \$0.52 or season average farm price)
= \$0.6573 - (higher of \$0.52 or season average farm price)

²⁶⁵U.S. First Written Submission, para. 164.

place. The United States made this adjustment using the FAPRI estimates of the annual impact on U.S. farm prices of eliminating the Step 2 program.²⁶⁶

207. Even after adjusting to reflect the higher U.S. prices that might likely have prevailed if the Step 2 program were still in effect, the projected average farm price for MY 2006 was only a fraction of a cent higher than the threshold. This is the negligible extent of the effect that a decline in the season average farm price resulting from elimination of the Step 2 program could have had on the counter-cyclical payment rate in MY 2006, which was the relevant year for the Panel’s analysis of “present” significant price suppression. Moreover, as the United States showed, because counter-cyclical payments are only paid in respect of historical yields, and are made only on 85 percent of base acres, a one cent decrease in the farm price would only be offset by a 0.66 cent increase in the counter-cyclical payment rate.²⁶⁷ Therefore, any possible increase in the counter-cyclical payment rate in MY 2006, based on a fraction of a cent drop in price below the statutory threshold, would have been far outweighed by the effect of the 10 percent decrease in marketing loan payments.

208. Despite the above U.S. evidence, the Panel still found that “the elimination of [the Step 2 program]. . . on the amounts of marketing loan payments and counter-cyclical payments suggests that the elimination of this subsidy does not affect the price suppressing effects of the marketing loan payments and counter-cyclical payments in the world market for upland cotton.”²⁶⁸

However, this finding cannot be squared with the fact that the repeal of Step 2 would lead to a

²⁶⁶U.S. First Written Submission, para. 165 & n.233.

²⁶⁷U.S. First Written Submission, para. 168.

²⁶⁸Panel Report, para. 10.253.

substantial decrease in marketing loan payments, and a negligible impact on counter-cyclical payments in the “present” marketing year, and beyond. Such effects on marketing loan and counter-cyclical payments would more than offset any alleged price suppressing effects of those payments.

209. The Panel’s analysis has another fatal flaw. The original panel never determined how much “price suppression” was caused by the basket of Step 2, market loss assistance, marketing loan, and counter-cyclical payments. Therefore, the Panel had no base from which to measure the impact of the repeal of Step 2. Under these circumstances, it was not enough for the Panel to assume that any remaining price suppression effect is “significant” – it needed to have done more of an analysis to determine how much of an effect remained after repeal of Step 2 and how this compared to the original price suppression in order to determine whether the remaining effect, under the Panel’s own view, was “significant.” The Panel therefore erred as a matter of law in finding that the “effect” of the marketing loan and counter-cyclical payments in the absence of the Step 2 program was significant price suppression.

4. Other Factors Impacting the World Market Price, Including the Role of China

210. Article 6.3(c) of the SCM Agreement requires a showing that “the effect *of the subsidy* is . . . significant price suppression . . . in the same market.”²⁶⁹ Reviewing this provision, the Appellate Body clarified that “it is necessary to ensure that the effects of other factors on prices are not improperly attributed to the challenged subsidies.”²⁷⁰ The Panel therefore was required to

²⁶⁹Emphasis added.

²⁷⁰*Upland Cotton (AB)*, para. 437; see also *Korea – Commercial Vessels (Panel)*, paras. 7.617-7.618.

undertake a meaningful assessment of the world upland cotton market, of actual world market prices, and of the factors observed to be affecting U.S. and foreign supply and demand, and ultimately, world prices. The Panel itself recognized that it had an obligation to conduct a non-attribution analysis, but ultimately failed to do so.²⁷¹

211. As the United States explained before the Panel, China is one of the most important “other” factors influencing the world price of upland cotton.²⁷² It is the world’s largest producer of upland cotton, the world’s largest consumer of upland cotton, and the world’s largest importer of upland cotton.²⁷³ Moreover, China has been a very dynamic factor in the market, with its share of world imports rising from only 1% in MY 1998 to 44% in MY 2005.²⁷⁴

212. Market reports have noted the role of China’s cotton trade in “prevent[ing] a significant price increase in 2005/2006.”²⁷⁵ Downward pressure on cotton prices may also have resulted from uncertainty over China’s supply and demand statistics, as well as *ad hoc* changes to government policies.²⁷⁶ In addition, the United States explained that there was a high correlation between the A-Index, a measurement of world upland cotton prices, and China’s net cotton trade, and that the A-Index itself was changed to reflect the impact of China on the world cotton

²⁷¹Panel Report, paras. 10.242-10.243.

²⁷²U.S. First Written Submission, paras. 308-18; U.S. Rebuttal Submission, paras. 387-96.

²⁷³Cotton: Review of the World Situation, ICAC (May-June 2006) (Exhibit BRA-485).

²⁷⁴Cotton: Review of the World Situation, ICAC (May-June 2006) (Exhibit BRA-485).

²⁷⁵U.S. First Written Submission, paras. 315-16 (citing, for example, “Cotton: Review of the World Situation,” International Cotton Advisory Committee at 7 (May-June 2006) (BRA-485)).

²⁷⁶U.S. First Written Submission, paras. 314-317.

market.²⁷⁷

213. The Panel, despite the ample evidence on the record concerning China, considered that because it had adopted a “but-for” approach as to the price effects of U.S. marketing loan and counter-cyclical payments, it was “not necessary in this respect to undertake a comprehensive evaluation of factors affecting the world market price for upland cotton.”²⁷⁸ The very use of a but-for analysis, however, requires the Panel not to attribute effects to U.S. payments that they are not having. The Panel tried to justify its failure to examine other factors by noting that “the *SCM Agreement* prescribes no precise methodology for such an analysis of the role of other factors in the context of Article 6.3.”²⁷⁹ There may be no “precise methodology,” but that does not mean that the Panel’s superficial analysis could pass for what the *SCM Agreement* requires.

214. Missing from the Panel’s analysis was any discussion of just how other factors, including China, actually played a role in establishing the world price for upland cotton. The Panel only acknowledged that China had a “significant role,” without examining how price changes could be attributed to that factor. Instead, the Panel merely returned to its argument that “with a share of world exports of around 40 per cent, the United States is capable of exerting a substantial proportionate influence on the world market.”²⁸⁰ This conclusion, however, begs the question – the mere share of U.S. exports alone does not mean anything, and the Panel should have placed that figure in the context of world market conditions influencing price, including China’s role as

²⁷⁷U.S. First Written Submission, paras. 309-13.

²⁷⁸Panel Report, para. 10.243.

²⁷⁹Panel Report, para. 10.242.

²⁸⁰Panel Report, para. 10.243.

the largest producer, consumer, and importer of cotton. The Panel’s failure to conduct a proper non-attribution analysis means that its finding that “the effect *of the subsidy* is . . . significant price suppression” fails as a matter of law.

5. Magnitude of the Subsidies

215. The United States demonstrated that the amount of the marketing loan and counter-cyclical payments alone was insufficient to support the alleged existence of a causal link between those payments and significant price suppression in the world market for upland cotton.²⁸¹

Instead, the Panel was required to look at the magnitude in relation to the structure, design, and operation of the marketing loan and counter-cyclical payments. As the United States explained, the marketing loan and counter-cyclical payments, regardless of size, did not insulate U.S. producers from market signals, and could not have caused significant price suppression.

216. Although the Panel agreed that “it is necessary to examine this factor in relation to other factors,” including the structure, design and operation of the subsidies, it ultimately found that “when considered in conjunction with other factors, the order of magnitude of the marketing loan payments and counter-cyclical payments supports a finding of significant price suppression, even when account is taken of the decline in the amount of marketing loan payments projected for MY 2006.”²⁸² This finding was premised upon the Panel’s earlier conclusion that the structure, design, and operation of the marketing loan and counter-cyclical payments had an “important revenue-stabilizing effect” on U.S. farmers, and that the payments bridged “the gap between

²⁸¹U.S. First Written Submission, paras. 236-41.

²⁸²Panel Report, para. 10.111.

costs of production and market revenues of US upland cotton producers.”²⁸³

217. According to the Panel’s own reasoning, the magnitude of the U.S. marketing loan and counter-cyclical payments *alone* means nothing if the structure, design and operation of the payments did not have important revenue-insulating effects, and if they did not assist U.S. cotton farmers to meet their costs of production when they otherwise would not have been able to do so. As the United States has demonstrated,²⁸⁴ the Panel’s findings regarding the structure, design, and operation of the U.S. marketing loan and counter-cyclical payments, and the payments’ role in covering the alleged cost-revenue “gap,” fail as a matter of law. Consequently, the Panel’s finding as to the magnitude of the marketing loan and counter-cyclical payments, which depends on those same findings, also fails as a matter of law.

6. Substantial Proportionate Influence

218. The Panel asserted that “the United States exerts a substantial proportionate influence on the world market for upland cotton” due to the U.S. share of world production and exports from MY 2002-2005, as well as projections for MY 2006.²⁸⁵ The Panel concluded that “this substantial proportionate influence of the United States, analyzed in light of the totality of the evidence before us. . .is an element that supports a finding that the marketing loan and counter-cyclical payments to US upland cotton producers cause significant price suppression in the world market for upland cotton.”²⁸⁶

²⁸³Panel Report, para. 10.111.

²⁸⁴See Parts IV.A1 and IV.B.1.

²⁸⁵Panel Report, para. 10.58.

²⁸⁶Panel Report, para. 10.58.

219. The Panel’s finding as to the alleged substantial proportionate influence of the United States is untenable. The relative size of shares of production and exports alone in a given marketing year does not explain price effects and cannot support a finding of significant price suppression. In fact, a proper analysis under Article 6.3(c) of the SCM Agreement required the Panel to analyze how U.S. upland cotton competed with cotton from other sources. Only by accounting for market conditions, and how those conditions interact to establish upland cotton prices, could the Panel have determined whether the size of U.S. production and exports really mattered. As the United States demonstrated, other factors in the world market, including the predominant role of China, have influenced world prices, and the U.S. marketing loan and counter-cyclical payments could not have caused significant price suppression. The Panel, however, never undertook such an analysis of competitive conditions.²⁸⁷

220. The Panel’s analysis fails on another account as well – the Panel overlooked its own finding that U.S. shares of world production and exports have been stable in recent years. As the United States explained in Part IV.A.2, these stable shares indicate that U.S. producers acted similarly to foreign producers, and that marketing loan and counter-cyclical payments did not insulate U.S. producers from market signals. If anything, then, the relative U.S. shares of world production and exports from MY 2002-2006 support the opposite conclusion that U.S. marketing loan and counter-cyclical payments did not cause significant price suppression.

C. The Panel Ultimately Failed to Determine What Degree of Price Suppression it Found to be “Significant”

²⁸⁷U.S. First Written Submission, paras. 308-18; *see also* Part IV.B.4, *infra* (discussing Panel’s lack of non-attribution analysis).

221. The Panel found that the “effect” of U.S. marketing loan and counter-cyclical payments was “significant price suppression” within the meaning of Article 6.3(c).²⁸⁸ The Panel should have explained the *degree* of price suppression that it considered to be “significant,” as applied to the facts before it. The Panel, however, failed to make such determination, and its finding of *significant* price suppression cannot stand as a matter of law.

222. The SCM Agreement, either in Article 6.3 or elsewhere, does not define “significant” price suppression. The ordinary meaning of “significant,” however, is “important, notable; consequential,”²⁸⁹ which suggests that any price suppression must reach a level at which it is important, notable, and consequential in order to be inconsistent with Article 6.3(c). The panel agreed with this interpretation in the original proceeding.²⁹⁰ Further, drawing contextual guidance from Article 15.2 of the SCM Agreement, which relates to analysis of the price effects of subsidized imports for purposes of countervailing duty investigations, the panel clarified that “it is the *degree* of price suppression or depression itself that must be ‘significant’ (i.e. important, notable or consequential) under Article 6.3(c) of the SCM Agreement.”²⁹¹ What is clear is that a finding of significant price suppression must take into account the *degree* of price suppression that is deemed “significant,” and that the degree must be the equivalent of “important, notable; consequential.”

²⁸⁸Panel Report, para. 10.254.

²⁸⁹*The New Shorter Oxford English Dictionary*, vol. 2, at 2860 (1993 ed.) (second definition) (Exhibit US-51).

²⁹⁰*Upland Cotton (Panel)*, para. 7.1325; *see also Upland Cotton (AB)*, para. 426; *Korea – Commercial Vessels (Panel)*, para. 7.571.

²⁹¹*Upland Cotton (Panel)*, para. 7.1328 (emphasis added).

223. The Panel’s finding of significant price suppression does little more than rest on the conclusion that “but for the subsidies at issue, the world market price for upland cotton would have increased significantly, or would have increased by significantly more than was in fact the case.”²⁹² The Panel cross-referenced its earlier discussion of the term “significant,” but made no attempt to apply that definition to the facts before it.²⁹³ The proper analysis under Article 6.3(c) required the Panel to set out the price suppression, if any, as shown by the facts, and to explain how the degree of that suppression was significant, if at all. The Panel, by merely repeating the term “significantly,” or “significant,” did nothing to satisfy this requirement.

224. The Panel’s finding essentially writes the word “significant” out of Article 6.3(c). It was sufficient for the Panel’s purposes that the evidence allegedly showed some price effects, however minimal.²⁹⁴ But Article 6.3(c) does not make actionable just any price suppression.

225. If left to stand, the Panel’s failure to set out the degree of price suppression would have detrimental consequences for the WTO dispute settlement system. Members would not know how to take appropriate steps to avoid the alleged “adverse effects” of price-contingent subsidies if it were impossible to discern the “adverse effects” that rise to the level of WTO-inconsistency. They would be left without guidance as to how to structure programs and payments so as to avoid significant price suppressing effects, and would be deterred from taking likely WTO-consistent actions when confronted with such uncertainty. The WTO agreements could not have

²⁹²Panel Report, para. 10.254.

²⁹³Panel Report, para. 10.254 (citing to para. 10.50).

²⁹⁴Possible price suppression of only 1 to 1.5 percent, as shown by the U.S. adjustments to Brazil’s economic model, can hardly be described as “important,” or “notable,” or “consequential.” U.S. Opening Statement, para. 85; Statement of Joseph W. Glauber, para. 12.

intended to constrain Members in such a way.

226. For all of the above-mentioned reasons, the United States respectfully requests that the Appellate Body reverse the Panel’s finding that the effect of U.S. marketing loan and counter-cyclical payments is “significant price suppression” within the meaning of Article 6.3(c) of the SCM Agreement.

D. The Panel Failed to Undertake an “Objective Assessment” of the Serious Prejudice Claims as Required Under DSU Article 11

227. Article 11 of the DSU provides that “a panel should make an *objective assessment* of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements. . . .”²⁹⁵ The question as to whether a panel has made an “objective assessment” is a “*legal* one, that may be the subject of an appeal.”²⁹⁶ As the United States sets forth below, the Panel here acted inconsistently with Article 11 by failing to carry out an objective assessment of Brazil’s claims that U.S. marketing loan and counter-cyclical payments made after September 21, 2005 caused significant price suppression in the world market for upland cotton. Consequently, the Panel’s findings regarding significant price suppression should be reversed.

228. In reviewing claims under Article 11, the Appellate Body has found that “[t]he deliberate disregard of, or refusal to consider, the evidence submitted to a panel is incompatible with a panel’s duty to make an objective assessment of the facts” and that “[t]he willful distortion or misrepresentation of the evidence put before a panel is similarly inconsistent with an objective

²⁹⁵Emphasis added.

²⁹⁶*United States – Wheat Gluten (AB)*, para. 151.

assessment of the facts.”²⁹⁷ Further, “[d]isregard’ and ‘distortion’ and ‘misrepresentation’ of the evidence, in their ordinary signification in judicial and quasi-judicial processes, imply not simply an error of judgment in the appreciation of evidence but rather an egregious error that calls into question the good faith of a panel.”²⁹⁸ The Appellate Body also has stated that under Article 11 panels may not make affirmative findings that “lack a basis in the evidence contained in the panel record.”²⁹⁹

229. In *U.S. – Softwood Lumber VI (21.5)*, the Appellate Body examined the requirements of Article 11 of the DSU in the context of the review by a panel of determinations made by investigating authorities.³⁰⁰ The Appellate Body applied a rigorous standard, noting that a “panel’s scrutiny should test whether the reasoning of the authority is coherent and internally consistent.”³⁰¹ Moreover, a panel should “be open to the possibility that the explanations given by the authority are not reasoned or adequate in the light of other plausible alternative explanations. . . .”³⁰² There is no reason why the Panel, which was the initial trier of fact in this dispute, should be held to a lower standard than a domestic investigating authority.

230. The Panel failed to provide a reasoned and adequate explanation of its conclusions and its errors in assessing the significant price suppression claims are egregious and rise to a level that

²⁹⁷*EC – Hormones (AB)*, para. 133.

²⁹⁸*EC – Hormones (AB)*, para. 133.

²⁹⁹*United States – German Steel*, para. 142.

³⁰⁰*U.S. – Softwood Lumber VI (21.5) (AB)*, para. 93.

³⁰¹*U.S. – Softwood Lumber VI (21.5) (AB)*, para. 93.

³⁰²*U.S. – Softwood Lumber VI (21.5) (AB)*, para. 93.

calls into question the objectivity of the Panel’s assessment. The United States presented substantial evidence to rebut Brazil’s claims that U.S. marketing loan and counter-cyclical payments were not significantly suppressing prices, yet the Panel’s analysis demonstrated a failure to either take such evidence into consideration, or to fairly assess the import of that evidence.

1. Structure, design, and operation of marketing loan and counter-cyclical payments

231. The United States placed evidence on the record relevant to the structure, design, and operation of marketing loan payments for the period MY 2003-2007, all of which was not before the original panel.³⁰³ This evidence, among other things, reflected producer expectations as to the price of upland cotton, as well as information regarding competing crops.³⁰⁴ It demonstrated that marketing loan payments did not have a significant impact on planting decisions, and that the structure, design, and operation of those payments did not act to “insulate” U.S. producers from market signals.

232. The Panel, in assessing the structure, design, and operation of marketing loan payments, disregarded the new U.S. evidence and relied exclusively on findings from the original panel and Appellate Body. It dismissed the U.S. argument as the “same” as the one that “was already rejected by the panel and the Appellate Body in the original proceeding,” and never evaluated evidence showing how cotton farmers actually made planting decisions during MY 2003-2006

³⁰³See, e.g., U.S. First Written Submission, paras. 229-35, 259-61; U.S. Response to Panel Question 51, para. 71; see also U.S. Comments on Brazil’s “Oral” Presentation, paras. 70-72.

³⁰⁴See Part IV.A.1, *supra*, for a more detailed discussion of the U.S. evidence.

and how they acted consistently with the market.³⁰⁵ Instead, the Panel focused on just one piece of the entire U.S. argument – that because the expected price of upland cotton, as measured by the New York futures price, was above the marketing loan rate, U.S. producers could not have been influenced by the availability of marketing loan payments in making planting decisions.

233. The Panel failed to provide a reasoned and adequate explanation for its conclusions, and displayed its lack of objectivity and its disregard for the new and highly relevant evidence in claiming the United States was making the “same” argument as before the original panel. That argument could not have been the “same” – in the original proceeding, the United States was addressing a different mix of subsidies (i.e., Step 2, market loss assistance, marketing loan, and counter-cyclical payments) during a different time frame (MY 1999-2002). Moreover, the Panel ignored all other evidence, aside from that concerning the futures price of upland cotton, in finding that the structure, design, and operation of marketing loan payments insulated U.S. cotton producers and led to levels of acreage and production that were higher than they would have been without such payments. Even the United States noted that the cotton futures price *alone* was not the sole basis for farmers’ planting decisions,³⁰⁶ so the Panel’s exclusive focus on the U.S. argument about those prices only underscores the Panel’s deliberate disregard of other relevant U.S. evidence about producers’ expectations and planting decisions and its failure to provide a reasoned and adequate explanation for its conclusions in the light of plausible alternative explanations.

³⁰⁵Panel Report, paras. 10.61-10.82.

³⁰⁶U.S. First Written Submission, paras. 256-58.

234. The Panel also willfully distorted and misrepresented the meaning of the economic studies that the United States submitted concerning the effects of counter-cyclical payments on production.³⁰⁷ These studies, which were not available at the time of the original proceeding, showed the *minimal* impact that counter-cyclical payments had on planting and production, including the capitalization of counter-cyclical payments into higher land values.³⁰⁸ For example, the Panel’s analysis failed to account for important survey evidence from the 2005 Goodwin and Mishra study. Although the study focused mainly on the effects of decoupled payments and not counter-cyclical payments, it also contained a survey of farmers, which asked them to rate the factors important to their acreage decisions on a 5-point scale ranging from “not at all important” to “very important.”³⁰⁹ The study found that almost half of farmers surveyed (44 percent) – in a nationwide survey comprising about 4,125 observations – indicated that counter-cyclical payments were strongly “not at all important” to their acreage decisions. The other substantial percentage (43 percent) indicated either ambivalence (that counter-cyclical payments were “neither important or unimportant”) or that counter-cyclical payments were “unimportant” to their acreage decisions. Such evidence runs contrary to the Panel’s finding that counter-cyclical payments somehow insulated U.S. producers from market prices and influenced their planting decisions.

235. The Panel considered it relevant that the studies placed on the record by the United

³⁰⁷Panel Report, paras. 10.92-10.95.

³⁰⁸U.S. First Written Submission, paras. 204-19; U.S. Rebuttal Submission, paras. 224-40, 253-62. For a more detailed discussion of each study, see Part IV.A.1, *supra*.

³⁰⁹Goodwin, B. and A. Mishra, “Another Look at Decoupling: Additional Evidence on the Production Effects of Direct Payments,” *American Journal of Agricultural Economics* 87(5):1200-1210, 2005 (Exhibit US-41).

States, along with those from Brazil, showed that “counter-cyclical payments can increase production and these production effects occur because increased wealth reduces risk aversion, the availability of the payments relieves credit constraints and provides some insurance from fluctuations in revenues and the payments allow farmers to cover fixed costs of production.”³¹⁰ The Panel relied on this conclusion about the economic studies to support its finding that counter-cyclical payments had market-insulating and significant production effects with respect to U.S. upland cotton producers,³¹¹ even though it acknowledged that the U.S. studies showed that “the production effects of counter-cyclical payments are likely to be small.”³¹² The Panel thus failed to provide a reasoned and adequate explanation for its conclusions in the light of a plausible alternative explanation, distorted the collective import of the U.S. studies, and misrepresented that those studies could lend support to a finding of market insulation and production effects leading to significant price suppression.

2. Stable U.S. Shares of Production and Exports

236. The United States submitted data indicating the stable U.S. shares of world production and exports of upland cotton throughout the entire period that U.S. marketing loan and counter-cyclical payments were made, and for many years before that.³¹³ The stable shares indicated that marketing loan and counter-cyclical payments were not inducing U.S. cotton farmers to plant, produce, and export where market signals would have caused their foreign counterparts to pull

³¹⁰Panel Report, para. 10.95.

³¹¹Panel Report, para. 10.104.

³¹²Panel Report, para. 10.93.

³¹³U.S. First Written Submission, paras. 243-52; U.S. Rebuttal Submission, paras. 282-86.

back. In other words, U.S. producers were responding to world market signals in much the same way as foreign producers, and could not have been “insulated” by U.S. marketing loan and counter-cyclical payments. And even if there still were some degree of insulation, it certainly was not enough to have any significant impact on planting decisions.

237. The Panel appeared to understand the significance of the U.S. evidence when it concluded that “[t]he fact that the US share of world cotton production and exports has remained relatively constant in MY 2002-2005 suggests to us that US producers have increased production and exports in proportionately the same way as foreign cotton producers.”³¹⁴ Yet the Panel deliberately distorted the meaning of this evidence on stable market shares and found that despite the stable U.S. shares, U.S. marketing loan and counter-cyclical payments still insulated U.S. producers from price signals to such a degree as to have significant effects on production and price.³¹⁵ Stable U.S. shares of production and exports, however, could only have rationally supported the opposite conclusion. The Panel failed to provide a reasoned and adequate explanation for its conclusions and failed to objectively evaluate this evidence.

3. Economic Simulation Model

238. The United States showed numerous flaws in Brazil’s econometric model, and submitted adjustments showing the minimal effect that U.S. marketing loan and counter-cyclical payments had on the price of upland cotton.³¹⁶ The U.S. re-calibrated model showed complete removal of

³¹⁴Panel Report, para. 10.127.

³¹⁵Panel Report, paras. 10.127, 10.248, 10.251, 10.254.

³¹⁶U.S. First Written Submission, paras. 319-27 & Annex I; U.S. Rebuttal Submission, paras. 349-351 & Annex I.

the marketing loan and counter-cyclical payment programs resulting in an increase in world prices of only 1.41 percent over baseline levels over the period MY 2002-2005 and of only 0.96 percent over the period MY 2006-2008. Using long-run values for supply and demand elasticities, complete removal of the two programs would only show an increase in world prices of 2.26 percent over the period MY 2002-2005 and 1.52 percent over the period MY2006-2008.³¹⁷ Even though the U.S. estimates were overstated given the structural flaws in Brazil’s model for which the United States was unable to adjust, the magnitude of the price suppression as demonstrated by the U.S. adjustments to the Brazilian model could hardly be called “significant.”³¹⁸

239. The Panel never determined which model or models were appropriate, and merely found that “all the simulations conducted by the parties support the view that US marketing loan and counter-cyclical payments have led to an increase in US production and exports of cotton that have then suppressed world prices,” and “[took] note of the fact that price suppression has been the outcome of all the simulation results whether one uses the parameter values proposed by Brazil or the FAPRI and ATPSM parameter values proposed by the United States.”³¹⁹ The results of the modeling were cited in support of the Panel’s finding of “significant” price suppression.³²⁰

³¹⁷These estimates were far below the 9 to 11 percent estimated by Brazil.

³¹⁸U.S. Opening Statement, para. 85; Statement of Dr. Joseph W. Glauber, paras. 12-13; U.S. Answer to Panel Question 32, para. 34.

³¹⁹Panel Report, paras. 10.222.

³²⁰Panel Report, paras. 10.251, 10.254.

240. The Panel’s reliance on the results of the U.S. re-calibrated model to justify a finding of significant price suppression is untenable. The U.S. modeling exercise (which, for purposes of argument, accepted Brazil’s model structure and corrected for Brazil’s distortions to that model) did not show any significant price effects due to marketing loan and counter-cyclical payments. The Panel, however, misrepresented and distorted the results of the U.S. econometric modeling exercise to fit its own version of what the facts demonstrated. It ignored the inherent flaws in Brazil’s model that the United States had demonstrated, and disregarded that, in view of the totality of the evidence on serious prejudice, neither model could support a finding of significant price suppression.

4. Non-Attribution Analysis

241. Reviewing Article 6.3(c) of the SCM Agreement, the Appellate Body found that “it is necessary to ensure that the effects of other factors on prices are not improperly attributed to the challenged subsidies.”³²¹ The Panel therefore was required to undertake a non-attribution analysis by examining the world upland cotton market, actual world market prices, and the factors observed to be affecting U.S. and foreign supply and demand, and ultimately, world prices.

242. The United States submitted substantial evidence explaining that China is one of the most important “other” factors influencing the world price of upland cotton.³²² This evidence showed that China is the world’s largest producer of upland cotton, the world’s largest consumer of

³²¹*Upland Cotton (AB)*, para. 437; *see also Korea – Commercial Vessels (Panel)*, paras. 7.617-7.618.

³²²U.S. First Written Submission, paras. 308-18; U.S. Rebuttal Submission, paras. 387-96; *see also* Part IV.B.4, *supra*, for more in-depth discussion of the U.S. evidence concerning China.

upland cotton, and the world’s largest importer of upland cotton.³²³ The evidence also demonstrated China’s role in influencing world marketing prices, including the fact that downward pressure on cotton prices may have resulted from uncertainty over China’s supply and demand statistics, as well as *ad hoc* changes to government policies.³²⁴

243. The Panel, despite the ample evidence on the record concerning China, concluded that it was “not necessary in this respect to undertake a comprehensive evaluation of factors affecting the world market price for upland cotton.”³²⁵ The Panel superficially acknowledged that China had a “significant role,” but ignored completely, and never took into account, the U.S. evidence showing the price changes in the world upland cotton market that could be attributed to that factor. Instead, the Panel fell back on its erroneous argument that “with a share of world exports of around 40 per cent, the United States is capable of exerting a substantial proportionate influence on the world market.”³²⁶ The Panel failed to provide a reasoned and adequate explanation for its conclusions in the light of an alternative plausible explanation. Its deliberate disregard for evidence highly relevant to the non-attribution analysis only confirms its failure to undertake an objective assessment of the matter before it, as required under Article 11.

E. The Panel’s Finding that the United States Failed to Comply with its Obligations Under Article 7.8 of the SCM Agreement “to Take Appropriate Steps to Remove the Adverse Effects or . . . Withdraw the Subsidy” Cannot Stand

³²³Cotton: Review of the World Situation, ICAC (May-June 2006) (Exhibit BRA-485).

³²⁴U.S. First Written Submission, paras. 314-317; *see also* U.S. First Written Submission, paras. 309-13.

³²⁵Panel Report, para. 10.243.

³²⁶Panel Report, para. 10.243.

244. The Panel found that “[t]he United States acts inconsistently with its obligations under Articles 5(c) and 6.3(c) of the *SCM Agreement* in that the effect of marketing loan and counter-cyclical payments provided to US upland cotton producers pursuant to the FSRI Act of 2002 is significant price suppression within the meaning of Article 6.3(c) of the *SCM Agreement* in the world market for upland cotton constituting ‘present’ serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*.”³²⁷ The Panel then concluded that “[b]y acting inconsistently with Articles 5(c) and 6.3(c) of the *SCM Agreement* the United States has failed to comply with the DSB recommendations and rulings. Specifically, the United States has failed to comply with its obligation under Article 7.8 of the *SCM Agreement* ‘to take appropriate steps to remove the adverse effects or. ..withdraw the subsidy.’”³²⁸

245. As an initial matter, the United States has demonstrated that the marketing loan and counter-cyclical payments made after September 21, 2005 were not within the scope of the Article 21.5 proceeding.³²⁹ Therefore, the Panel should never have reached Brazil’s “present” serious prejudice claims concerning those payments.

246. Even aside from the fact that the Panel lacked jurisdiction to examine the serious prejudice claims, the United States has shown in this submission that the Panel’s finding of significant price suppression, constituting “present” serious prejudice, fails as a matter of law. Consequently, the Panel’s finding as to non-compliance by the United States with the DSB’s recommendations rulings and recommendations relating to the original panel’s finding of

³²⁷Panel Report, para. 15.1(a).

³²⁸Panel Report, para. 15.1(a).

³²⁹See Part II.B, *supra*.

inconsistency with Articles 5 and 6 of the SCM Agreement, based exclusively on the Panel’s finding of “present” serious prejudice, cannot stand.

V. Conclusion

247. For the reasons set out above, the United States respectfully asks the Appellate Body to find that:

- (1) the Panel’s legal conclusion that Brazil’s claims relating to GSM 102 export credit guarantees for exports of pig meat and poultry meat were within the scope of this proceeding under Article 21.5 of the DSU is in error;³³⁰
- (2) the Panel’s legal conclusion that Brazil’s claim that the United States failed to comply with its obligation under Article 7.8 of the SCM Agreement with respect to marketing loan payments and counter-cyclical payments made by the United States after September 21, 2005 was properly before the Panel is in error;³³¹
- (3) the Panel’s legal conclusion that as to GSM 102 export credit guarantees issued after July 1, 2005, the United States acted inconsistently with Article 10.1 of the *Agreement on Agriculture* by applying export subsidies in a manner which resulted in the circumvention of U.S. export subsidy commitments with respect to unscheduled products and certain scheduled products (rice, pig meat, poultry meat), and as a result acted inconsistently with Article 8 of the *Agreement on Agriculture*, is in error;³³²

³³⁰See, e.g., Panel Report, paras. 9.20-9.27.

³³¹See, e.g., Panel Report, paras. 9.75-9.81.

³³²See, e.g., Panel Report, paras. 14.89, 14.97, 14.110, 14.115, 14.120, 14.128-14.129, 14.131, 14.133(a)-(c), 14.134, 14.140, 14.149, 15.1(c).

- (4) the Panel’s legal conclusion that the United States acted inconsistently with Articles 3.1(a) and 3.2 of the SCM Agreement by providing export subsidies to unscheduled products and by providing export subsidies to scheduled products (rice, pig meat, poultry meat) in excess of U.S. commitments under the *Agreement on Agriculture* is in error;³³³
- (5) the Panel failed to make “an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements” as required by Article 11 of the DSU with respect to Brazil’s claims that the GSM 102 export credit guarantees constituted prohibited export subsidies, including the following:
- (a) the Panel disregarded and misconstrued the import of the GSM 102 export credit guarantee budgetary re-estimates data submitted by the United States;³³⁴ and
- (b) when conducting its analysis under item (j) of the Illustrative List of Export Subsidies to the SCM Agreement, the Panel relied upon assumptions not supported by evidence on the record³³⁵ and on inappropriate comparisons of fees;³³⁶
- (6) the Panel’s legal conclusion that the United States failed to comply with the DSB’s rulings and recommendations relating to the original panel’s findings of inconsistency with Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of

³³³See, e.g., Panel Report, paras. 14.156, 15.1(c).

³³⁴See, e.g., Panel Report, paras. 14.80-14.81.

³³⁵See, e.g., Panel Report, paras. 14.101, 14.125, 14.129

³³⁶See, e.g., Panel Report, paras. 14.94-14.103, 14.124-14.128, 14.129-14.131.

- the SCM Agreement is in error;³³⁷
- (7) the Panel’s legal conclusion that the United States acted inconsistently with its obligations under Articles 5(c) and 6.3(c) of the SCM Agreement in that the effect of marketing loan and counter-cyclical payments provided to U.S. upland cotton producers after September 21, 2005 was significant price suppression within the meaning of Article 6.3(c) of the SCM Agreement in the world market for upland cotton constituting “present” serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the SCM Agreement is in error;³³⁸
- (8) the Panel failed to make “an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements” as required by Article 11 of the DSU with respect to Brazil’s claims of present serious prejudice, including, for example, the following:
- (a) the Panel disregarded and misconstrued evidence on the record concerning the structure, design, and operation of marketing loan and counter-cyclical payments;³³⁹
- (b) the Panel disregarded and misconstrued evidence on the record and its own finding that the U.S. share of world upland cotton production and exports was

³³⁷See, e.g., Panel Report, paras. 14.150, 14.157, 15.1(c), 15.2.

³³⁸See, e.g., Panel Report, paras. 10.50, 10.58, 10.104, 10.111, 10.196, 10.222, 10.231, 10.239, 10.243, 10.247-10.256, 15.1(a).

³³⁹See, e.g., Panel Report, paras. 10.61-10.82, 10.92-10.95.

stable over MY 2002-2005;³⁴⁰

- (c) the Panel misconstrued the results of U.S. econometric modeling concerning the effect of U.S. marketing loan and counter-cyclical payments on the world price for upland cotton;³⁴¹
 - (d) the Panel disregarded evidence relevant to ensuring that the effect of other factors on upland cotton prices was not improperly attributed to U.S. marketing loan and counter-cyclical payments,³⁴² and
- (9) the Panel’s legal conclusion that the United States failed to comply with the DSB’s rulings and recommendations related to the original panel’s findings of inconsistency with Articles 5 and 6 of the SCM Agreement is in error.³⁴³

248. The United States respectfully requests the Appellate Body to reverse these legal conclusions and findings by the Panel.

³⁴⁰See, e.g., Panel Report, paras. 10.127, 10.251.

³⁴¹See, e.g., Panel Report, paras. 10.221-10.222, 10.251.

³⁴²See, e.g., Panel Report, para. 10.243.

³⁴³See, e.g., Panel Report, paras. 10.257, 15.1(a), 15.2-15.3.