UNITED STATES – SUBSIDIES ON UPLAND COTTON:

Recourse to Article 21.5 of the DSU by Brazil

(WT/DS267)

Answers of the United States of America
to the Second Set of Questions from the Panel

April 2, 2007

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1. The United States submits below responses to the Panel's questions directed at either both parties or the United States alone. Before turning to those questions, the United States notes that important new data has become available since the meeting with the Panel providing even further support for the U.S. arguments that marketing loan and counter-cyclical payments do not "numb" the planting decisions of the U.S. farmers. As the Panel may recall, in the meeting with the Panel, the United States submitted the recently-issued survey of MY 2007 upland cotton planting intentions, showing that U.S. producers intended to pull back on their upland cotton plantings in MY 2007 by approximately 14 percent in response to such factors as the relatively more attractive prices for corn and the poor performance of U.S. exports since August 2006 (at which time the Step 2 program was eliminated). This evidence clearly contradicted Brazil's claims that U.S. farmers do not respond to market signals and continue to plant upland cotton in situations where – without marketing loan and counter-cyclical payments – they would not do so.

2. Brazil has attempted to dismiss this evidence asserting that "[i]f marketing loan and CCP subsidies did not exist, and if U.S. cotton farmers would have to react to market price signals, far more than 14 percent of cotton acreage predicted by the NCC would switch to substitute crops."[1] Brazil has not substantiated that assertion, nor explained how a projected 14 percent year-over-year decline in planted acreage is consistent with the proposition that U.S. cotton farmers' planting decisions are numbed and do not react to market signals. Moreover, recent data published by USDA show that, in fact, "far more than 14 percent of cotton acreage" is projected to switch to other crops in the upcoming crop year. According to the "Prospective Plantings" report published by the National Agricultural Statistics Service ("NASS") based on surveys conducted by USDA in the first two weeks of March from a sample of more than 86,000 farm operators across the United States, "upland cotton acreage is expected to total 11.9 million, ***down 21 percent from last year and the lowest since 1989***."[2] The magnitude of the acreage shift is even more remarkable when one considers regional responses. According to the NASS report, "due to the increased demand and higher prices of crops used for bio-fuels," acreage is expected to decline dramatically ***in every single area in which upland cotton is grown***. These shifts are so substantial that, in many cases, planted acreage is at historically low levels; levels lower than they were in years well before either the marketing loan or counter-cyclical payments came into effect:[3]

- Upland growers in the Delta States (Arkansas, Louisiana, Mississippi, Missouri, and Tennessee) are expecting the largest decrease in acreage. Producers intend to plant 2.91 million acres, ***a 31 percent decrease from the previous year***.

- Farmers in Mississippi expect to plant 740,000 acres, ***40 percent less than last year and the lowest acreage since 1983***.

- In Louisiana producers intend to plant 380,000 acres, ***the lowest since 1975***.

[1] Oral Statement of Brazil, para. 73.

[2] NASS Prospective Plantings Report, p. 1 (March 30, 2007) (Exhibit US-140).

[3] *See* NASS Prospective Plantings Report, pp. 28-29 (March 30, 2007) (Exhibit US-140).

- In the Southeastern States (Alabama, Florida, Georgia, North Carolina, South Carolina, and Virginia) growers intend to plant 2.55 million acres, ***a decrease of 24 percent from last year***.

- The planted area in North Carolina is expected to decline 570,000 acres, ***34 percent less than 2006***.

- Producers in Texas, Oklahoma, Kansas, and New Mexico intend to plant 6.01 million acres, ***a 13 percent decrease from last year***.

- Texas producers expect to plant 5.70 million acres, ***down 700,000 acres from last year***.

- Upland planted acreage in California and Arizona is expected to total 390,000 acres, ***down 18 percent from last year***.

- California producers intend to plant 210,000 acres, ***the lowest since USDA began tracking upland cotton acreage intentions in 1941***.

3. In other words, there is no longer any question of "*if* U.S. cotton farmers would have to react to market price signals." The evidence proves definitively that, even under Brazil's arguments, U.S. cotton farmers *do* react to market price signals and other planting and production signals (such as considerations of weather, pests, and good agronomic practices). This is a matter of fact. And no amount of econometric gymnastics performed by Brazil for purposes of this proceeding – which appears, increasingly, to be the main evidentiary basis for its claims – detracts from it.

4. As a large number of the Panel's questions deal with the question of the effect of marketing loan and counter-cyclical payments on plantings, production and exports, the above data are particularly important in reviewing the U.S. and Brazilian responses.

A. SCOPE OF THIS PROCEEDING

Questions to both parties

44. The European Communities argues in respect of the preliminary objection raised by the United States regarding the claims of Brazil relating to export credit guarantees for pig meat and poultry meat under the GSM 102 programme that "the important issue is the nexus or the degree of interrelatedness or interdependence between different elements of the measure." (Oral Statement of the European Communities, para. 6) The European Communities submits in this regard that:

> ***" the Panel should examine the original measure at issue and the 'measures taken to comply,' and, with particular reference to the 'elements of the measure' that the United States argues are outside the Panel's terms of reference, enquire into the extent to which these are interrelated or interdependent with measures or 'elements of measures' that the United States accepts are within the Panel's terms of reference." (Oral Statement of the European Communities, para. 11)***

Do the parties agree with the approach suggested by the European Communities and with the considerations in paragraph 13 of the Oral Statement of the European Communities?

1. The United States does not agree with the approach suggested by the European Communities. Nor does the United States agree that the "factors" listed in paragraphs 13 of the EC Oral Statement support expanding the scope of this proceeding to include GSM 102 export credit guarantees provided for exports of pig meat and poultry meat.

2. The scope of matters that are properly reviewed in an Article 21.5 proceeding are established by Article 21.5 of the DSU. That Article provides that:

> Where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures. . . .

3. Two things about this language indicate the proper approach to determining the measures that are properly within the scope of an Article 21.5 proceeding:

- First, the text provides for dispute settlement procedures for the resolution of disagreements regarding "measures taken to comply *with the recommendations and rulings* [of the DSB]."

- And, second, the text does *not* provide for "measures taken to comply with the recommendations and rulings" of the DSB *and any other "interrelated" or "interdependent" measures*.

4. By the terms of Article 21.5, the touchstone for determining what is a "measure taken to comply" is *the recommendations and rulings* of the DSB. It is these recommendations and rulings that – necessarily and logically – drive what measures are taken to comply and, thus,

what measures are properly the subject of a "compliance" proceeding under Article 21.5 of the DSU. Considerations of "interrelatedness" or "interdependence" may be implicated in resolving as a factual matter *what the measure taken to comply is* in a particular dispute. However, the "interrelatedness" or "interdependence" that is relevant in that context is between elements of the *new* measure taken to comply (e.g., *EC – Bed Linen (21.5)*)[4] or multiple *new* measures that may not all be declared by a responding Member as being taken to comply with the DSB's recommendations and rulings but nonetheless are properly deemed measures taken to comply given the particular recommendations and rulings in the original proceeding and the facts of the dispute (e.g., *Softwood Lumber (21.5), Australia Leather II (21.5)*, and *Australia – Salmon (21.5)*).[5]

5. Moreover, it is not "interrelatedness" or "interdependence" in the abstract that is important but, rather, such a connection *vis-a-vis the DSB's recommendations and rulings*. Thus, if the DSB's recommendations and rulings distinguish between different elements of a measure or different measures then that distinction is determinative for purposes of the compliance proceeding as well. There is no fresh test of "interrelatedness" or "interdependence" applied under Article 21.5 of the DSU such as the one the European Communities now espouses that would allow *any measure* deemed to be "interrelated" or "interdependent" with a measure taken to comply to be swept into the scope of a compliance proceeding.

6. In the present dispute, the DSB's recommendations and rulings clearly distinguish "export credit guarantees under the GSM 102, GSM 103 and SCGP export credit guarantee programmes . . . *in respect of exports of upland cotton and other unscheduled agricultural products supported under the programmes, and in respect of one scheduled product (rice)*"[6] from other export credit guarantees under those programs. This is because the original panel

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[4] In *EC – Bed Linen (21.5)* a question raised was whether all elements of the new dumping redetermination on imports from India should be considered part of one indivisible measure such that even those elements that had not changed since the original proceeding and had not been subject to any recommendations and rulings therein should be subject to renewed challenge in the Article 21.5 proceeding. The Appellate Body explained that:

> we are of the view that the investigating authorities of the European Communities were not required to change the determination as it related to the "effects of other factors" in this particular dispute. Moreover, we do not see why that part of the redetermination that merely incorporates elements of the original determination on "other factors" would constitute an inseparable element of a measure taken to comply with the DSB rulings in the original dispute. Indeed, the investigating authorities of the European Communities were able to treat this element separately. Therefore, we do not agree with India that the redetermination can only be considered "as a whole new measure."

EC – Bed Linen (AB), para. 86.

[5] The *Australia – Salmon (21.5)*, *Australia – Leather (21.5)*, and *U.S. – Softwood Lumber IV (21.5)* disputes all dealt with situations in which two new measures were taken close in time – one that was declared to achieve compliance – and another that the complaining party alleged "undid" the compliance achieve by the first. In those disputes, the panels assessed the connectedness of the new measures to determine whether they should both be considered "measures taken to comply" such that compliance is examined by reference to both.

[6] *Upland Cotton (Panel)*, para. 8.1(d) (emphasis added).

found that Brazil had only made its case under Articles 10.1 and 8 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement* with respect to export credit guarantees provided in respect of exports of rice and unscheduled products.[7]

7. By contrast, the original panel found that "[i]t has not been established . . . that such actual circumvention has resulted in respect of the twelve other United States scheduled commodities."[8] According to the original panel, "in these circumstances, and as Brazil has also not made a *prima facie* case before this Panel that the programmes do not conform fully to the provisions of Part V of the Agreement on Agriculture, this Panel must treat them as if they are exempt from actions based on Article XVI of the GATT 1994 and Article 3 of the SCM Agreement in this dispute."[9]

8. Whether one understands the original panel's finding to have been made with respect to *guarantees* or the export credit guarantee *programs* that provided for the guarantees, what is indisputable is that the original panel *drew a clear distinction* between some of the measures (or aspects of measures) and others. And as a result of that distinction, neither all export credit guarantees (nor the entirety of the programs) were subject to findings of WTO-inconsistency or to the DSB's recommendations and rulings on their basis. Put another way, the original panel and Appellate Body did not consider export credit guarantees in respect of exports of pig meat, poultry meat, or any of the other twelve scheduled products to be so "interrelated" to, or "interdependent" with, export credit guarantees in respect of unscheduled products and rice that they found themselves unable to make separate findings of WTO-consistency with respect to the two. The original panel and Appellate Body did not consider the two to be so "interrelated" or "interdependent" that the same *implementation obligations* had to be extended to both. Indeed, Brazil does not contest the fact that "there is no adopted finding that the original GSM 102 program is applied in a manner that circumvents the United States' commitments with respect to pig meat and poultry meat."[10] Moreover, Brazil admits that "[d]uring implementation, the United States could have taken steps to amend the GSM 102 program exclusively with respect to the terms and conditions applicable to rice and unscheduled products."[11]

9. In short, the original panel distinguished between the different guarantees, the DSB's recommendations and rulings distinguished between the different guarantees, and the U.S. obligations only applied to – and could have been implemented by – action only with respect to certain of the guarantees. Under these conditions, there is no reason why all guarantees under the GSM 102 program – or the program itself – must be considered one "indivisible" measure for purposes of this compliance proceeding as the European Communities has suggested.

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[7] *Upland Cotton (Panel)*, para. 8.1(d).

[8] *Upland Cotton (Panel)*, para. 7.881.

[9] *Upland Cotton (Panel)*, para. 8.1(d)(ii).

[10] Brazil Responses to Panel Section A-C Questions, para. 14 (February 26, 2007).

[11] Brazil Responses to Panel Section A-C Questions, para. 15 (February 26, 2007).

10. Moreover, this is true regardless of the fact that the United States chose to make the same improvements vis-a-vis all guarantees under the program. The European Communities' own arguments in *EC – Bed Linen (21.5)* – and the compliance panel's adoption of those arguments and the resulting DSB rulings – are instructive on this issue. In that dispute, the original panel made – and the Appellate Body upheld – a finding that the European Communities acted inconsistently with the *AD Agreement* by, *inter alia*, "determining the existence of margins of dumping on the basis of a methodology incorporating the practice of zeroing."[12] The European Communities was asked to bring the measure at issue – a dumping order on imports of bed linens from India – into conformity with its obligations under the *AD Agreement*.[13] Although the only measure subject to the recommendations and rulings was the order as it applied to Indian imports, the European Communities chose to make a redetermination of dumping, without applying any "methodology incorporating the practice of zeroing," with respect to all imports under the order, including imports from Pakistan and Egypt.[14] As a result of this redetermination, the European Communities found that imports from Pakistan and Egypt had not been dumped.[15] That, in turn, necessitated a reassessment of injury to determine whether imports of bed linens from India alone caused injury (and the EC found that they did).

11. In the Article 21.5 proceeding that followed, India challenged not only the redetermination of *dumping* with respect to imports from India but also the redetermination of *dumping* with respect to imports from Pakistan and Egypt as well as the redetermination of *injury* with respect to imports from India alone. India argued that these other redeterminations were so "closely connected to the Panel and Appellate Body reports in the original dispute" that they were properly within the scope of the Article 21.5 proceeding.[16] The European Communities disagreed, arguing that "[n]ot all the measures that are somehow 'connected' to the measure in dispute in the original panel proceedings qualify as measures 'taken to comply.'"[17] According to the European Communities:

> The EC considers that *since there were no rulings by the DSB concerning the anti-dumping measures against imports from Egypt and Pakistan, there was nothing for the EC to "comply" with, and no obligation to undertake any reassessment of the original findings*. Therefore, the EC maintains that Regulation 160/2002 [(redetermination of dumping with respect to imports from

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[12] *EC – Bed Linen (Panel)*, para. 7.2(g).

[13] *EC – Bed Linen (Panel)*, para. 7.5; *see also EC – Bed Linen (AB)*, para. 86(1) ("upholds the finding of the Panel in paragraph 6.119 of the Panel Report that the practice of "zeroing" when establishing "the existence of margins of dumping", as applied by the European Communities in the anti-dumping investigation at issue in this dispute, is inconsistent with Article 2.4.2 of the Anti-Dumping Agreement.")

[14] *EC – Bed Linen (Panel)*, para. 6.9-6.10.

[15] *EC – Bed Linen (Panel)*, para. 6.9-6.10.

[16] *EC – Bed Linen (Panel)*, para. 6.12.

[17] *EC – Bed Linen (Panel)*, Annex D-3 (Oral Statement of the European Communities, para. 5 (September 10, 2002)).

> Pakistan and Egypt)] *cannot be considered as a measure "taken to comply" within the meaning of Article 21.5*. Similarly, the EC asserts that the injury redetermination in Regulation 696/2002 was *rendered necessary by the decision of the EC authorities to re-examine the findings of dumping for Pakistan and Egypt, which decision was not itself a measure "taken to comply" with the DSB's recommendation*. Thus, the EC asserts this measure was also *independent*, and *not a measure "taken to comply."* In the EC's view, *India's claims against these two measures can only be heard in the context of a new dispute*.[18]

12. The panel agreed with the European Communities. It noted that:

> [N]either the Panel nor the Appellate Body found any violation with respect to the anti-dumping measures concerning imports from Egypt or Pakistan. As a consequence, the DSB's rulings cannot have touched upon these anti-dumping measures. Nor could the DSB have recommended that the EC bring into conformity with its obligations measures as to which there was no finding of violation. Thus, the EC was under no legal obligation to do anything with respect to the anti-dumping measures on imports from Egypt and Pakistan.
>
> *The EC chose, at its own volition, to open the determinations of dumping with respect to imports from Egypt and Pakistan so as to apply to those determinations the conclusion of the adopted Reports finding the practice of "zeroing" to be inconsistent with the AD Agreement. While this decision on the part of the EC may have been prudent, and is commendable, it was not required by the DSB's recommendation in the original dispute, which was to bring the measure at issue, viz., the antidumping measure on imports of bed linen from India, into conformity with the EC's obligations under the AD Agreement*.[19]

13. The Panel found, on this basis, that the redetermination of dumping for imports from Egypt and Pakistan were not properly the subject of the Article 21.5 proceeding. Further, even though the redetermination of injury applied in respect of imports from India, the panel found that it was not within the scope of the proceeding because it was not alleged to "*undo* the compliance effectuated by the [measure asserted to be taken to comply (*i.e.,* the redetermination of dumping with respect to imports from India)]."[20] In this way, the panel distinguished the facts of *EC – Bed Linen (21.5)* as being "fundamentally different"[21] from the facts of *Australia – Leather (21.5)*, in which "the complaining Member . . . argued that Australia had taken two measures, the first of which was purported to implement the DSB's ruling, while the second

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[18] *EC – Bed Linen (Panel)*, para. 6.11.

[19] *EC – Bed Linen (Panel)*, para. 6.18-6.19 (emphasis added).

[20] *EC – Bed Linen (Panel)*, para. 6.21.

[21] *EC – Bed Linen (Panel)*, para. 6.16.

measure undid the purported compliance."[22] While the *Australia – Leather (21.5)* panel considered that it was appropriate to deem the second new measure a "measure taken to comply" under the circumstances of that dispute, the same reasoning did not apply under the facts of *EC – Bed Linen (21.5)*.

14. The analysis in *EC – Bed Linen (21.5)* confirms that there is no blanket test of "connectedness" or "interrelatedness" that applies in Article 21.5 proceedings. Moreover, the mere fact that improvements have been made to more than just the original measures subject to findings of WTO-inconsistency and DSB recommendations and rulings does not render all changed measures "measures taken to comply." Where the improvements are made to measures that were in existence at the time of the original panel proceeding and that were nonetheless not subject to any DSB recommendations and rulings, the compliance proceeding must respect the fact that the DSB's recommendations and rulings do not apply to the measures.

15. Here, if the United States had not made any changes with respect to guarantees for exports of pig meat and poultry meat, Brazil could not – in the European Communities' words – "have requested an Article 21.5 panel to complain about the absence of implementation measures."[23] The right to make such a complaint does not arise merely because the United States decided not to wall off those guarantees from all other guarantees in applying the positive changes it was making to bring the other guarantees into compliance with the DSB's recommendations and rulings with respect to the latter. That just means that the United States went *beyond* its implementation obligations. Voluntary improvements such as these by Members are "prudent" and, in the view of the *EC – Bed Linen (21.5)* panel, "commendable."[24] They do not transform all measures subject to the changes into measures taken to comply with the recommendations and rulings of the DSB.[25]

16. Finally, the United States notes that the European Communities references *U.S. – Softwood Lumber IV (21.5)* in connection with its arguments. However, the facts and reasoning of *U.S. – Softwood Lumber IV (21.5)* are inapposite. Indeed, *U.S. – Softwood Lumber IV (21.5)* simply built on the reasoning in *Australia – Leather II (21.5)* and *Australia – Salmon (21.5)* in clarifying when the scope of a compliance proceeding may be expanded to include a new measure that is issued at approximately the same time as the one declared to be the measure taken to comply and that is alleged to "undo" the compliance achieved by the declared "measure taken to comply."[26] Because *EC – Bed Linen (21.5)* did not involve any such situation, the *EC –*

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[22] *EC – Bed Linen (Panel)*, para. 6.16. The panel similarly distinguished *Australia – Salmon (21.5)*, which also involved two measures, one notified to the DSB and another not so notified that might have undermined the measure taken to comply.

[23] *EC – Bed Linen (Panel)*, Annex D-3 (Oral Statement of the European Communities, para. 9 (September 10, 2002)).

[24] *EC – Bed Linen (Panel)*, para. 6.18-6.19 (emphasis added).

[25] *EC – Bed Linen (Panel)*, para. 6.18-6.19 (emphasis added).

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

Bed Linen (21.5) panel found the facts before it to be "fundamentally different" from the facts in *Australia – Leather II (21.5)* and *Australia – Salmon (21.5)* and declined to apply the reasoning from those disputes. Precisely the same factual difference exists here between the facts of this dispute and those in *U.S. – Softwood Lumber IV (21.5)*.

45. Could the parties comment on the observations made by the European Communities in paras. 15-24 of its Oral Statement on the issue of whether the marketing loan and counter-cyclical payment programmes are within the scope of the Panel's proceeding?

17. The United States disagrees with a number of the European Communities' observations in paragraph 15-24 of its oral statement.

(1) There is no basis for the European Communities' suggestion that statutory/regulatory provisions authorizing payments and individual payments thereunder can be conflated "for the purposes of a compliance panel" if the statutory/regulatory provisions set out the conditions under which payments are to be made.

18. The United States disagrees with the European Communities' suggestion that where "entitlement to payment is conditional . . . only upon certain essentially factual requirements, essentially in the hands of the recipient" the distinction between the statutory/regulatory provisions authorizing the payments and particular payments thereunder "may be less clear" than in other circumstances, "and there may be a degree of nexus or interrelatedness of interdependence between the (for example, fiscal) programme and payments under it, such as might justify their treatment as indivisible for the purposes of a compliance proceeding."[27] Moreover, the United States considers that the suggestion has no application here.

19. First, the present situation is not one in which "entitlement to payment is conditional . . . only upon certain essentially factual requirements, essentially in the hands of the recipient."[28] Payments under the Step 2, marketing loan, and counter-cyclical payment programs are conditional upon, *inter alia*, certain price conditions prevailing. Whether or not these price conditions prevail is *not* a matter within the hands of any potential recipients. In fact, the recipients cannot even know whether they will, in fact, receive such payments at the time that planting decisions must be made. Thus, the European Communities' suggestion that it is permissible to conflate the statutory and regulatory provisions authorizing payments and the payments themselves where "entitlement to payment is conditional . . . only upon certain essentially factual requirements, essentially in the hands of the recipient"[29] simply has no application here.

[27] Oral Statement of the European Communities, para. 19.

[28] Oral Statement of the European Communities, para. 19.

[29] Oral Statement of the European Communities, para. 19.

20. Second, even leaving aside the lack of relevance, the premise that a compliance panel may conflate two distinct measures – the statutory and regulatory provisions authorizing payments and the payments themselves – where the former set out particular circumstances in which the payments are to be made is arbitrary and without basis.[30] Not surprisingly, the European Communities does not provide a single citation to support this assertion. It identifies no provision of the WTO agreement that justifies it. Nor does the European Communities articulate any rationale that would support simply disregarding in the asserted circumstances that the statutory and regulatory framework authorizing payments and particular payments made thereunder are distinct measures *as a matter of fact*.

21. The distinction between "a measure of general and prospective application" – the epitome of which is a statutory/regulatory provision – and individual instances of its application is well-established in WTO dispute settlement. Indeed, the European Communities acknowledges that very distinction.[31] The United States is not aware of any basis in the DSU or in WTO dispute settlement practice for the suggestion that statutory/regulatory provisions cease to be measures distinct from individual instances of their application *solely because of what the statutory/regulatory provisions say*.

22. A statutory or regulatory provision does not cease to be "a measure of general and prospective application" if it identifies conditions under which payments are to be made. And the considerations that underpin the distinction between such measures and particular instances of their application are no less applicable in those circumstances.

23. Specifically, where a complaining Member challenges statutory/regulatory provisions and other measures of general and prospective application themselves, they "by definition" assert:

> that a Member's conduct—not only in a particular instance that has occurred, but in future situations as well—*will necessarily be inconsistent with that Member's WTO obligations*. In essence, complaining parties bringing "as such" challenges seek to prevent Members *ex ante* from engaging in certain conduct. The implications of such challenges are obviously more far-reaching than "as applied" claims.[32]

Because of this, the Appellate Body underscored the "seriousness" of as such claims against

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[30] Oral Statement of the European Communities, para. 19.

[31] Oral Statement of the European Communities, para. 17 ("[t]he European Communities agrees with the United States that there is a distinction between a subsidy programme within the meaning of the *SCM Agreement* (which may be a measure at issue) and instances of a subsidy under such programme (each of which may also be a measure at issue). . . .These measures should not normally be conflated.")

[32] *U.S. – Oil Country Tubular Goods from Argentina (AB)*, para. 172 (emphasis added).

measures of general and prospective application.[33]

24. The European Communities has provided no reason why challenges to statutory/regulatory provisions should be considered any *less* serious, or any *less* far-reaching than "as applied" claims if the provisions set out particular conditions under which payments are to be made. This is especially true where, as here, the asserted WTO-inconsistency relates to the *effects* of subsidies under specific market conditions. The fact that particular payments may have caused adverse effects under the particular market conditions prevailing in one marketing year, does not necessarily mean that if payments are made "in future situations . . . [they] will necessarily be inconsistent with that Member's WTO obligations."[34] While a Member is certainly free to argue that will be the case, if it does so, the complaining Member bears the burden of proving its claims. This is no different in a situation where a statute sets out the conditions when payments are to be made.

25. Indeed, Brazil's arguments confirmed precisely this point in the original proceeding. There, in the case of its "as such" challenge to the provisions of the 2002 FSRI Act and the 2000 ARP Act providing for Step 2, marketing loan, and counter-cyclical payments, Brazil argued that:

> [T]he Panel needs to evaluate whether the U.S. subsidies will *necessarily threaten to cause serious prejudice* at price levels below the trigger prices of the U.S. subsidies. Second, the Panel needs to consider whether the U.S. subsidies *threaten to cause serious prejudice even at price levels at which only crop insurance subsidies and direct payments are made*."[35]

Moreover, Brazil asked the Panel "to find that the mandatory provisions of the 2002 FSRI Act and the 2000 ARP Act together with their implementing regulations, as listed above, *cannot be applied in a WTO consistent manner*."[36]

26. In addition, the EC has provided no reason why the well-established distinction between the statutory/regulatory provisions providing for payments and particular payments provided thereunder is any less important "for the purposes of a compliance panel." In *U.S. – Countervailing Measures on Certain EC Products*, the panel articulated succinctly the limited purpose of "compliance" proceedings pursuant to Article 21.5 of the DSU: "[t]he purpose of Article 21.5 is to provide an expeditious procedure to establish whether a Member has properly

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[33] *U.S. – Oil Country Tubular Goods from Argentina (AB)*, para. 172.

[34] *U.S. – Oil Country Tubular Goods from Argentina (AB)*, para. 172 (emphasis added).

[35] Brazil Further Submission, para. 426 (9 September 2003) (emphasis added).

[36] Brazil Further Submission, para. 435-436 (9 September 2003) (emphasis added). As the Panel declined to address Brazil's claims against the "2002 FSRI Act and the 2000 ARP Act together with their implementing regulations," however, the Panel neither conducted the requested evaluations, nor made any findings along the lines requested by Brazil.

implemented the DSB recommendations and rulings."[37] Moreover, it noted many of the attendant limitations on the applicable procedures:

> [T]here is no provision for a "reasonable period" to implement the ruling in an Article 21.5 dispute. Thus, an Article 21.5 panel ruling . . . may immediately give rise to rights for compensation or suspension of concessions under Article 22 DSU. Moreover, the parties do not have the same opportunity to present evidence and arguments in Article 21.5 proceedings. [I]mportant facts and issues . . . [may] continue[] to surface quite late into the Article 21.5 proceedings, proceedings that are already abbreviated. . . . Finally, the shorter timeline significantly limits both the panel's opportunity to interact with the parties and the panel's time to deliberate. The panel typically has only one opportunity to meet with the parties, unlike the normal proceedings where two substantive meetings take place.[38]

27. It is precisely in these circumstances that *maintaining* the well-established distinction between the statutory/regulatory provisions providing for payments and particular payments provided thereunder would seem all the *more* important, especially given the seriousness of "as such" claims underscored by the Appellate Body in *U.S. – Oil Country Tubular Goods from Argentina*.[39]

28. Third, the European Communities' arguments are again based on the untenable premise that there is a blanket test of "interrelatedness" or "interdependence" under Article 21.5 of the DSU such that even measures not found to be WTO-inconsistent in an original proceeding may nonetheless be swept into the scope of an Article 21.5 proceeding if they nonetheless are deemed to be "interrelated" to, or "interdependent" with, the measures found to be WTO-inconsistent. As discussed above, that premise is unfounded. In the European Communities' own words in a dispute in which it was the responding party, "[n]ot all the measures that are somehow 'connected' to the measure in dispute in the original panel proceedings qualify as measures 'taken to comply.'"[40]

29. The EC's new assertion of a blanket "interrelatedness" or "interdependence" test is not only unfounded, it makes little sense, especially in the context of this dispute. The EC has not offered any reason why a measure should be considered "indivisible" from another "for purposes of a compliance panel" where the measures were not "indivisible" for purposes of an original proceeding. Indeed, this was a critical consideration in resolving a second scope question in *EC – Bed Linen (21.5)*. There the Appellate Body rejected an attempt by India to have the scope of

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[37] *U.S. – Countervailing Measures on Certain EC Products (Panel)*, para. 7.74. This panel report was not appealed.

[38] *U.S. – Countervailing Measures on Certain EC Products (Panel)*, para. 7.75, n. 294.

[39] *U.S. – Oil Country Tubular Goods from Argentina (AB)*, para. 172.

[40] *EC – Bed Linen (Panel)*, Annex D-3 (Oral Statement of the European Communities, para. 5 (September 10, 2002)).

an Article 21.5 proceeding expanded to include an element of a measure taken to comply (the "other factors" analysis in an antidumping redetermination) that was identical to an element that had been found to be WTO-consistent in an original measure. India argued that the element was an inseparable part of the measure taken to comply. But the Appellate Body disagreed, explaining that "we do not see why that part of the redetermination that merely incorporates elements of the original determination on 'other factors' would constitute an inseparable element of a measure taken to comply with the DSB ruling in the original dispute. *Indeed, the investigating authorities were able to treat this element separately*."[41] Similarly here, Brazil, the United States, and the original panel all were able to treat the statutory/regulatory provisions providing for payments separately from particular payments thereunder in the original proceeding. There is no reason why those measures should be treated as inseparable in this compliance proceeding.

(2) There is no basis to the EC's argument that "if there is sufficient *nexus* between payments and programme for one programme; and if there is sufficient *nexus* between all payments; this in turn suggests a sufficient *nexus* between all three programs, such that the whole new bundle can and should be treated as indivisible for the purposes of this compliance proceeding."[42]

30. The United States disagrees with EC's argument that "if there is sufficient *nexus* between payments and programme for one programme; and if there is sufficient *nexus* between all payments; this in turn suggests a sufficient *nexus* between all three programs, such that the whole new bundle can and should be treated as indivisible for the purposes of this compliance proceeding."[43]

31. First, the EC argument again assumes incorrectly that original measures never found to be WTO-inconsistent may be within the scope of an Article 21.5 proceeding simply because they are deemed to have some "nexus" either with original measures or measures taken to comply with recommendations and rulings of the DSB. This is patently incorrect, for the reasons discussed above. Indeed, the EC argument would effectively make Article 21.5 proceedings an "open season" for complaining parties to challenge measures "as such" that had either not been challenged or had been challenged unsuccessfully in original proceedings. There will *always* be a "nexus" between statutory and regulatory provisions and individual instances in which they are applied. If the EC argument were credited, a complaining party could simply challenge one instance of the application of a statutory/regulatory provision in an original proceeding and save any claims against the statutory/regulatory provisions themselves until a compliance proceeding where "there is no provision for a 'reasonable period,'" and "the parties do not have the same

[41] *EC – Bed Linen (AB) (21.5 – India)*, para. 86.

[42] Oral Statement of the European Communities, para. 21.

[43] Oral Statement of the European Communities, para. 21.

opportunity to present evidence and arguments" as in an original proceeding.[44] The negotiators of the DSU never agreed that compliance proceedings could be used (some could argue "abused") in this way.

32. Second, the fact that the original panel cumulated the effects of the Step 2, marketing loan, and counter-cyclical payments made in MY 1999-2002 in assessing whether they caused "present" significant price suppression does not mean that those measures became one "indivisible" measure for purposes of WTO dispute settlement. That argument bears no connection to reality. Payments under the three programs are distinct measures as a matter of fact and as a matter of WTO dispute settlement, regardless of whether their effects can be added together in assessing whether there is sufficient "price suppression" to meet the standard of "significant price suppression" for purposes of Article 6.3(c) of the *SCM Agreement*.

33. Third, the unreasonableness of the approach suggested by the European Communities here is especially apparent when one considers that the European Communities argued – successfully – in *EC – Bed Linen (21.5)* that an analysis of "other factors" did not share a sufficient "nexus" with the other parts of the *same* determination to be deemed one "indivisible" measure. In other words, even though they were all part of a *single* antidumping redetermination that was part of a *single* EC regulation involving imports of bed linens from India and formed an integral and necessary basis for the imposition of a *single* antidumping order, the EC argued (and the panel agreed) the "other factors" analysis should not be considered an "inseparable" part of the redetermination. Yet, here, for some reason, the European Communities suggests that entirely distinct payments made to entirely different recipients under entirely different conditions and under entirely different statutory/regulatory provisions must somehow be considered one indivisible measure for purposes of this compliance proceeding simply because their effects were examined cumulatively in the original dispute. The United States submits that this is an entirely untenable argument.

34. Moreover, the Appellate Body has clarified that the "measure" identified as being subject to WTO claims cannot "vary depending on the substance of the legal provision invoked by a complainant and the interpretation that a panel might give to that provision."[45] The European Communities' suggestion that what is a "measure" depends on how effects were examined for purposes of Articles 5(c) and 6.3(c) of the *SCM Agreement* is not consistent with the Appellate Body's clarification and should be rejected on that basis as well.

(3) The European Communities is mistaken in its suggestion that the United States has argued that "the fact that something has not changed . . . necessarily means that it is outside the scope of a compliance proceeding."[46]

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[44] *U.S. – Countervailing Measures on Certain EC Products (Panel)*, para. 7.75, n. 294.

[45] *EC – Customs (AB)*, para. 132.

[46] Oral Statement of the European Communities, para. 22.

35. The European Communities appears to misunderstand the U.S. arguments. The United States has never suggested that "the fact that something has not changed necessarily means that it is outside the scope of a compliance proceeding."[47] The United States fully agrees that where the "something" that "has not changed" is a measure that was subject to DSB recommendations and rulings, it is possible – although not always – that a compliance proceeding could determine that no measure taken to comply exists.

36. The United States has simply argued that where a measure is *not* one that was subject to DSB recommendations and rulings, and where it is *not* a measure taken to comply (*evidence* of which is the fact that it has not changed), that measure is not properly within the scope of a compliance proceeding.

(4) The European Communities' argument that "claims of present serious prejudice and *threat* of serious prejudice are closely interrelated, such that a threat claim in an original panel may inevitably give rise to a claim of present serious prejudice in a compliance panel"[48] is illogical.

37. The United States notes a number of flaws in the European Communities' argument that:

> Finally, and *significantly*, the European Communities observes that there is support in the case law for the view that claims of present serious prejudice and *threat* of serious prejudice are closely interrelated, such that a threat claim in an original panel may inevitably give rise to a claim of present serious prejudice in a compliance panel.[49]

38. First, despite the asserted "significance" of the point, the European Communities fails even to identify the alleged "support in the case law."[50] Indeed, there is not a single citation provided by the European Communities; the point is entirely unsupported.

39. Second, this assertion is not logical. The *claims* that a Member makes in an original proceeding do not limit the *claims* that it makes in a compliance proceeding so long as, in the compliance proceeding, the claims apply with respect to a measure taken to comply. In contrast, if there are no measures taken to comply then only one claim is available – that no measures taken to comply exist.

40. Here, the marketing loan program and counter-cyclical payment programs are not original measures subject to any finding of WTO-inconsistency. "As a consequence," in the

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[47] Oral Statement of the European Communities, para. 22.

[48] Oral Statement of the European Communities, para. 23.

[49] Oral Statement of the European Communities, para. 23.

[50] This is aside from the fact that there is no such thing in the WTO as "case law." The WTO is not a common law system.

words of the *EC – Bed Linen (21.5)* panel, "the DSB's rulings cannot have touched upon these [programs]. Nor could the DSB have recommended that the [United States] bring into conformity with its obligations measures as to which there was no finding of violation. Thus, the [United States] was under no legal obligation to do anything with respect to the [marketing loan program and counter-cyclical payment programs]."[51] In these circumstances, there is obviously no basis for Brazil to claim that the United States failed to bring those measures into conformity with any (non-existent) DSB recommendations and rulings.

41. Moreover, the marketing loan program and counter-cyclical payment programs are not measures taken to comply with any recommendations and rulings in respect of *other* measures (*i.e.,* measures that *were* found to be WTO-inconsistent). The Appellate Body has explained before that "[i]n our view, the phrase 'measures taken to comply' refers to measures which have been, or which should be, *adopted by a Member to bring about compliance with the recommendations and rulings of the DSB*."[52] Neither the marketing loan program, nor the counter-cyclical payment program, nor any marketing loan payments or counter-cyclical payments, nor some combination of these measures was "adopted by [the United States] to bring about compliance with the recommendations and rulings of the DSB." In fact, these measures were in existence and were even at issue in the original proceeding. And, as Brazil acknowledges, they have not been changed since that proceeding to implement any DSB recommendations and rulings or for any other reason.[53] Thus, under the express terms of Article 21.5 of the DSU, those measures cannot be the subject of any claims of inconsistency "with a covered agreement" – whether or "present" serious prejudice, "threat" of serious prejudice or anything else – in this compliance proceeding.

46. In its Oral Statement, the European Communities characterizes Brazil's and the United States' respective approaches as the "measure model" and the "element of the measure model" (Oral Statement of the European Communities, para. 7). Please discuss whether you agree with this characterization and whether, in your view, the application of a measure alleged to be a subsidy to different agricultural products relates to a "measure" (or elements thereof) or if, rather it relates to a "claim". Would it be permissible for a compliance panel to examine a "claim" that relates to subsidies (granted as part of measures taken to comply) provided to agricultural products to which the "initial measure" did not apply?

42. With respect to the first of the Panel's questions, the United States does not agree with the European Communities regarding the characterization of the parties' views, the appropriateness of framing the question of the scope of Article 21.5 proceedings through an elaborate construct of "models" that is not found anywhere in the text (but instead has been made

[51] *EC – Bed Linen (Panel)*, para. 6.18-6.19 (emphasis added).

[52] *Canada – Aircraft (AB) (21.5 – Brazil)*, para. 36.

[53] Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 35.

up by the EC for purposes of this proceeding), or the necessity of any such construct in resolving the question of whether or not GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat are within the scope of this proceeding.

43. The United States recalls that the Members have expressly agreed in Article 3.2 of the DSU that the WTO dispute settlement system "serves to preserve the rights and obligations of Members under the covered agreements, and to *clarify the existing provisions of those agreements* in accordance with customary rules of interpretation of public international law." The United States does not see "element of measure model," "measure model" or any other similar language in Article 21.5 of the DSU. What the United States does find, instead, is the following language, which identifies both the measures that are properly within the scope of Article 21.5 proceedings and the claims that can be made therein:

> Where there is disagreement as to the existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings such dispute shall be decided through recourse to these dispute settlement procedures. . . .

44. This language makes clear that only measures "taken to comply" with the recommendations and rulings of the DSB are properly before a compliance panel. Where the DSB's recommendations and rulings are limited to particular things – regardless of whether those things are measures or elements of a measure – it follows that the focus of a compliance proceeding is whether those things have been brought into compliance consistently with the DSB's recommendations and rulings and with the provisions of the WTO Agreement cited by the complaining party. There can be no presumption that the responding Member's measures taken to comply are inconsistent with its WTO obligations; the burden is on the complaining party to prove inconsistency.

45. Applying that logic in the present dispute, the same result obtains whether one understands GSM 102 guarantees as elements of the GSM 102 program or as individual measures themselves; the latter being the correct understanding, in the U.S. view for the reasons explained previously.[54] In either case, the fact is that the original panel found that Brazil had only established its case with respect to export credit guarantees in respect of exports of rice and unscheduled products.[55] Neither the original panel nor the Appellate Body found that Brazil had proven its case with respect to guarantees provided in respect of the twelve other scheduled products (export credit guarantees in respect of exports of wheat, coarse grains, vegetable oils, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, pigmeat, poultry meat, live dairy cattle, or eggs).[56] As the original panel clearly distinguished between these different guarantees, there is no basis for either ignoring the fact that it did so or suggesting

[54] U.S. Comments on Brazil's Answers to First Set of Panel Questions, paras. 9-17.

[55] *Upland Cotton (Panel)*, para. 8.1(d)(i).

[56] *Upland Cotton (Panel)*, para. 8.1(d)(ii).

that no such distinction can be drawn in this compliance proceeding. Indeed, given the abbreviated and expedited nature of compliance proceedings, discussed above, it is all the more important that Brazil not be permitted to eliminate such distinctions here.

46. Turning to the Panel's second question – whether "the application of a measure alleged to be a subsidy to different agricultural products relates to a 'measure' (or elements thereof) or if, rather it relates to a 'claim'" – the United States considers that the fact that a measure is applied to particular products (or is applied generally to all products) is necessarily relevant to understanding the *nature* and *scope* of the measure. However, it may *also* be relevant in assessing the particular claim being made. In the case of Brazil's claims against the export credit guarantees, it was relevant to both. Consider the following examples:

- Section 1207 of the Farm Security and Rural Insurance Act ("FSRI Act") of 2002 – the Step 2 program – that Brazil challenged, as such, for providing prohibited export and import substitution subsidies in the original proceeding was limited by its terms only to upland cotton.[57] This fact was relevant to understanding the nature and scope of the measure being challenged in the original proceeding. However, the fact that Section 1207 applied with respect to upland cotton was not an important consideration in assessing the prohibited subsidy claims that Brazil made.

- By contrast, Sections 1201-1205 of the 2002 FSRI Act – the marketing loan program – provides for non-recourse loans and loan deficiency payments with respect to a number of different products.[58] Brazil challenged separately (a) the provisions themselves to the extent that they applied to upland cotton and (b) individual instances of their application (payments made in MY 1999-2002 and payments allegedly "mandated" to be made in MY 2003-2007). The particular product to which the measure applied was important, in both cases, in understanding the nature and scope of the measure(s) challenged.

  However, the fact that Section 1201-1205 applied with respect to upland cotton was also relevant to the *claims* made by Brazil under Articles 5 and 6 of the *SCM Agreement* because the claims required the identification of a "subsidized product" and an examination of the effects of payments under the programs on the "subsidized product."[59] Brazil could only prevail on its claims against these measures if it could show the requisite effects with respect to the "subsidized product."

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[57] *See* 2002 Farm Security and Rural Investment Act (Exhibit BRA-29).

[58] *See* 2002 Farm Security and Rural Investment Act (Exhibit BRA-29). The United States does not include the counter-cyclical payment program in this discussion because it does not provide for payments in respect of any particular product. It simply authorizes payments in respect of historical base acres.

[59] *See* Articles 6.3(c) and 6.3(d) of the *SCM Agreement*.

- Similarly, Section 202 of the Agricultural Trade Act of 1978 allows the Commodity Credit Corporation ("CCC") to guarantee the "repayment of credit made available to finance commercial export sales of agricultural commodities."[60] To avoid the application of the mandatory-discretionary principle – which would have been fatal to any "as such" claim given that these provisions clearly do not even mandate the provision of guarantees, let alone the provision of *export subsidies* – Brazil argued that its claims of actual circumvention under the *Agreement on Agriculture* were "akin to . . . 'as applied' claim[s]" with respect to the export credit guarantees.[61] However, Brazil did not initially limit its challenge to the provision of guarantees to any subset of eligible products. The original panel therefore considered whether Brazil had proven its claims of circumvention with respect to *all* guarantees in respect of *all* eligible products.

  Nonetheless, Brazil was only *successful* in proving that the provision of export credit guarantees to exports of rice and unscheduled products resulted in actual circumvention under the *Agreement on Agriculture* or in breach of any obligations under the *SCM Agreement*. Therefore, the products to which the guarantees applied were important in defining the scope of measures that were subject to any finding of WTO-inconsistency, DSB recommendations and rulings, or any implementation obligation on the part of the United States. This is no different, for example, than if Brazil had challenged, under Articles 5 and 6 of the *SCM Agreement*, the marketing loan program not only as it applied to upland cotton but all other products eligible for payments thereunder. If, in those circumstances, it had been able to make its case only in respect of upland cotton, that fact would have been important in understanding both the scope of U.S. implementation obligations and the scope of measures taken to comply. The same is true in the case of the export credit guarantees.

47. This brings us to the third question presented by the Panel – whether it would be "permissible for a compliance panel to examine a 'claim' that relates to subsidies (granted as part of measures taken to comply) provided to agricultural products to which the 'initial measure' did not apply." The United States recalls, again, that by the very terms of Article 21.5, the touchstone of any analysis of "measures taken to comply" is the recommendations and rulings of the DSB and the consideration of whether or not a challenged measure is properly understood to have been "taken to comply" with those recommendations and rulings. The Panel's question appears to assume that critical consideration since it asks whether subsidies that are "part of measures taken to comply" may be subject to claims in a compliance proceeding. It is difficult – in the abstract – to conceive of why a Member would comply with DSB

[60] 7 U.S.C. 5622 (Exhibit US-141). *See also*, implementing regulations in 7 C.F.R. 1493 (Exhibit US-142), which maintain the same product scope.

[61] Brazil's Answers to Additional Questions Following Second Panel Meeting, paras. 11, 37 (20 January 2004).

recommendations and rulings relating to subsidies provided to one product by providing subsidies in respect of other products.

48. That is, in any event, an entirely different situation than the one before this Panel. Here, Section 202 of the Agricultural Trade Act of 1978[62] and its implementing regulations permit guarantees to be made to the exact same group of agricultural products as before. The question is whether the United States – through the various changes it has made – has brought into conformity with the DSB's recommendations and rulings and with any provisions of covered agreements cited by Brazil those guarantees that were found to have been provided in a WTO-inconsistent manner by the original panel. The guarantees provided in respect of exports of pig meat and poultry meat are not measures taken to comply with any recommendations and rulings of the DSB, nor are they part of any measures taken to comply with any recommendations and rulings of the DSB.[63]

Questions to the United States

> ***47. The United States has raised a preliminary objection regarding Brazil's claims of (threat of) serious prejudice in respect of the marketing loan and counter-cyclical payment programmes. Is the Panel's understanding correct that, apart from this preliminary objection regarding programmes, the United States also considers that the issue of whether payments made under the marketing loan and counter-cyclical payment programme after 21 September 2005 cause serious prejudice to the interests of Brazil is not properly within the scope of this proceeding?***

49. Yes. As depicted in the chart below, the original panel (a) made a finding of "present" serious prejudice only with respect to payments made under the Step 2, marketing loan and counter-cyclical payment program in MY 1999-2002; (b) declined to make any finding of "threat" of serious prejudice with respect to payments allegedly "mandated" to be made in MY 2003-2007; and (c) declined to make any find of "threat" of serious prejudice with respect to the Step 2, marketing loan, and counter-cyclical payment programs themselves (which would have implicated *all* payments under the programs). In these circumstances, the only measures subject to any finding of WTO-inconsistency, and DSB recommendations and rulings based thereon, or any implementation obligations were payments made under the Step 2, marketing loan and counter-cyclical payment program in MY 1999-2002 (*i.e.,* through July 31, 2003). Thus, unless Brazil were to establish that payments made after September 21, 2005 were measures taken to comply with the recommendations and rulings of the DSB – and, for the reasons explained in the U.S. comments on Brazil's response to Question 15 in the first set of questions from the Panel,

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[62] 7 U.S.C. 5622 (Exhibit US-141).

[63] As discussed above, the mere fact that they were subjected to the same improvements as the guarantees that were subject to the DSB's recommendations and rulings do not render them measures taken to comply or elements of any measures taken to comply.

the United States does not consider that Brazil has presented any basis to make such a finding – those payments are not properly within the scope of this Article 21.5 proceeding.

Measure Challenged	Claim Made	Resolution by Original Panel	Paragraph in Panel Report
"U.S. subsidies provided during MY 1999-2002"	"Present" serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*	**Finding** of WTO-inconsistency against Step 2, marketing loan, and counter-cyclical/market loss assistance programs	7.1416 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 *prima facie* 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, *inter alia*, because of finding of inconsistency with Articles 5(c) and 6.3(c) of the *SCM Agreement*	7.1476
"U.S. subsidies" allegedly "mandated" to be provided during MY 2003-2007	"Threat" of serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*	**Declined** to address in light of finding of inconsistency with Articles 5(c) and 6.3(c) and 3.1(a) and 3.2 of the *SCM Agreement*	7.1503
"U.S. subsidies" allegedly "mandated" to be provided during MY 2002-2007	"Threat" of serious prejudice under Articles 5(c) and 6.3(d) of the *SCM Agreement*	**Rejected** for failure to make *prima facie* case	7.1504
"U.S. subsidies" allegedly "mandated" to be provided during MY 2003-2007	"Threat" of serious prejudice under Articles XVI:1 and XVI:3 of the GATT 1994	**Declined** to address, *inter alia*, because of finding of inconsistency with Articles 5(c) and 6.3(c) of the *SCM Agreement*	7.1505
"selected provisions of the FSRI Act of 2002 and the ARP Act of 2000"	"Threat" of serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*	**Declined** to address in light of findings regarding export subsidies, import subsidies, "present" serious prejudice, and "threat" of serious prejudice	7.1511
"selected provisions of the FSRI Act of 2002 and the ARP Act of 2000"	"Threat" of serious prejudice under Articles 5(c) and 6.3(d) of the *SCM Agreement*	Same as above	7.1511
"selected provisions of the FSRI Act of 2002 and the ARP Act of 2000"	"Threat" of serious prejudice under Articles XVI:1 and XVI:3 of the GATT 1994	Same as above	7.1511

48. How does the United States address the argument of Brazil that "[i]f the United States were to prevail on its view that subsequent mandatory and price-contingent marketing loan and CCP payments are not properly before this Panel, the grant of annual recurring subsidies becomes 'a moving target that

escape from [the WTO subsidy] disciplines'"? (Closing Statement of Brazil, para. 4)

50. As the United States explained in its comments on Brazil's response to Question 15 in the first set of questions from the Panel, the United States does not consider this to be a valid argument. Under the reasoning of the original panel, nothing prevents Members from challenging present adverse effects of past or current payments, threat of serious prejudice of past, current, or future payments, or present adverse effects or threat of serious prejudice from payment programs as such. Indeed, Brazil availed itself of many of those opportunities in the present dispute. The obligations of a responding Member depend on what the outcome is of those challenges. Where, as here, a complaining Member only *prevails* on one claim – that of "present" serious prejudice with respect to particular payments made in particular years – the Member is bound by that outcome. The complaining Member cannot seek to avoid that outcome either through *post hoc* attempts to rewrite the original panel report, or by complaining that its remedy is more limited that it would have been had the original panel's findings of WTO-inconsistency been made with respect to a different and broader set of measures.

51. Nor is this a situation where Brazil had no remedy under the original panel's findings. Brazil has itself expressly recognized otherwise. Before the Appellate Body, Brazil argued that subsidies provided in MY1999-2002 must be found to be capable of having "present" effects at the time of the appeal (*i.e.,* in late 2004 to 2005) in order for it to have any remedy in the dispute. Brazil argued, specifically, that if the U.S. arguments to the contrary were credited "Brazil will have no remedy under Article 7.8 of the SCM Agreement for its serious prejudice, since it is allegedly legally impossible for the MY 2002 price-contingent recurring subsidies to have any adverse effects after 31 July 2003 (the close of MY 2002)."[64] The Appellate Body agreed, finding that "the effects of a 'recurring' subsidy may continue after the year in which it is paid."[65]

52. Under Brazil's own arguments, then, it would have had "a remedy under Article 7.8 of the SCM Agreement for its serious prejudice" even in years after the MY 1999-2002 subsidies were provided. This not only confirms that the U.S. measures were not, in fact, "a moving target" but that Brazil specifically understood the limited scope of the original panel's findings. Had the findings been with respect to the programs themselves and/or all future payments as Brazil alleges, there would have been no basis for Brazil to allege that "Brazil will have no remedy under Article 7.8 of the SCM Agreement for its serious prejudice" since the findings of serious prejudice found by the original panel would have extended beyond MY 2002 to all times in the future in which Step 2, marketing loan, and counter-cyclical payments were to be made.

53. At the same time, it is clear that claims of serious prejudice under the SCM Agreement have a temporal scope. This is established by the text of the agreement, for example the

[64] *Upland Cotton (AB)*, para. 529.

[65] *Upland Cotton (AB)*, para. 484.

distinction between present and "threat of" serious prejudice. The fact that the negotiators specifically agreed on obligations that have a temporal scope means that a Member is not free in dispute settlement proceedings to complain that the temporal scope constrains their remedies.

49. Could the United States comment on the argument of the European Communities that the text of Article 21.5 of the DSU does not limit the temporal scope of that provision in the manner suggested by the United States? (para. 29 of the Oral Statement of the European Communities)

54. It is unclear from the oral statement of the European Communities what it means by "limit[ing] the temporal application [of Article 21.5] in the manner advocated by the United States."[66] In any event the European Communities' arguments do not appear to respond to the arguments that the United States has actually made.

55. Specifically, the United States has argued that Brazil has not identified any textual basis that requires the Panel to make findings regarding compliance as of the end of the six-month period set out in Article 7.9 of the *SCM Agreement* rather than as of the date of panel establishment pursuant to Article 21.5 of the DSU. Contrary to Brazil's suggestions, neither Article 21.5 of the DSU nor Article 7.9 of the *SCM Agreement* require this. Moreover, prior panels in *EC – Bed Linen (21.5)* and *U.S. – Shrimp (21.5)* have properly assessed compliance as of the date of establishment of the panel.

56. The European Communities' assertion that there is no temporal limitation in Article 21.5 of the DSU is, thus, fully consistent with the U.S. argument. Indeed, in *EC – Bed Linen (21.5)*, the European Communities made precisely this point, noting that the absence of a temporal limitation applicable to compliance proceeding *supported* its argument that "the relevant date for assessing the consistency of the measures 'taken to comply' with the covered agreements is the date of establishment of the panel, and not that of the end of the 'reasonable period of time.'"[67] Specifically, the European Communities argued there that:

> As noted by the panel in US – Shrimps (Article 21.5), "the DSU is silent as to the date on which the existence or consistency of the implementing measure must be assessed". The same panel went on to find that:
>
> > … it should take into account all the relevant facts occurring until the date the matter was referred to it. By applying this approach, an Article 21.5 panel can reach a decision that favours a prompt settlement of the dispute. Indeed, it avoids situations where implementing measures allowing for compliance with the DSB recommendations and rulings would be disregarded simply

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[66] Oral Statement of the European Communities, para. 29.

[67] *EC – Bed Linen (21.5)*, Annex A-2, First Written Submission of the European Communities, para. 35.

> because they occur after the end of the reasonable period of time. The Panel, while mindful of the obligation of the United States to bring its legislation into conformity by the end of the reasonable period of time, considers that it is consistent with the spirit of Article 3.3 of the DSU to take into account any relevant facts until the date on which the matter was referred to the Panel.

. . . .[T]he EC submits that the relevant date for assessing the consistency of the measures "taken to comply" with the covered agreements is the date of establishment of the panel, and not that of the end of the "reasonable period of time".

Of course, the EC is not suggesting that the implementing Member is under no obligation to implement the DSB's rulings and recommendations within the "reasonable period of time". That obligation, however, does not flow from Article 21.5, but instead from Article 21.3 of the DSU, which states in pertinent part that

> If it is impracticable to comply immediately with the recommendations and rulings, the Member concerned shall have a reasonable period to comply.

It is obvious, nevertheless, that a finding that a Member has violated Article 21.3 of the DSU by implementing late the DSB's recommendations and rulings would be necessarily declaratory, since there is nothing that such Member could do in order to correct that violation. In any event, as discussed below, in the present case India did not state in its panel request any claims based on Article 21.3 of the DSU.[68]

57. When India clarified in *EC – Bed Linen (21.5)* that it was looking for two findings – one regarding compliance as of the end of the reasonable period of time and one as of the date of establishment of the panel, the European Communities again forcefully argued that the former was not within the compliance panel's terms of reference:

> The EC has requested the Panel to make a ruling to the effect that the relevant date for assessing the consistency of the measures "taken to comply" with the covered agreements is the date of establishment of the Panel.
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> India agrees with that request. Nevertheless, it argues that, in addition, the Panel should assess the consistency of the measures "taken to comply" also as of the date of expiry of the "reasonable period of time".

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[68] *EC – Bed Linen (21.5)*, Annex A-2, First Written Submission of the European Communities, para. 34-37.

> India's request is not within the Panel's terms of reference. The obligation to comply within the "reasonable period of time" does not arise from Article 21.5, but from Article 21.3 of the DSU. Yet, India has not cited Article 21.3 in its panel request.
>
> In any event, the ruling requested by India would serve no useful purpose and would complicate unnecessarily the Panel's task. If the Panel found that the EC did not comply as of end of the 'reasonable period of time', but did so as of the date of establishment of the panel, there would be nothing else that the EC could do in order to remedy that temporary lack of compliance.
>
> . . . . While it may be true that no Member has ever invoked a violation of Article 21.3 in Article 21.5 proceedings, this does not prove that it is unnecessary to state that claim separately. Rather, it seems more likely that no Member has ever bothered to invoke a violation of Article 21.3 because a ruling that the implementing Member has complied late would be declaratory and devoid of practical consequences.[69]

58. In response to questions, the European Communities clarified its view that "the position expressed in paragraph 35 of the EC's First Written Submission" – *i.e.,* that "the relevant date for assessing the consistency of the measures 'taken to comply' with the covered agreements is the date of establishment of the panel, and not that of the end of the 'reasonable period of time'" – did not depend on the particular terms of reference of a panel but, rather, "is valid with respect to all Article 21.5 disputes."[70]

59. There is no basis for the European Communities to argue that the analysis should somehow be different here. In particular, the United States notes the European Communities' argument now that "whether or not Brazil's request would ever be capable of having any practical utility is a different matter that this Panel does not need to address, being essentially a matter for Brazil, exercising its judgement in good faith."[71] This would appear diametrically opposite to its argument that the panel in *EC – Bed Linen (21.5)* should review compliance as of the date of establishment because "the ruling requested by India would serve no useful purpose and would complicate unnecessarily the Panel's task. If the Panel found that the EC did not comply as of end of the 'reasonable period of time', but did so as of the date of establishment of the panel, there would be nothing else that the EC could do in order to remedy that temporary lack of compliance."[72]

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[69] *EC – Bed Linen (21.5)*, Annex D-3, Rebuttal Submission of the European Communities, paras. 12-19.

[70] *EC – Bed Linen (21.5)*, Annex E-3, Answers of the European Communities to Questions from India, para. 3.

[71] Oral Statement of the European Communities', para. 29.

[72] *EC – Bed Linen (21.5)*, Annex D-3, Rebuttal Submission of the European Communities, paras. 18.

60. While the European Communities' position may differ depending on whether or not its own measures are at issue, the fact remains that the panel in *EC – Bed Linen (21.5)* considered the reasoning identified by the European Communities in *EC – Bed Linen (21.5)* to be persuasive and proper and applied it to dismiss India's request. The panel explained:

> It appears India considers that we must make two decisions on the existence or consistency of measures taken to comply – one as of the end of the reasonable period of time, and one as of the date of establishment of the Panel. We do not consider that it would be either necessary or appropriate, as a matter of judicial economy, to first examine whether compliance had occurred as of the end of the reasonable period of time, and second consider compliance as of the later date.[73]

61. This mirrored the reasoning of the *U.S. – Shrimp (21.5)* panel invoked by the European Communities and set out above. The United States recalls – and agrees with – the European Communities' argument that the reasoning underpinning this result "is valid with respect to all Article 21.5 disputes."[74] The same result is certainly valid here.

Question to Brazil

> ***50. Does Brazil maintain its claims with respect to the three unscheduled products (lyocell, lysine, wood products) identified by the United States as falling outside the scope of the Agreement on Agriculture? (see paragraph 83 of the United States' Rebuttal)***

B. CLAIMS OF BRAZIL REGARDING PRESENT SERIOUS PREJUDICE

1. Significant price suppression - Article 6.3(c) of the SCM Agreement

Questions to both parties

> ***51. The parties disagree on whether or not the marketing loan and counter-cyclical payments have more than minimal effects on production of upland cotton. Could each party explain how its approach to the analysis of the impact of these payments on production of upland cotton is supported by the provisions of Articles 5 and 6 of the SCM Agreement and by any other relevant WTO provisions?***

62. Brazil makes two claims of "present" serious prejudice under Article 5(c) of the *SCM Agreement*, one alleging significant price suppression under Article 6.3(c) and the other alleging

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[73] *EC – Bed Linen (Panel) (21.5 – India)*, para. 6.28.

[74] *EC – Bed Linen (21.5)*, Annex E-3, Answers of the European Communities to Questions from India, para. 3.

a comparative increase in world market share within the meaning of Article 6.3(d) of the *SCM Agreement*. In either case, the key consideration is what "the effect of the subsidy *is*" at present (i.e., for purposes of this dispute, MY 2006).[75] The use of the present tense -- "is" – is important not only because it helps to identify the proper period for examination of the effects but also confirms that the effects that are important are those that *exist* in *fact* – not any potential or speculated effects that may or may not arise under different market circumstances. "Is" means, *inter alia*, "that which exists, that which is; the fact or quality of existence."[76] "Is" comes from the verb "to be," which itself means, *inter alia*, "have place in the realm of fact, exist, live" "be the case or the fact; obtain."[77]

63. That the concern of Articles 6.3(c) and 6.3(d) is with "effects that exist in fact" is further confirmed by the ordinary meaning of "effect" which is, *inter alia*, "something accomplished, caused or produced; a result, a consequence" and "reality, fact as opp[osed] to appearance."[78] Thus, to prove its claims under Articles 5(c) and 6.3(c) or 6.3(d), Brazil's must show that the effects that exist in fact of marketing loan and counter-cyclical payments are either significant price suppression or an increase in world market share as, respectively, contemplated under those provisions.

64. Brazil has argued that effects of marketing loan and counter-cyclical payments on production of upland cotton are a key element of the alleged causal link between the payments and significant price suppression/increase in world market share. According to Brazil, marketing loan and counter-cyclical payments induce U.S. farmers to plant upland cotton in circumstances where, without (or "but for") the marketing loan and counter-cyclical payments they would not have done so. Brazil asserts that this allegedly subsidy-induced level of planting leads to overproduction, which leads to increased exports (under Brazil's theory pre-Panel meeting) – or unsold stocks (under Brazil's theory as of the Panel meeting) – and, ultimately, to the adverse effects with respect to price/market share claimed by Brazil.

65. To examine whether marketing loan and counter-cyclical payments have these alleged effects on the production of upland cotton, it is necessary to look at the particular decision matrix of U.S. producers and the factors that they *actually* consider as they decide whether and what to plant. Moreover, it is important to look at the way that the marketing loan and counter-cyclical payment programs *actually* operate and interact with production decisions. These considerations underpin the U.S. approach to examining the effects of marketing loan and counter-cyclical payments on production in this proceeding.

66. By the same token, the United States submits that for Brazil's arguments regarding

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[75] This was the marketing year in effect at the time this Panel was established on September 28, 2006. *See* Minutes of Meeting, para. 49 WT/DSB/M/220 (circulated November 2, 2006).

[76] *The New Shorter Oxford English Dictionary* at 1421, Volume 1, (1993 Edition) (Exhibit US-129).

[77] *The New Shorter Oxford English Dictionary* at 195, Volume 1, (1993 Edition) (Exhibit US-130).

[78] *The New Shorter Oxford English Dictionary* at 793, Volume 1, (2005 Edition) (Exhibit US-143).

planting decisions – to be given any weight – must be consistent with, at the very minimum, the basic facts of upland cotton production and with how the marketing loan and counter-cyclical payment programs operate. This means, for example, that the arguments cannot be inconsistent with the fact that in each year when a farmer sits down to decide whether to plant cotton, he does not *know*:

- whether the weather will cooperate and how much cotton will ultimately be produced, what the demand and consumption situation will look like at the time of harvest, and what price cotton will ultimately fetch on the market at harvest,

- what the supply, demand, and price situation will be for other competing crops,

- whether the adjusted world price (or "AWP") will be below 52 cents so that he might receive a marketing loan payment with respect to upland cotton that he decides to grow (or whether he might receive a marketing loan payment for a competing crop),

- what his variable costs will ultimately be if he decides to grow upland cotton (versus some other crop or versus putting his land to some other use), and

- (while it does not depend on whether he plants upland cotton or not) if the season-average farm price for the marketing year to come will ultimately be below the threshold at which he might receive a counter-cyclical payment with respect to any upland cotton or other crop *base acres* that he holds.

67. The farmer's planting decision *must* be made on the basis of *expectations* about, *inter alia*, weather, supply, demand, prices, government payments, and variable costs both with respect to upland cotton and competing crops. Whether or not his expectations ultimately turn out to be correct or incorrect is not a relevant factor in his planting decision; he cannot rewind time and make different production decisions based on how things *actually* turn out. Brazil has conceded this both in this proceeding,[79] and in the original proceeding.[80] Moreover, this is the

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[79] *See* Brazil First Written Submission, Annex I, para. 36 ("U.S. cotton producers respond to the *expected* prices and *expected* rates of subsidy that apply at the time planting and other key decisions are made in the production cycle") (emphasis added) and Brazil First Written Submission, Annex I, para. 58 ("[t]he magnitude of the impact on incentives to produce cotton is equal to the *expected* difference between the loan rate, which is known at planting time, and the grower's *expectations* at the time of planting about the AWP for cotton that will apply when the grower makes that marketing loan transaction.") (emphasis added). Brazil Further Submission, Annex I, para. 17-18.

[80] *US – Upland Cotton (AB)*, para. 440 ("Brazil counters that farmers decide what to plant based on expected market prices as well as expected payments under the challenged subsidy programs, such that planted acreage responds to both these factors.")

general approach underlying Brazil's modeling efforts both in this and the original proceeding.[81]

68. The United States has shown that much of the evidence and arguments presented by Brazil fails to withstand scrutiny when examined in the light of these basic facts of upland cotton production. For example:

- Brazil has repeatedly attempted to show effects on upland cotton production in MY 2006 (or MY 2005, under Brazil's preferred approach) based on the actual prices received and/or actual payments received in those years, effectively assuming that production decisions were made on the basis of facts that do not even materialize until many months after planting decisions are made;[82]

- Brazil has repeatedly ignored the fact that U.S. farmers consider net revenue, planting conditions and other relevant factors for competing crops vis-a-vis upland cotton – and not just such factors as they relate to upland cotton in isolation – in determining what to plant;[83]

- Brazil has repeatedly attempted to establish production effects with reference to actual levels of production in a particular year, which are affected substantially by factors entirely out of the farmer's control (such factors as pests, weather, and technological changes), rather than with respect to effects on planting (*i.e.,* the actual production decision within the hands of the farmer);[84]

- Brazil denies in the face of fact that the use of genetically-improved varieties in the United States and elsewhere have resulted in a dramatic increase in yields that has changed substantially the cost structure of upland cotton farmers in the United States and other countries (for example, India);[85]

- Brazil repeatedly attempts to frame production decisions by reference to costs other than the variable (or operating) costs actually considered by U.S. farmers in

[81] Brazil First Written Submission, Annex I, para. 4 ("U.S. producers respond to revenue they expect to receive from market prices and expected government subsidies, where relevant expectations are those that are held around the time that planting and other key production decisions are made. U.S. producers do not know with certainty what actual prices and subsidies will turn out to be as they unfold during the marketing year. Therefore, as in reality, the model assumes that actual prices or subsidies in a marketing year do not affect cotton growers' behavior in that marketing year.")

[82] *See e.g.*, Brazil First Written Submission, paras. 127, 144-145; Brazil Rebuttal Submission, para. 191; Oral Statement of Brazil, para. 31.

[83] *See e.g.*, Brazil First Written Submission, para. 142, Brazil Rebuttal Submission, paras. 221-224.

[84] *See e.g.*, Brazil First Written Submission, paras. 93, 96, 124.

[85] *See e.g.,* Brazil Comments on U.S. Oral Statement, para. 32.

their decision matrix;[86] and

- Brazil fails to take into account or distinguish in its analysis the effects on price that are the result of factors on the demand side of the economic balance, including, importantly, the influence of China's upland cotton trade on world market prices. These are effects confirmed by the very evidence Brazil submits, including a report by the International Cotton Advisory Committee ("ICAC") showing the strong correlation between Chinese supply and demand and the A-Index,[87] the fact that the A-Index itself has been changed to reflect the influence of Chinese trade on the upland cotton market, as well as market reports observing the role of China's trade in "prevent[ing] a significant price increase in 2005/2006."[88]

69. Brazil's theories about the allegedly significant effects that marketing loan and counter-cyclical payments are having on production, exports (or, under the latest theory, unsold stocks), and ultimately world market prices are divorced from reality and are, instead, heavily dependent on the modeling exercise it has commissioned precisely for the purposes of showing significant price effects. As the United States has shown, that modeling exercise is flawed in its structure and operation as well as in the parameters and assumptions upon which it rests.[89] Indeed, to get the most exaggerated results possible, Brazil has attempted to discredit its own earlier modeling as "unnecessarily complicated and cumbersome" and "not directly appropriate to the issue at hand."[90] Brazil has submitted in its stead a model that its own creator (Brazil's economist in this dispute) described as a "simple model" that "does not represent the depth of analysis that would be appropriate to support a trade remedy proceeding or a serious prejudice claim before a WTO panel."[91] Not only this but Brazil has systematically adjusted virtually each and every parameter in order to produce even greater impacts on production and prices than would have obtained had it used even the elasticities employed in its original modeling exercise (which were themselves often overstated).[92]

70. In short, the United States submits that although Brazil bears the burden of proof of

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[86] *See e.g.,* Brazil First Written Submission, paras. 159-164, Brazil Rebuttal Submission, paras.245-253, Oral Statement of Brazil, paras. 63-78.

[87] *See* ICAC "Review of the World Market Situation" for May-June 2006 at p. 8 (Exhibit BRA-485).

[88] U.S. First Written Submission, para. 315-316 (citing, for example, "Cotton: Review of the World Situation", International Cotton Advisory Committee at 7 (May-June 2006) (BRA-485)).

[89] U.S. First Written Submission, Annex I; U.S. Rebuttal Submission, Annex I, U.S. Oral Statement, Statement of Dr. Glauber.

[90] Brazil Rebuttal Submission, Annex I, para. 4.

[91] Daniel A. Sumner. "Boxed In: Conflicts Between U.S. Farm Policies and WTO Obligations." Center for Trade Policy Studies, The Cato Institute, December 2005. (Exhibit US-108)

[92] Of course, many of the elasticities in the model used for purposes of the original proceeding were already overstated.

proving its claims under Articles 5(c)/6.3(c) and 5(c)/6.3(d) of the *SCM Agreement*, it has failed to show that marketing loan and counter-cyclical payments are having the kind and degree of effects on planting and production that it has alleged. Under Brazil's own theory that is a critical first step in establishing a causal link between the payments and the adverse effects alleged to exist.

71. What the data do show – instead – is that for the entire period MY 2002-2007, U.S. cotton farmers expected to meet or exceed their variable costs of planting cotton. Moreover, compared to key competing crops, upland cotton was the most attractive option from the standpoint of costs and revenue in at least three of the years (MY 2003, MY 2004, and MY 2006). In two of the other three years (MY 2002 and 2007), where cotton was not the most attractive option, upland cotton plantings declined *substantially* consistent with the signals from the market. And in the single year (MY 2005) in which acreage shifts did not line up with the different relative attractiveness of cotton and competing crops, other factors were clearly responsible (most importantly, a shift away from soybean acreage due to concerns about an outbreak of Asian soybean rust at the end of MY 2004).[93] Thus, U.S. upland cotton farmers' planting decisions are entirely consistent with the decisions that they would have made had there been no marketing loan and counter-cyclical payments, and are fully consistent with both market signals and other planting and production considerations.

72. The fact that U.S. upland cotton production in these years was both economically rational and consistent with market and planting/production considerations is further confirmed by the fact that U.S. production has been generally stable as a percentage of world production throughout the entire period that U.S. marketing loan and counter-cyclical payments have been made and for a great many years before that as well. This evidence shows that – contrary to Brazil's assertions – marketing loan and counter-cyclical payments have not been inducing U.S. farmers to plant, produce, and export where market signals would cause their foreign counterparts to pull back. The stable share of U.S. production and exports over this period indicates that whatever signals the "world market" is sending, U.S. producers are receiving it clearly and responding to it in much the same way as their foreign counterparts.

73. The independent studies that the United States has submitted – which, unlike Brazil's modeling exercise, were not commissioned for the purposes of this proceeding – lends further support for the argument that the challenged payments are *not* having effects on production that are likely to lead to "significant" price suppression. These studies show, in particular, that counter-cyclical payments likely have minimal effects on acreage and hence production and that a substantial part of counter-cyclical payments paid are capitalized into higher land rents and land values. Moreover, data regarding the planted acreage and base acreage show that U.S. farmers do, in fact, use the planting flexibility afforded by the direct and counter-cyclical payment programs (indeed, even before the dramatic decline in expected cotton planted acres for the upcoming marketing year, the data show that U.S. cotton farmers holding cotton base acres

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[93] *See* U.S. Comments on Brazil's "Oral" Presentation, paras. 70-72.

are planting approximately *40 percent less* upland cotton than they planted at the time base acres were set). In addition, a significant – and growing percentage – of cotton is grown on farms that do not hold *any* upland cotton base acreage or on planted acreage that is in excess of the upland cotton base acreage held by a farm. That is, for these cotton farmers, there can be no link – even alleged – between cotton base counter-cyclical payments and upland cotton production because these farmers are growing cotton on acreage *beyond* any cotton base acreage.[94]

74. This data reinforces other evidence submitted by the United States; for example, data regarding cost of production shows that for most U.S. production (at least 92 percent) market revenue not only covers variable costs of production but also *all* costs of production. As discussed further below in response to Question 59, this is highly significant because the "total" costs of production reported by USDA include imputed economic opportunity costs. These are not even actual cash costs for many – if not most – upland cotton farmers and, thus, may not ever need to paid out. The data show, therefore, that the vast majority of U.S. farmers are not only able to meet their variable costs of producing upland cotton – the costs that are important from a short-run perspective – they are able to meet their total *cash* costs of producing upland cotton *and* they are able to meet economic opportunity costs that are, for the most part, not even real expenditures that need to be made in order for the farm to stay in business. When one considers this together with the fact that whole-farm decisions about whether or not to close down operations are made on the basis of whole-farm costs and revenue – not just the costs and revenue relating to individual crops – it is clear that U.S. upland cotton farming in the United States is an entirely economically rational business and one that does not depend on marketing loan and counter-cyclical payments for its continued financial viability.

75. Finally, consistent with the evidence before the Panel showing that marketing loan and counter-cyclical payments do not have the kind of "major" production enhancing effects that Brazil's claims assume, Brazil's own modeling exercise reflects minuscule price effects when the modeling parameters are re-adjusted to more realistic levels (that is, *even without* adjusting the model itself for the many fundamental flaws in its structure and operation). Any possible price suppression would only be in the range of 1 to 1.5 percent in the re-calibrated run of the Sumner II model for MY 2006-2008. Even though this result is overstated, it translates into a *less than one cent per pound* impact on world market prices at present A-Index levels.[95] Brazil has provided no evidence to establish that such an impact – exaggerated as it is – nonetheless constitutes "significant" price suppression of the world market price for upland cotton. Indeed, Brazil's approach would effectively equate *any* effect on prices with *significant* price suppression and, thereby, write "significant" out of Article 6.3 of the *SCM Agreement* altogether. Neither that approach – nor the specific arguments made by Brazil as to production effects – is supported by the text of Articles 5 and 6 of the *SCM Agreement*.

52. In its Third Party Submission New Zealand observes:

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[94] *See* U.S. First Written Submission, paras. 220-225; U.S. Rebuttal Submission, 263-266.

[95] The average A-Index for January 2007 was 60.44 cents/lb.

> ***"Marketing loan payments are amber box measures, the category in which are included the non-prohibited measures with the most trade distorting effect on production and trade." (para. 5.19)***

> ***Do the parties consider that the fact that under the Agreement on Agriculture a subsidy is included in the 'amber box' is relevant to the analysis of the subsidy's consistency with Articles 5 and 6 of the SCM Agreement?***

76. No. The fact that a measure is notified as an amber box measure does not indicate that it is causing adverse effects within the meaning of Article 5(c) of the *SCM Agreement*. The "amber box" is simply a catch-all category that refers to "domestic support measures in favour of agricultural producers" that do not fit within the so-called "green"[96] (measures that Members agree are non- or minimally-trade distorting) or "blue" (direct payments under production limiting programs) boxes.[97] While "amber box" measures may not meet all the requirements necessary to be deemed non- or minimally-trade distorting for purposes of the "boxes" set out in the *Agreement on Agriculture*, this does not mean that they are causing any of the adverse effects identified in Article 5 of the *SCM Agreement*.

77. To the contrary, the different effects discussed above simply serve to illustrate that there is a spectrum of effects that support measures may have, with no or minimal effects on one end of the spectrum and adverse effects on the other. Articles 5 and 6 of the *SCM Agreement* are only concerned with measures that are at the latter end of the spectrum. Those provisions are not concerned with the non- or minimally-trade distortive measures within the "green box," or with any "amber box" measures that – while they might have somewhat greater effects on trade than green box measures – are not causing any adverse effects within the meaning of Articles 5 and 6.

78. This spectrum of effects is a relevant consideration in assessing Brazil's claims that effectively *any* degree of price suppression must be considered to be "significant" price suppression for the purposes of the present dispute. Brazil's arguments ignore the fact that some amount of trade distortion is expected and tolerated for domestic support measures and that it is only when the trade distortion is found to rise to the level of *significant* price suppression, or one of the other adverse effects identified in Articles 5 and 6 the *SCM Agreement* that the obligation to either withdraw the measure or eliminate the adverse effects thereof arises under Article 7.8 of that agreement.

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[96] *See* Article 6.1 and Annex 2 of the *Agreement on Agriculture*.

[97] Article 6.5 of the *Agreement on Agriculture*. Certain reduction commitments apply to "amber box" measures unless they are covered by the *de minimis* or agricultural and rural development provisions of the *Agreement on Agriculture*. *See* Article 6.4 and 6.2 of the *Agreement on Agriculture*, respectively.

Questions to the United States

53. The United States argues that Brazil has not provided evidence of 'actual production inducing' effects of marketing loan and counter-cyclical payments and that Brazil 'purports to demonstrate indirect production effects through its claim that the US planting, production, and exports are not responsive to prices.' (Opening Statement of the United States at the meeting of the Panel with the parties, paras. 62 and 69, emphasis in original)

(a) Could the United States explain further the distinction between what it terms "actual production inducing effects "and "indirect production effects"? Could the United States also elaborate on how this distinction is legally relevant in the context of Articles 5 and 6 of the SCM Agreement?

79. The United States does not intend to draw a distinction between "actual production effects" and "indirect production effects." In the paragraphs of the U.S. Oral Statement listed above, the United States argues two different things.

80. First, the United States argues that Brazil's own theory of causation under Articles 5(c) and 6.3(c) – and the ordinary meaning of the treaty terms therein – require an examination of the *actual* effects that marketing loans and counter-cyclical payments are having on U.S. farmers' planting decisions.[98] In the U.S. view, this requires that any evidence be consistent with the fundamental facts of how planting/production decisions are made by upland cotton farmers. These facts are discussed above in response to Question 51. As discussed therein, much of the data that Brazil submits is *not* consistent with these facts and, thus, says little about the effects of marketing loan and counter-cyclical payments on U.S. farmers' planting decisions.

81. Second, the United States addresses Brazil's arguments that a link between payments under the marketing loan and allegedly artificially high U.S. planted acreage, production, and exports can be gleaned *indirectly* by what it has asserted is the *absence* of a "link" between "prices, on the one hand, and [U.S.] planted acreage, production, and exports, on the other hand. . . ."[99] According to Brazil's argument, if it can show that there is no link between prices for upland cotton and U.S. planting, production, and exports, this means that marketing loans and

[98] *See Upland Cotton (AB)*, para. 97 ("Brazil explains that United States upland cotton farmers base planting decisions on expected net returns, meaning expected market prices together with expected government support."); Brazil First Written Submission, Annex I, para. 36 ("U.S. cotton producers respond to the *expected* prices and *expected* rates of subsidy that apply at the time planting and other key decisions are made in the production cycle") (emphasis added) and Brazil First Written Submission, Annex I, para. 58 ("[t]he magnitude of the impact on incentives to produce cotton is equal to the *expected* difference between the loan rate, which is known at planting time, and the grower's *expectations* at the time of planting about the AWP for cotton that will apply when the grower makes that marketing loan transaction.") (emphasis added). Brazil Further Submission, Annex I, para. 17-18.

[99] Brazil First Written Submission, para. 145.

counter-cyclical payments must have somehow "insulated" U.S. producers' planting, production and exports from market signals. The United States submits that this reasoning is flawed at its inception because U.S. planting, production, and exports react to factors other than just the price of upland cotton (and, in terms of prices, respond to expected not actual prices). For example, as discussed above, the decision to plant upland cotton results from considerations including of expected net revenue for upland cotton *and competing crops*, expected planting and production conditions, and other such factors. It is, therefore, unrealistic to suggest that there should be a one-to-one link between upland cotton planting, production, and exports and upland cotton prices.

82. Moreover, the comparisons that Brazil has attempted to make to demonstrate the absence of a "link" are inconsistent with the very facts of upland cotton production discussed by the United States above. For example, recall that Brazil has argued that there is no link between U.S. upland cotton production in each year and U.S. farm prices. As the United States has explained this ignores the fact that (a) planting decisions cannot be explained through an examination of cotton prices alone, (b) U.S. farmers base planting decisions on expected not actual prices and (c) "producers do not decide on production, but on plantings. Ultimate production is affected by weather and other factors affecting yields."[100]

83. Indeed, the same alleged "absence" of a "link" between absolute production levels and prices is apparent when one compares foreign production to movements in the A-Index.[101] So, either all producers are cut off from market signals – applying Brazil's reasoning – or, in fact, the evidence submitted by Brazil does not in fact support its assertions of market insulation. The United States submits that the latter is the more logical conclusion.

84. Similarly, Brazil has also attempted to compare annual U.S. upland cotton export levels and the average farm price for the marketing year to show the alleged absence of a link between exports and prices. However, there again, Brazil's evidence ignores the reality – readily recognized by its own cotton industry outside this dispute – that U.S. exports have reacted to a dramatic decline in U.S. mill use and the contemporaneous increase in foreign consumption.[102] It is those market conditions, rather than marketing loan and counter-cyclical payments that explain U.S. export behavior in the years prior to the FSRI Act coming into effect. Since the Act came into effect, U.S. export behavior has been entirely consistent with that of foreign counterparts.

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[100] Brazil Appellee Brief, para. 706, n. 995.

[101] The United States uses the A-Index because the U.S. farm price is not the price for foreign-grown cotton. However, given that Brazil considers that there are "broad similarities" between the U.S. farm price and the A-Index, it presumably considers the comparison of U.S. and foreign production to the A-Index to be analogous to the comparison Brazil makes above between U.S. production and farm prices. Brazil First Written Submission, para. 97.

[102] *See e.g.,* U.S. First Written Submission, para. 249.

85. Brazil has also presented a third set of comparisons purporting to show that planting decisions in a marketing year do not correlate to the prices for upland cotton that prevail many months later[103] or to the futures prices of upland cotton *alone*.[104] Here, too, Brazil's analysis fails to account for the actual bases on which planting decisions are made; in particular, the fact that planting decisions are made on the basis of *expectations* about net revenues not only for cotton but *for competing crops* (as, revealingly, reflected in Brazil's own economic model in this dispute). Moreover, the analysis that Brazil presents in this regard – flawed as it is – actually *undermines* Brazil's claims. For example, Brazil's analysis of shifts in U.S. versus foreign harvested acreage compared to futures prices for upland cotton shows U.S. harvested acreage shifting consistently with harvested acreage in the rest of the world in most years. However, where the two diverge, it is because U.S. harvested acreage reacts more *conservatively* than foreign acreage to increasing futures prices for upland cotton (as in MY 2003 and 2006).[105] Indeed, the *only* year since the FSRI Act came into effect in which U.S. harvested acreage shifts were *less* conservative was MY 2005, and that difference is easily explained when one takes into account such factors as (a) the shift in acreage from soybeans to upland cotton in the Delta and Southeast regions of the United States due to fears of another soybean rust outbreak; and (b) exceptionally good growing conditions resulting in low abandonment.

86. In short, the United States submits that Brazil has not substantiated its argument that U.S. planted acreage does not react to market, planting and production signals. The data show, instead, that U.S. production and exports shift consistently with production and exports elsewhere in the world. This – and an examination of changes in U.S. planted acreage in light of expected revenues and other factors *both* for upland cotton and competing crops – confirms that U.S. producers receive and react to market signals in an economically rational manner that is entirely consistent with the behavior of their foreign counterparts.

(b) What is the response of the United States to the argument that the fact that "U.S. upland cotton producers know that their overall revenue will always be protected by marketing loans and counter-cyclical payments ... plays a major role in their planting decisions"? (Rebuttal of Brazil, para. 185; see also Third Party Submission of New Zealand, paras 5.20-5.21)

87. The United States submits that any eligible recipient of income support knows that he or she will receive some income protection due to payments under the income support program. That is the very nature and intent of income support programs – to ensure that producers receive some income that they would not otherwise get on the market. This is true for payments under the direct payment program, payments under the counter-cyclical payment program, payments

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[103] *See e.g.,* Brazil First Written Submission, paras. 144-145.

[104] *See e.g.,* Brazil First Written Submission, paras. 142-143 and Brazil Rebuttal Submission. paras. 221-224.

[105] *See* U.S. Rebuttal Submission, para. 306.

under the marketing loan program, and for any other income support program of any Member (for example, those supporting elderly or low-income recipients) . This is precisely the point that Brazil illustrates in the graph it submits purporting to show that not only marketing loan and counter-cyclical payments but also direct payments, crop insurance payments, and cottonseed payments provide revenue support to U.S. producers.[106]

88. The mere fact that income support programs provide income support to agricultural producers does *not*, however, mean that the payments have "major" effects on planting or cause any of the adverse effects listed in Articles 5 and 6 of the *SCM Agreement*. If that were true, income support *could not* be listed as one of the types of so-called "green box" measures listed in Annex 2 of the *Agreement on Agriculture*, which by definition only have "no, or at most minimal, trade-distorting effects or effects on production."

89. Whether or not marketing loans and counter-cyclical payments are *in fact* having "major" effects on planting and causing U.S. producers to plant upland cotton where they would not otherwise do so is a question of fact and one that Brazil must prove in the affirmative through evidence of how upland cotton farmers actually make their production decisions and how the programs actually operate. Moreover, the question is not merely proving *any* effect on production. As the United States has noted before, most economists agree that any type of payment to a producer of agricultural products will have some effect on risk and wealth and that this may, in turn, have some effect on production. In fact, the *Agreement on Agriculture* contemplates that even "green box" payments – measures that Members considered may be freely provided without limitation by domestic support reduction commitments – may have *minimal* effects on production. The question is whether Brazil has shown that the risk, wealth, or production effects rise to the level that they cause – under existing market conditions – the *significant* price suppression that Brazil has alleged to exist in the present proceeding. The United States submits that for the reasons above and explained in the prior U.S. submissions, Brazil has not so shown.

(c) In its Opening Statement at the meeting of the Panel with the Parties, Brazil observed:

> ***"...we have demonstrated that these subsidies stabilized cotton producers' revenue despite wildly fluctuating market prices, thereby insulating and numbing acreage response to market price signals. These subsidies also cover the huge long-term gaps between market returns and total costs of production. Both effects are closely interrelated." (para.55)***

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[106] *See* Brazil First Written Submission, para.133, Figure 8 and Brazil Rebuttal Submission, para. 189, Figure 6.

Is the United States only arguing that Brazil has not empirically substantiated that these two "effects" have actually occurred or is it also the position of the United States that these effects are in any event legally irrelevant to an analysis of whether a subsidy causes significant price suppression within the meaning of Article 6.3 (c) of the SCM Agreement?

90. The United States is arguing two things in respect of this assertion. First, the very purpose of income support programs is to add to the income of recipients. Therefore, Brazil's assertion that it has "demonstrated" that payments under the marketing loan and counter-cyclical payment programs "stabilize" the income of eligible producers is not remarkable. There is no need for an elaborate graph to "demonstrate" this – it is clear from the very formula for payment under the marketing loan and counter-cyclical payment programs that payments are made when prices fall below certain thresholds.

91. The fact that upland cotton farmers may end up receiving marketing loan and counter-cyclical payments in a year in which prices are below the applicable thresholds does not mean, however, that the payments have had the effect of "insulating and numbing acreage response to market price signals," as Brazil asserts.[107] For one, planting decisions are made in light of *expectations* about revenue and other factors at the time of planting, not the actual revenue ultimately received or other factors that actually come about much later on when the marketing year actually starts. Moreover, the question of whether expectations of income support under the marketing loan and counter-cyclical payments actually cause U.S. producers to plant more upland cotton than they otherwise would based on market, planting, and production signals alone is a question of fact. And the evidence does not support Brazil's assertion of such substantial planting/production effects.

92. Again, it is indisputable that decisions on whether to plant upland cotton are made many months before a single penny is paid out under the marketing loan and counter-cyclical payment programs. In making these decisions, an upland cotton farmer eligible for payments is likely take into account the fact that he will receive a payment under the marketing loan and counter-cyclical payment programs if market prices fall below the level at which such payments are made. The key question is whether this fact will cause him to plant upland cotton where he otherwise would not have done so based solely on market signals and whether this will result in such substantial excess planting and production that there will be significant suppression of world market prices within the meaning of Article 5(c) and 6.3(c) of the *SCM Agreement*. The answer depends on a comparison of what he would do based on market signals vis-a-vis what he does when one adds in the possibility of receiving payments under the marketing loan and counter-cyclical payment programs.

93. In the case of the counter-cyclical payment programs, there is no reason for the farmer to

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[107] Brazil Opening Statement, para. 55.

plant upland cotton to receive any payments. He will receive that payment regardless of whether he chooses to plant upland cotton, a competing crop (such as soybeans or corn), or decides to let the land sit idle. Thus, the rational farmer would plant the crop that he is best able to plant (based on expectations about weather, pests, his own expertise etc.) and that he expects will obtain the highest revenue for him on the market. While the expectation that he may receive payments under the counter-cyclical program may have indirect effects on production by making him less risk averse, the research suggests that such effects are likely to be minimal and not crop-specific.[108] So, it is highly unlikely that – *even if* the farmer expects to receive payments under the counter-cyclical payment program – these expectations will induce him to plant upland cotton to any substantially greater extent than if he was simply responding to signals from the market. And consistent with this economic analysis, independent studies and empirical data show that counter-cyclical payments likely have had minimal effects on acreage and hence production.[109]

94. In the case of marketing loan payments, the analysis is somewhat different because there the farmer does have to decide to plant upland cotton in order to get payments under the program. The question is whether he will do so where he otherwise would not have based on market signals (and other planting/production signals) alone. The data show, however, that in every single marketing year since the FSRI Act came into effect, it would have been economically rational for upland cotton farmers to plant upland cotton rather than allowing their land to sit idle because the farmers expected that, even without any payment from the government, market revenue for upland cotton was more than sufficient to cover variable costs. In some of these years, however, it would have been more economically rational (using average U.S. price expectations and costs) to plant a competing crop (for example, corn in MY 2002 and MY 2007). Consistent with that analysis, in those years, the acreage data show a corresponding drop in U.S. upland cotton plantings. Indeed, the only year there was not such a corresponding shift in acreage was MY 2005, and the data also show precisely why that was the case – namely, shifts in acreage away from soybeans to cotton in the Southeast and Delta regions due to fears of another outbreak of Asian soybean rust and other planting/production-related considerations.

95. In other words, in each of the years under FSRI Act, shifts in U.S. planted acreage were consistent with what one would expect if there were no marketing loan payments or counter-cyclical payments and U.S. farmers were basing their planting decisions solely on market price signals and other considerations relevant to planting and production. This is true regardless of whether the particular year was one in which expected prices were at levels at which farmers believed both marketing loan payments and counter-cyclical payments were likely (such as MY

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108 *See e.g.,* Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 203 (Exhibit US-35), Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter- cyclical Payments' Production Impacts*," Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, (Spring 2007), p. 81 (Exhibit US-85).

109 *See e.g.,* U.S. First Written Submission, paras. 203-276; U.S. Rebuttal Submission, paras. 226-267, 282-295.

2002 and 2005) or one in which expected prices were higher and the expectations were that marketing loan payments were unlikely (such as MY 2003, MY, 2005, and MY 2006).

96. This brings us to the third U.S. argument relating to Brazil's assertion that marketing loan and counter-cyclical payments allegedly "cover the huge long-term gaps between market returns and total costs of production." As discussed in response to Questions 51 and 59, Brazil's assertion of "huge long-term gaps" and their alleged significance make improper use of the "total cost" figures published by USDA. To illustrate the fallacy in the "total cost" approach that Brazil advances, recall that, in its "oral" presentation to the Panel, Brazil submitted charts comparing total costs of producing cotton, corn, and soybeans to total gross revenue earned in respect of the crop.[110] Brazil claimed that this proved the "economically irrational business of growing cotton in the United States without marketing loan and CCP subsidies."[111] What it showed, however, was the unreasonableness of Brazil's analysis.

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

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

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

98. In other words, Brazil's analysis of "rational" farming behavior would require the Panel accept that *none* of the 434 million acres of cropland in the United States should have been planted to any major field crop in MY 2005. Under Brazil's approach no upland cotton, corn, wheat, rice, sorghum, barley, oats, sugarbeet, or peanuts should have been grown. And any evidence that they were in fact grown must be accepted as evidence of the production effects of

[110] Brazil Oral Statement, para. 57 and paras. 57-91.

[111] Brazil Oral Statement, para. 57 and paras. 57-91.

the marketing loan and counter-cyclical payments.[112]

99. The absurdity of these results confirms that Brazil's "total cost" approach is a fundamentally erroneous approach to assessing the planting decisions of U.S. farmers. Rather, any proper assessment of the "economic rationality" of upland cotton farming must look to, *inter alia*, the variable costs of production. Indeed, the fact that variable costs are the relevant consideration in planting decisions is well-accepted in agricultural economics,[113] and has been recognized by the Appellate Body.[114] It is also evidenced by the fact that there is *no economic model* of which the United States is aware that uses total costs in its supply response equations (that is, to examine the planting decision).

100. The "total costs" that Brazil uses to assert the existence of "long-term gaps between market returns and total costs of production" can neither be used to examine planting decisions, nor do they permit a proper assessment of the long-term viability of U.S. upland cotton farmers. As discussed in response to Question 59, Brazil's argument on the basis of these alleged "gaps" that U.S. farmers would close down their operations if marketing loan and counter-cyclical payments were not available is simply wrong.

54. Could the United States explain whether, and, if so, why, it is of the view that this Panel should not rely on the findings and analysis by the original Panel regarding the effects of marketing loan and counter-cyclical payments on production and exports? Please comment in particular on paras. 7.1291, 7.1295, 7.1302, 7.1349, 7.1353 of the Panel Report.

101. The question decided by the original panel was what effect the marketing loan, counter-cyclical payment, and Step 2 payments made in MY 1999-2002 were having in that period (and whether that effect amounted to "significant" price suppression with the meaning of Article 5(c) and 6.3(c) of the *SCM Agreement*). The question Brazil presses before this Panel is a different one; it is whether the marketing loan and counter-cyclical payments are causing "present" serious prejudice (*i.e.,* under the marketing conditions prevailing in the current marketing year in the absence of the Step 2 program).

[112] Notably, no payments were made in respect of wheat or soybeans in MY 2005 (and have never been made in respect of those crops).

[113] *See e.g.*, U.S. Further Rebuttal Submission in the Original Proceeding, paras. 117-122 (18 November 2003); Cecil Davison and Brad Crowder, "Northeast Soybean Acreage Response Using Expected Net Returns" *Northeastern Journal of Agriculture and Resource Economics*, April 1991, pp. 33-41 (Exhibit US-137) and Duncan M. Chembezi and Abner W. Womack, "Regional Acreage Response for U.S. Corn and Wheat: The Effects of Government Programs", *Southern Journal of Agricultural Economics*, July 1992, pp 187-198 (Exhibit US-138).

[114] *US – Upland Cotton (AB)*, para. 453 ("We agree with the general proposition of the United States that *variable costs may play a role in farmers' decision-making as to whether to plant upland cotton or some alternative crop, and how much of each crop to plant*. From a short-term perspective, variable costs may be *particularly important*.") (emphasis added).

102. Under Article 11 of the DSU, the Panel is tasked with, *inter alia*, making "an objective assessment of the matter before it, including an objective assessment of the facts of the case." The Appellate Body has explained before that the task of a compliance panel is to examine the evidence and arguments presented to it in the compliance proceeding, even in situations where the factual situation is precisely the same one that had examined in the original proceeding (e.g. the assessment by an administering authority of the effects of the same exports in the same period on the same industry).[115] The obligation is, clearly, all the more important where the factual situation presented is a different one (*i.e.,* where the measures, the time period, and the market conditions are all different from those examined in the original proceeding). This – and the fact that Brazil is obligated to prove its claims in this proceeding – means that there is no basis to automatically adopt for purposes of this proceeding the same factual conclusions drawn by the original panel about the effects of the marketing loan, counter-cyclical payment, and Step 2 payments in a different period. Those conclusions are appropriate here only if Brazil proves that the same reasoning is valid and supported by the arguments and evidence before this Panel. For the reasons set out in the U.S. submissions and presentations to date, the United States submits that Brazil has not so proven.

103. With this in mind, the United States addresses the particular conclusions in the paragraphs identified by the Panel above:

104. ***Paragraphs 7.1291 and 7.1295:*** Paragraphs 7.1291 and 7.1295 of the original panel report speak about marketing loan payments. The original panel states in both these paragraphs that it considers that payments under the marketing loan program "stimulate production and exports and result in lower world market prices than would prevail in their absence." However, the discussion of the reasoning underpinning the panel's conclusion to this effect is very limited.

105. The original panel states, in support of its conclusion, that "[w]e concur with Brazil, who cited certain USDA economists in support, that the structure, design and operation of the marketing loan programme has enhanced production and trade-distorting effects."[116] The USDA economists cited by the original panel, however, simply acknowledge that payments under the marketing loan program may have effects on production based on farmers' expectations about revenues from the market and the market loan program.[117] Moreover, the footnote to this statement by the original panel notes that "[t]he fact that the United States notifies the marketing loan programme as 'amber box' support under the Agreement on Agriculture may not

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[115] *U.S. – Softwood Lumber (21.5)*, para. 101 (Noting that Canada's arguments "seem to assume that a panel is *required* to evaluate the facts in an Article 21.5 proceeding in exactly the same way as it evaluated those facts in the original panel proceedings, and to hold an investigating authority making a redetermination to the inferences that it drew from the same evidence in the original determination. . . . [W]e do not see why the Panel would be bound by the findings of the original panel.") (emphasis in original).

[116] *Upland Cotton (Panel)*, para. 7.1295.

[117] *See e.g.,* "Analysis of the U.S. Commodity Loan Program with Marketing Loan Provisions," USDA, AER 801 (BRA-222).

necessarily be determinative for the purpose of our 'adverse effects' analysis under Part III of the SCM Agreement."[118] Read together, the United States understands the original panel to be noting that the particular design and operation of the marketing loan program is such that it may have more than non- or minimally-trade distorting effects given the particular market conditions that prevail. The United States does not disagree.

106. Whether – under the particular market conditions in any particular year – payments under the marketing loan program do in fact have such effects and whether the effects give rise to such a degree of overproduction and export of excess production that "significant" price suppression result is a question of fact. That question requires an examination of the expectations of the upland cotton farmer about prices, payments, variable costs, yields, weather and other such factors. The evidence and arguments before this Panel that examine these expectations and the reactions of U.S. farmers to those expectations do not support a finding that marketing loan payments are having substantial effects on production, exports, and prices under the prevailing market conditions. Rather, the evidence shows that shifts in U.S. planted acreage are consistent with the shifts one would expect if U.S. farmers were basing their planting decisions solely on market price signals and other considerations relevant to planting and production.

107. ***Paragraphs 7.1302:*** Paragraphs 7.1302 of the original panel report address counter-cyclical payments. The original panel makes two main observations here. The first is that "[w]e agree with the view of USDA economists that, due to their market-price contingency, CCPs may influence production decisions indirectly by reducing total and per unit revenue risk associated with price variability in some situations" and the second is that there is an allegedly "strong positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production." The United States does not disagree with the former observation. However, the very USDA economists whose views the original panel has noted have conducted further analysis and explained that the degree of any such production effects is likely to be minimal and mitigated by a number of factors. For example, Westcott notes in this regard that:

(a) where prices are expected to be above maximum threshold – counter-cyclical payments behave just like the fixed direct payments;[119]

(b) "cross-commodity effect[s] suggest[] that CCPs may provide a general reduction in revenue risks rather than a crop-specific effect. Net returns among alternative crops would remain the primary consideration underlying production choices;"[120]

(c) "while a number of studies indicate that farmers are risk averse (Chavas and Holt,

[118] *Upland Cotton (Panel)*, para. 7.1295, n. 1401.

[119] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 203 (Exhibit US-35).

[120] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 204 (Exhibit US-35).

1990, 1996, for example), other risk reduction instruments already exist to manage risks. Thus, with revenue risk reduction now provided by CCPs as part of farm programs, farmers may adjust their use of these other farm and nonfarm risk management strategies;"[121] and

(d) "a large portion of output in the U.S. agricultural sector is produced by a small share of large producers. . . . Evidence that risk aversion decreases as income rises (Chavas and Holt, 1990, 1996) suggests that risk aversion may also tend to decline as the size of farms increases. Thus, with larger farms that account for most production being less averse to facing risk, this lowers potential production effects of CCPs due to risk reduction. And while smaller farms may be more risk averse in their farm enterprise, off-farm income may reduce the overall level of household income risk."[122]

108. On the basis of these and other factors, Westcott concludes that "there are several mitigating factors which suggest that overall production effects of CCPs through revenue risk reduction are likely to be limited."[123] The United States agrees with that assessment. Other studies submitted by the United States – for example, a 2007 study by Lin & Dismukes in which the authors found that "[t]he effect of CCPs on producers' planting decisions . . . appears to be *very negligible* – an increase in the acreage of major field crops of less than 1% . . . ."[124] – confirm that the effects of the counter-cyclical payments are, in fact, likely to very limited. These studies are important because – as discussed below – the counter-cyclical payment program had just come into effect at the time of the original panel proceeding. Accordingly, the studies available to the original panel were necessarily forward-looking and did not have much or any actual experience with the operation of program itself. The more recent studies incorporate deeper experience with, and understanding of, how the program operates in practice.

109. Regarding the second observation, as the United States has explained in response to Question 29 of the first set of questions from the Panel,[125] the United States does not disagree that many holders of upland cotton base acres produce some amount of upland cotton. However, the United States submits that this does *not* support the conclusion that payments under the counter-cyclical payment program *cause* U.S. farmers to produce upland cotton. To the

[121] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 204 (Exhibit US-35).

[122] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 204 (Exhibit US-35).

[123] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 205 (Exhibit US-35).

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

[125] U.S. Answers to Parts D-E of First Set of Panel Questions, paras. 14-23.

contrary, the data show that:

- On farms that have upland cotton base acres (and thus may receive cotton counter-cyclical payments), the ratio of cotton *planted* acres to total upland cotton *base* acres was only 60 percent in MY 2002-2005. In other words, U.S. upland cotton farmers were planting only approximately 60 percent of the cotton acres that they planted in the historical period used to calculate base acres.

- Second, a significant portion of U.S. upland cotton planted acreage (over MY 2002-2005, an average of about 17 percent) is on farms with cotton planted acreage that exceeds cotton base acres, or, indeed, on farms with no cotton base acres at all.

110. In the view of the United States, these facts confirm that U.S. farmers do, in fact, use the planting flexibility afforded by the direct and counter-cyclical payment programs. This is consistent with the fact that U.S. farmers base their production decisions on market signals and are not somehow induced to plant upland cotton simply because they hold upland cotton base acreage. Moreover, the data above show that a significant – and growing percentage – of cotton is grown on farms that do not hold *any* upland cotton base acreage or on planted acreage that is in excess of the upland cotton base acreage held by a farm. That is, for these cotton farmers, there can be no link – even alleged – between cotton base counter-cyclical payments and current production because these farmers are growing cotton on acreage *beyond* their cotton base acreage, if any. These are the facts that the United States considers to be the most relevant because they focus on the level of upland cotton *planting* and *production* and the relationship that these bear – if any – to payments. Brazil's claim focuses on *precisely* this same relationship.

111. By contrast, the fact that many holders of upland cotton base acres produce some amount of upland cotton is hardly remarkable. This just shows that upland cotton is often still produced on land that was historically planted to upland cotton (*i.e.,* at the time base acres were established). Upland cotton is grown in a limited number of areas in the United States, primarily in a few southern and western states, where the weather and other conditions are ideal for upland cotton production. Upland cotton was grown in these areas well before the counter-cyclical payment program came into effect and continues to be grown there now. Continued planting of upland cotton on this farmland is not the effect of any government payment; it is a function of the fact that upland cotton can be grown easily in these areas but cannot be grown in others. As the United States has shown, cotton is grown in the same states and – in large part – the same counties in 2005 as it was in 1992, well before the counter-cyclical payments came into effect. The same would be true if one were to go back even decades earlier in time. Many of the same farms produce *some* upland cotton today for the same reasons that they did so at the time that base acres were enrolled and even in years before that – for example, farmers may have experience and expertise growing upland cotton in those areas and know they can grow upland cotton with good results given the particular growing conditions in the region. The continuity noted by the original panel does not support any finding that counter-cyclical payments are

inducing U.S. farmers to plant upland cotton to any significant degree.

112. ***Paragraphs 7.1349 and 7.1353:*** These two paragraphs deal with the collective effects of the Step 2, marketing loan, and counter-cyclical payments made in MY 1999-2002. As that question is not before this Panel, the analysis therein is not directly applicable here. Nonetheless, the United States addresses the general reasoning in those paragraphs. In paragraph 7.1349, the original panel explains that "[w]e agree with the United States that 'the question is one of the nature of the subsidy examined and the degree of any predicted effect, which could range from significant to negligible.' These price-contingent subsidies were, in our view, sufficient to cause the significant price suppression that we have found to exist in the same world market." By contrast, here, Brazil has not even provided empirical substantiation that there is presently any significant price suppression let alone that marketing loan and counter-cyclical payments are the cause thereof. Moreover, the evidence discussed above regarding how the marketing loan and counter-cyclical payments are actually operating at present and under the prevailing market conditions indicates that, contrary to Brazil's assertions, these payments are not having substantial effects on production, exports, or significant price suppressive effects on prices.

113. In paragraph 7.1353, the original panel explains that it considers "the divergence between United States producers' total costs of production and revenue from sales of upland cotton" to be a relevant consideration as to whether there are effects on production in the medium- to long-term." The original panel explains that "*[f]ixed and variable costs* are the total amount which the producer incurs in order to produce the product and the total amount it must recoup, in the long-term, to avoid making losses. To the extent that the producer charges prices that do not recoup the total cost of production, over time, it sustains a loss which must be financed from some other source, or else the producer simply has to close down his business."[126]

114. The United States does not disagree that total costs of production are a relevant consideration and that over the long-term, farmers must recoup both fixed and variable costs. As discussed below, in response to Question 59, however, the data indicate that the vast majority of U.S. upland cotton production is economically viable in both the short- and the long-term without the marketing loan and counter-cyclical payments programs. The vast majority of U.S. farmers met or exceeded their total fixed plus variable cash costs in almost *each year* since the FSRI Act came into effect. Moreover, cumulatively, over the long term, the U.S. farmers generated a cash surplus, not a deficit.[127] The cumulative returns over the period 2000-2005 were a *positive* return of $161 per acre. Moreover, for MY 2000-2006, the cumulative net returns are an (estimated) *positive* $133 per acre.[128] These farmers were not, therefore, "sustain[ing] a loss" that they would have had to finance using marketing loan and counter-

[126] *Upland Cotton (Panel)*, para. 7.1353, n.1465.

[127] This analysis considers those items in the published USDA figures that are true cash costs (i.e. fixed and variable).

[128] *See* U.S. Comments on Brazil's "Oral" Statement, para. 77.

cyclical payments or other sources of income "or else . . . close down [their] business[es]."[129]

115. Indeed, while Brazil again asserts the kind of "divergence" that the original panel noted, the fact is that this "divergence" has been *created by Brazil* by using the "total cost" data published by USDA. As discussed below in response to Question 59, these "total" costs were never intended to be used as an indicator of the long-term viability of upland cotton producers. The data simply provide a stylized snapshot of one crop on a hypothetical farm to which USDA attributes not only average actual operating/variable costs of production but also an allocated value for fixed cash costs and – even beyond that – an allocated value for economic opportunity costs that, for the large part, do not ever have to be paid out. Therefore, it is simply inaccurate to suggest that a farmer would – in the absence of marketing loan and counter-cyclical payments – be forced to "close down [their] business[es]"[130] if they were not able to meet the "total" costs reflected in the USDA data. This is not only because of the nature of the data but because of the fact that whether or not farmers will "close down [their] business[es]"[131] depends on the overall cost-revenue balance of the farm, not one enterprise of that farm.

116. Nonetheless, even despite the conceptual flaws in conducting an single-crop-specific assessment of "total costs"for purposes of assessing the financial viability of an entire farm – let alone an entire sector of the agricultural economy (*i.e.* upland cotton farmers) – the data indicate that the vast majority of U.S. upland cotton farmers are meeting not only their variable costs of producing upland cotton, but they are generating enough additional market revenue to cover *both* fixed cash costs and enough excess that they could – if they had to do so (*quad non*) – cover the kind of imputed economic costs that Brazil has attempted to include in its calculations. These issues are addressed in further detail below in response to Question 59.

55. Can the United States confirm that the figures "$868 million" and "$838 million" Brazil cited in para. 40 of its Opening Statement are correct figures if one uses the "Brazil's methodology" and the "Cotton-to-Cotton methodology"? (Please note that the Panel is not asking whether the US agrees with these methodologies.)

117. These figures appear consistent with the so-called "Brazil methodology" and the "Cotton-to-Cotton" methodology, respectively.

56. The United States has cited new empirical research on the production effects of counter-cyclical payments. How does the United States address Brazil's criticism that none of this research has dealt specifically with the effects of countercyclical payments under the FSRI Act of 2002 on upland cotton? (Rebuttal Submission of Brazil, para. 120)

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129 *Upland Cotton (Panel)*, para. 7.1353.

130 *Upland Cotton (Panel)*, para. 7.1353.

131 *Upland Cotton (Panel)*, para. 7.1353.

118. The United States believes the recent research regarding counter-cyclical payments is highly relevant to an assessment of the economic effects of such payments. Recall that when the panel made its original findings, the counter-cyclical payment program had just come into effect. Thus, few studies were available based on empirical analysis or practical experience with the program to help the original panel in assessing the effects of payments therenunder.

119. Since that time, there have been a number of studies conducted regarding the effects of the program. Much of research has, not surprisingly, been focused on those crops that account for most of the U.S. planted area – corn, soybeans, and wheat. But there is no reason to believe that the payments under the counter-cyclical program in respect of upland cotton base acres would affect planting incentives in any materially differently way than would counter-cyclical payments in respect of other base acres. To the contrary, studies such as the 2005 Westcott analysis – which Brazil asserts "largely reaffirms his earlier qualitative findings" that the original panel considered relevant – agree that any possible effect is likely to be "indirect" and only through "reducing revenue risk associated with price variability in some situations."[132] Westcott has explained that "cross-commodity effect[s] suggest[] that CCPs may provide a general reduction in revenue risks rather than a crop-specific effect."[133] This indicates that counter-cyclical payments may have general revenue risk effects regardless of the base acres in respect of which the payments are made and regardless of the crop that is ultimately selected for planting. Notably, while Brazil has criticized other aspects of the Westcott analysis – despite citing his earlier analysis itself in its first written submission[134] – it has not challenged this aspect of the Westcott reasoning.[135] Nor has Brazil submitted any other evidence or studies to show that the counter-cyclical payments in respect of upland cotton base acreage would necessarily have different effects with respect to upland cotton production than counter-cyclical payments in respect of base acreage for any other crop.

120. In any event, the United States has submitted this research to provide a more robust basis – deriving from tested and reviewed economic methods – for understanding the operation of the counter-cyclical payment program and what the economic effects on planting/production might be as a result of payments thereunder. Especially in the absence of any specific analysis on counter-cyclical payments made with respect to upland cotton base acres and upland cotton production, this research is important in providing context and guidance for assessing the effects of counter-cyclical payments. As Brazil has provided no upland cotton-specific studies itself, it has no basis to criticize the United States in this regard. The research that has become available since the original panel, whatever its limits, fills an important gap in the understanding and assessment of the counter-cyclical payment program and supports a conclusion that the effects

[132] Brazil Rebuttal Submission, para. 129.

[133] Paul A. Westcott, "Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited" at 204 (Exhibit US-35).

[134] Brazil First Written Submission, para. 128 (citing *Upland Cotton (Panel)*, para. 7.1302.)

[135] Brazil Rebuttal Submission, paras. 128-133.

on cotton production of counter-cyclical payments are likely to be minimal.

57. The United States has offered the Lin and Dismukes (Exhibit US-34) and Westcott (US-35) studies as examples of new empirical research on the production effects of counter-cyclical payments.

(a) Is it not more accurate to characterize the Lin and Dismukes study as a simulation of the possible effect of countercyclical payments on production rather than a study on the actual impact of the payments since it does not statistically estimate the effect of the actual payments (which began only in 2002) on crop production? (Please refer to pages 9-12 of the paper which describe the data, covering the period 1991-2001, used for the study).

121. The United States agrees that the Lin and Dismukes study aims to estimate the likely effects of the counter-cyclical payments. As the United States recognized in its rebuttal submission, "Lin & Dismukes (2007) addressed the possible production impacts of counter-cyclical payments for the 2005 crop."[136]

122. With respect to the data used by the Lin and Dismukes study, however, the United States submits one clarification. Specifically, while the Lin and Dismukes study uses "state-level data for the North Central during 1991-2001 . . . cover[ing] major field crops in this region" – corn, soybeans, and wheat – to estimate the "acreage response equations,"[137] the authors note that they "accurately reflect major characteristics of CCPs in analyzing the payments' potential production impact in the simulation analysis."[138] Thus, the study takes into account the actual operation of the counter-cyclical payment program in assessing effects. For example, the authors use 2003 base acres and program yields for Illinois corn, soybeans, and wheat to determine a possible per-acre or per-unit counter-cyclical payment (based on actual data). Moreover, the study takes into account recent market conditions (for example, "new crop futures prices in mid February 2005 after adjusting for basis to arrive at the farm price equivalents") in assessing production effects.[139]

123. Indeed, the authors state that their "[a]nalysis . . . seeks to answer the following question:

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[136] U.S. Rebuttal Submission, para. 232.

[137] Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter- cyclical Payments' Production Impacts*," Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 68 (Exhibit US-85).

[138] Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter- cyclical Payments' Production Impacts*," Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 68 (Exhibit US-85) (emphasis added).

[139] Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter- cyclical Payments' Production Impacts*," Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 83 (Exhibit US-85).

'Given the market price scenario for major field crops perceived by producers at planting decision times, how would CCPs have affected the plantings of 2005 major field crops in the North Central region?'"[140] They submit that the use of input data from 1991-2001 – rather than more recent years – is reasonable because, *inter alia*, more recent input data to estimate the acreage response equations would likely not have "yield[ed] different results from those in the simulation analysis for the 2005 crop."[141]

(b) How does the United States deal with Brazil's characterization of the Westcott study as offering no new empirical evidence, and instead, being a qualitative discussion, much like that presented to the original panel (see para 128 of Brazil's rebuttal)?

124. The United States agrees that the Westcott study does not present a quantitative assessment. It may be said to examine from a qualitative standpoint how counter-cyclical payments operate and what effects they might have at different expected price levels. While that study is similar to the Westcott analysis presented to the original panel, it benefits from having had experience with the actual operation of the counter-cyclical payment program.

125. The United States recalls that the first Westcott study, which provided only a hypothetical assessment of the effects of the counter-cyclical payments, in the absence of any studies reflecting experience with the program itself, was the only evidence about the economic effects of counter-cyclical payments presented by Brazil before the original panel.[142] The United States has now submitted a range of studies and reviews, quantitative as well as qualitative, to assist the Panel in assessing the effects of payments under the program. As these studies and reviews show, the consensus view that is forming about the effects of counter-cyclical payments is that the payments have no effects on crop-specific production decisions and minimal effects on overall production. The United States submits that this is a highly relevant consideration in assessing the present effects of the counter-cyclical payments on upland cotton production.

58. The Unites States stated that the key consideration in assessing a farmer's decision to grow upland cotton is whether the farmer has been covering his variable costs of production. In this connection, it presented upland cotton costs and returns estimates for marketing years 1999-2005 (Exhibit US-47). Brazil has disputed the absence of certain items – land, labour and capital recovery costs - in the US calculations of variable costs. In response, the United States

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[140] Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter- cyclical Payments' Production Impacts*," Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 81 (Exhibit US-85).

[141] Lin, William and Dismukes, Robert. "Supply Response Under Risk: Implications for Counter- cyclical Payments' Production Impacts*," Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 69 (Exhibit US-85).

[142] *See e.g., Upland Cotton (Panel)*, para. 7.1302

has referred to the Commodity Costs and Returns Estimation Handbook (Exhibit US-88) prepared by a Task Force of the American Agricultural Economics Association as the basis for leaving out these items in its calculations. However, the Task Force which authored the Handbook does not use the categories "fixed" or "variable" costs and in fact recommends that the microeconomic concepts of fixed and variable costs not be used in preparing and reporting cost and return estimates. Page 2-67 of the Handbook states:

> ***The Task Force therefore recommends that costs should be categorized only as to whether they are associated with expendable factors or the services of capital assets. The division of costs into categories such as fixed and variable should generally be avoided in preparing CAR estimates. For the purpose of preparing CAR estimates for specific enterprises, the Task Force recommends that all the costs of all expendables be allocated to the generic group OPERATING COSTS and that all other costs be allocated to the group ALLOCATED OVERHEAD.***

Would the United States clarify whether the categories "operating costs" and "allocated overhead" correspond to the economic concepts of fixed and variable costs? In particular, are "operating costs" variable costs or not? Would the United States please indicate whether, and if so, where, the Handbook makes these clarifications or distinctions.

126. In presenting their analyses of costs, both the United States and Brazil have used the cost of production data published by the U.S. Department of Agriculture's Economic Research Service ("ERS"). As ERS states on its website, "[t]he costs and returns estimation program uses surveys conducted about every 4-8 years for each commodity as part of the annual Agricultural Resource Management Survey (ARMS), and methods that conform to standards recommended by the American Agricultural Economics Association (AAEA)."[143]

(A) "Operating Costs" or "Variable Costs"

127. ERS uses the term "operating costs" to describe those costs that are "expendable."

> "**Expendable factors of production** are raw materials, or produced factors that are completely used up or consumed during a single production period. Common examples of these factors that lose their identity with a single use are seed, fuel, lubrication, some

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[143] Economic Research Service, Commodity Costs and Returns available at http://www.ers.usda.gov/data/CostsandReturns/ (Exhibit US-144).

pesticides and fertilizer, feed, and feeder animals."[144]

128. The United States has used the ERS operating cost data, but has at times referred to this data interchangeably as "variable cost" data, another commonly-used term. To be clear the United States has not used this term to denote "variable costs," as that terms is defined by the AAEA Handbook. Rather, it has used the term to simply refer to the operating cost data published by ERS.

129. As explained in the U.S. rebuttal submission, however, there are two items with respect to which the U.S. categorization of "operating" (or "variable") costs has differed from that used by ERS.[145] First, the United States has included hired labor as an operating cost. This item raises several conceptual issues and even the ERS data have not treated the item consistently over the years. Therefore, to be conservative, the United States included hired labor as an operating cost, not as an item of allocated overhead. And, second, to isolate the costs and revenues for the "subsidized product" that is the subject of Brazil's claims under Articles 5 and 6 (*i.e.,* upland cotton lint), the United States has adjusted both ginning costs and cottonseed revenue. As the latter are ordinarily simply covered by proceeds gained by the gin from sales of cottonseed, the United States adjusted ginning costs to account for costs not covered by the revenue from cottonseed.[146]

130. Despite having relied on the ERS data and categorization throughout this dispute, Brazil attempts in its rebuttal submission to bring in a new definition of "variable cost" that differs from the one used by ERS (and therefore also differs from "operating costs" within the terminology used in the AAEA handbook).[147] Specifically, Brazil has attempted to include as "variable" or "operating" costs, costs that are not in fact "expendable in a single defined period" including land, unpaid labor, and capital recovery costs. There is no support in the ERS approach to cost of production data nor in the AAEA Handbook nor in the agricultural economics literature for Brazil's argument that these are "variable" or "operating" costs. Nor is there any support for Brazil's suggestion that farmers actually consider those costs in making year-to-year planting decisions regarding whether and what to plant.

(B) "Fixed Costs" and "Allocated Overhead"

131. The concept of "allocated overhead" is more complicated than the concept of operating costs. As a review of the AAEA Handbook makes clear, it is much broader than the concept of fixed costs. Allocated overhead includes both allocated (fixed) cash costs and imputed costs. The latter are not actually expenditures that must be made but rather are costs imputed based on

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[144] *Commodity Costs and Returns Estimation Handbook*, updated 09/30/2005, A Report of the AAEA Task Force on Commodity Costs and Returns, pp. 2-7 (Exhibit US-88).

[145] *See* U.S. Rebuttal Submission, paras. 326-343.

[146] *See* U.S. Rebuttal Submission, paras. 338-343

[147] Brazil Rebuttal Submission, paras. 254-283.

the concept of economic opportunity cost. It is this data regarding "allocated overhead" (plus "operating"/"variable" costs) that Brazil has referred to as "total costs" and that Brazil has used to attempt to show an alleged gap between U.S. farmers costs and revenue.[148]

132. Neither "fixed costs" nor "allocated overhead" affect farmers' decisions regarding what to plant in each year. As Brazil has acknowledged, if a "farmer would not be able to cover even variable costs, he or she would not plant anything at all to minimize losses."[149] Conversely, where the farmer *is* covering his variable costs, it is economically rational for him to plant *something*. The question is then *what* to plant. And that decision is made taking into account which crop will get the highest return after netting out variable/operating costs.

59. In discussing the impact of long-term costs of production (and hence long-term profitability) of upland cotton production on farmers' decisions to exit cotton farming, the United States argues that income from other crops and off-farm income must be into account. Why does the United States consider these issues relevant given the original Panel's decision that "off farm income" is not a legally relevant consideration. (Panel Report, para. 7.1354, footnote 1470) Please respond to Brazil's arguments on this matter in paragraphs 249-253 of its Rebuttal Submission.

133. The United States considers that the question of "off-farm income" is important because it goes to Brazil's ability to prove one of the key facts that it asserts in this proceeding; namely, that without marketing loan and counter-cyclical payments, U.S. producers would exit the business of upland cotton farming altogether or, in the original panel's words, be forced to "close down [their] business[es]."[150]

134. The United States recalls that it is a "generally and consistently accepted and applied . . . rule that the party who asserts a fact . . . is responsible for providing proof thereof."[151] To "prove" that U.S. upland cotton farmers would be forced to "close down [their] business[es]"[152] in the absence of marketing loan and counter-cyclical payments, Brazil has presented a simple comparison of "total costs of production" for upland cotton – which comprise all operating costs, fixed cash costs, and imputed economic opportunity costs for capital, labor and land – to market revenue. Brazil asserts that there is a gap between these two figures which, allegedly, proves the "economic irrationality" of producing upland cotton in the United States without marketing loan and counter-cyclical payments. Citing to the original panel report, Brazil asserts that this shows that "upland cotton producers would have lost money over the longer term if they were involved

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148 Brazil Rebuttal Submission, para. 249.

149 Brazil Oral Statement, para. 67.

150 *Upland Cotton (Panel)*, para. 7.1353.

151 *U.S. – Shirts and Blouses (AB)*, p. 14.

152 *Upland Cotton (Panel)*, para. 7.1353.

in upland cotton production alone."[153]

135. This evidence does not, however, prove the points asserted. The flaw is both in the nature, type, and amount of the costs that Brazil includes in its total cost analysis but also in Brazil's analysis on the basis of those costs; in particular, its flawed assumptions about how farmers make decisions about whether to stay in or go out of business. The issue of off-farm income and income from other commodities is relevant to the latter.

136. The United States will discuss the factual and conceptual problems in Brazil's arguments momentarily. As a threshold matter however – and in response to the question from the Panel – the United States notes that whether or not a party proves the facts it asserts is always a "legally relevant" consideration. It is no less true here. Moreover, as discussed above in response to Question 51, Brazil's claim in this case is under, *inter alia*, Article 6.3(c) of the *SCM Agreement* which, by it terms, requires an examination of the *actual* effects that the challenged subsidies have on the world market price of the allegedly subsidized product. Since Brazil has alleged that the challenged measures cause significant world market price suppression by, *inter alia*, keeping U.S. upland cotton farmers in business who otherwise would have closed down their operations, it is imperative for Brazil to show that U.S. upland cotton farmers would actually have done so absent marketing loan and counter-cyclical payments. The fact that U.S. upland cotton farmers actually make their decisions about whether or not to close their operations based on the total costs and revenues *for the farm* as a whole – including revenue from *all* crops as well as from off-farm sources – is necessarily a relevant and important consideration.

137. The original panel's suggestion to the contrary – and Brazil reiteration of that suggestion in this proceeding – appears to be based on the mistaken premise that there is some inconsistency between (a) the reference to "subsidized product" and "like product" in Article 6.3(c) of the *SCM Agreement* and (b) and examination of the total cost/revenue balance for a farm in assessing whether farmers would in fact cease their operations if they did not receive marketing loan and counter-cyclical payments. There is no such inconsistency. The fact is that the effect that Brazil is attempting to attribute to marketing loan and counter-cyclical payments – permitting the farmer to avoid exit or bankruptcy – is itself a farm-wide, not an crop-specific, effect.

138. To the extent that marketing loan and counter-cyclical payments *do* have this kind of effect of keeping the farm in business, there is a consequent effect on the "subsidized product" only because upland cotton farming is *one of the enterprises on the farm* that continues on. Any such effect with respect to the "subsidized product" – if proven – may be a valid consideration for purposes of the analysis under Article 6.3(c) of the *SCM Agreement*. However, by using a proper analysis that focuses on whole farm revenue versus costs, the analysis tracks the *actual* decision matrix of farmers, rather than assuming incorrectly that all upland cotton farms are single-crop farms that are devoted full-time to upland cotton production.

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[153] Brazil Rebuttal Submission, para. 251 (citing *Upland Cotton (Panel)*, para. 7.1354, n. 1470).

139. This brings us to the flaws in Brazil's approach. Brazil attempts to paint a striking picture in which U.S. upland cotton farmers would have suffered billions of dollars in losses – and widespread bankruptcies – if it had not been for marketing loan and counter-cyclical payments under the FSRI Act. To make this dramatic point Brazil, however, ignores fundamental facts about cotton farming in the United States and puts "total" cost data published by USDA to a use for which it was never intended and is inappropriate. As discussed above, Brazil's flawed approach based on "total costs" would show that U.S. farmers of most – if not all – fields crops were losing money year and after year. Brazil's reasoning would have the Panel accept that almost 500 million acres of U.S. cropland – over 10 percent of the entire U.S. land mass – is being kept in production solely by marketing loan and counter-cyclical payments (even where a number of the crops do not even receive those payments). The United States submits that these are absurd conclusions and ones that underscore perfectly the conceptual weakness in Brazil's approach – using the "total" costs published by USDA are simply not an appropriate means of assessing the financial viability of farms let alone of an entire agricultural sector.

140. For one, the "total" cost data is an average across all U.S. farms, ranging from very small retirement and residential farms to large non-family owed farms with sales in the millions of dollars. By presenting a single average for all such farms, the data obscures the fact that the vast majority of *U.S. production* occurs on farms that are highly profitable. As the United States has explained, the USDA survey data show that, in MY 2003, fully *92 percent* of U.S. production was on farms on which total revenue *exceeded* not only all variable costs actually reported in response to the survey but also the cash costs allocated to upland cotton by USDA and – indeed – even the items of economic opportunity cost included in "total" costs published by USDA. The latter are, for the most part, not even actual expenditures that must be paid out.[154]

141. Not surprisingly, Brazil asks the Panel to simply ignore this data on the basis that it reflects costs/revenue for a marketing year – MY 2003 – in which U.S. upland cotton prices were high. While it is true that prices in MY 2003 were high, however, that does nothing to undermine either the validity or the usefulness of this data. Importantly, there is a substantial spread between the total cost figures and the market revenue figures for the low- and mid-cost producers that made up the 92 percent figure. In the case of the former, U.S. producers' market revenue was almost *double* (or 29 cents/lb more than) the "total" costs reflected in the USDA data. For the mid-cost producers, the difference is almost 10 cents/lb. While prices did fall in MY 2004 and MY 2005 this would simply have had the effect of lowering or eliminating the *excess* above the "total" costs reflected in the USDA data. It does not mean that substantially less production would be shown to be meeting all possible costs. Moreover, Brazil fails to take into account that with yields increasing in later years, costs also were likely to have fallen for these producers in those years. Thus, there is no basis to assume that the results would have been substantially different in later years.

[154] *See* U.S. Oral Statement, paras. 72-74.

Costs of Production for Cotton, by Cost Group, 2003

Item	Low-cost	Mid-cost
Operating costs 1/ ($/acre)	197.07	256.23
Total costs ($/acre)	356.29	446.24
Operating costs ($/lb.)	0.20	0.33
Total costs ($/lb.)	**0.35**	**0.57**
Harvest month price ($/lb.)	**0.64**	**0.67**
Actual yield (lb per acre)	1,009	781
Share of production (%)	39	53

1/ Includes hired labor. Data on cottonseed value are not available. Using the average 2003 cottonseed revenue as a share of total value (13 percent), cottonseed value is assumed to account for 13 percent of total value of production. Ginning costs are then adjusted as described below.
Source: USDA[155]

142. What this means is that, even if Brazil's arguments about "total cost" were true, they would only relate to a small fraction of U.S. production. Nonetheless, Brazil's arguments – even about this small percentage of U.S. production – are actually not conceptually sound.

143. First, by using the crop-specific cost data published by USDA to reach conclusions about the financial viability of upland cotton farmers generally, Brazil's analysis assumes in effect that all U.S. upland cotton farmers produce nothing but upland cotton. The fact is, however, that for agronomic and risk management reasons farmers in the United States would rarely, if ever, rely solely on the production of one crop, year after year. A farmer manages his farm in a manner to maximize net revenue from the entire operation, which could include producing various crops and livestock, and providing other agricultural services (such as custom harvesting) to other producers. A producer manages his or her farm in a manner to maximize net revenue from the entire operation, which could include producing various crops and livestock, and providing other agricultural services (such as custom harvesting) to other producers.[156] The USDA cost of production data – and other similar cost data – do not purport to show the financial viability of a farm growing upland cotton that also relies on many other sources of income and incurs other costs. Rather, it provides a stylized, abstract view of one single crop or livestock enterprise that an individual producer of upland cotton can look at as a kind of general benchmark to compare against his own costs and revenues. The use of this data to extrapolate about the financial viability of upland cotton farmers generally or the entire U.S. upland cotton sector is simply not appropriate.

144. For example, the "total" cost figures used by Brazil include all the items under "allocated overhead," which are either not specific to upland cotton (in which case they are allocated

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[155] Exhibit US-93 (WTO-CONFIDENTIAL).

[156] *See e.g.,* U.S. Answers to Parts A-C of First Set of Panel Questions, para. 12 showing that only on average 47% of total farm revenue on upland cotton farms was from cotton.

expenses over all the crops and enterprises on a farm) or are not actual cash outlays (in which case they are economic costs arrived at through imputed values).[157] The AAEA Handbook explains at length the difficulties in concepts and methods of measuring allocated costs such as general farm overhead. For example:

> The third category [general farm overhead] is usually referred to as general farm or business overhead and typically includes items *for which it is difficult or impossible to determine the impact of the input on either output or cost for a specific enterprise*. For example, it is difficult to determine the impact of buying a new set of Allen wrenches on the average corn yield per acre or the impact of attending pesticide applicator training on cucumber gross returns.[158]

145. And further:

> "General overhead costs associated with operating a business are usually incurred at the total farm level, across all enterprises, although in some instances these costs can be assigned to groups of products. Examples include liability insurance, subscriptions and dues, accounting and legal fees, shop tools, equipment storage, road maintenance, and so forth. *Allocation of these shared costs to individual enterprises is often difficult or impossible in anything but an arbitrary manner*."[159]

146. While the USDA makes such allocations for purposes of presenting the published costs and returns data, there is no "allocation" of actual costs on farms. These costs are simply incurred and aggregated; and they and must be paid in the long-term using whatever net aggregate revenue remains after variable/operating costs are paid. The assumption that U.S. farmers would "close down [their] businesses" based on a narrow crop-by-crop or enterprise-by-enterprise assessment of allocated overhead is unrealistic.[160]

147. The conceptual flaw in using the total cost data published by USDA to assess financial viability of farms and – more generally an entire sector – are magnified by the fact that they include imputed opportunity costs. For the most part, these are costs that have been calculated by USDA to attribute some value to unpaid labor and owned land. For example, if a farmer-operator has the skill to serve as a manager in a bank, the prevailing wage for that job might be attributed as the "opportunity cost" of working on the farm. Similarly, if a farmer owns his own land, the "opportunity cost" of using the land may be the value of renting it to some other

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157 *See* U.S. First Written Submission, paras. 293-295 (December 15, 2006).

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

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

160 *Upland Cotton (Panel)*, para. 7.1353.

operator. There are inherent difficulties in valuing such items for which there is no market transaction or cash outlay.[161]

148. More importantly, however, these are not necessarily costs that must be paid off in order for farmers to avoid having to "close down [their] business[es]."[162] A farmer who owns his land does not have to pay anybody an imputed economic cost to account for that fact. According to available data from USDA's Agricultural Resource Management Survey, an estimated 66 percent of all farmland operated in 2003 was on owned land.[163] This means that – for this percentage of farmland – the attribution of an imputed economic cost (and the treatment thereof as a kind of cash cost that must be paid on pains of closing down one's business) is simply not accurate.

149. Nor is it reasonable to suggest that farmers are behaving in an economically irrational way if they do not choose to close down their businesses simply because the total revenues – while sufficient to meet all the operating/variable and fixed cash costs – do not meet these hypothetical imputed economic costs. This ignores important factors, including that farm owners may reasonably anticipate that their equity investment will gain in value and provide long-term returns. That equity investment, therefore, has a value in addition to the annual returns of the commodities planted on the farm. Moreover, 98 percent of all farms in the United States are family farms and, in many cases, the farm is also home to the operators.[164] Given all of these realities, there is simply no reason to believe that a farmer will "close down [his] business" if he were meeting his variable costs and even his total cash costs over the long-run but nonetheless could – theoretically – make more money by renting or selling his land and taking some other job (e.g., as a teller in a nearby town).[165] Nor is reasonable to extrapolate such reasoning out to suggest that an entire agricultural sector is not economically viable without marketing loan and counter-cyclical payments.

150. In sum, the use of the "total cost" data to extrapolate about the financial viability of an upland cotton farms generally or the entire U.S. upland cotton sector does not itself withstand scrutiny. Nor does the reasoning underpinning that analysis; in particular, the assumption that farmers make decisions about their farm based on narrow crop-by-crop or enterprise-by-

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

[162] *Upland Cotton (Panel)*, para. 7.1353.

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

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

[165] *Upland Cotton (Panel)*, para. 7.1353.

enterprise analyses of the "total" costs published by USDA (variable costs plus some allocation of fixed cash costs plus some hypothetical imputed economic costs).

151. The flaw in Brazil's reasoning is not only in its use of the crop-specific "total costs" as reflected in the USDA data in assessing the financial viability of upland cotton farmers but in its disregard of off-farm income – and income from other crops – that are an important part of his revenue. For example, the United States has provided data showing that in MY 2002-2005, on average, only 47% of total farm revenue on upland cotton farms was from cotton. That is, the majority of farm revenue (not even taking off-farm revenue into account) was coming from other production. Off-farm revenue adds substantially to that. As the United States explained in its first written submission,[166] in a study of changes in U.S. farm structure over the 20th century, Dmitry et. al. (2005) noted that:

> [A]bout a third of farm operators worked off the farm for at least 100 days in 1930. . . . By 1970, more than half of farms had off-farm income, and by 2000, 93 percent of farms earned off-farm income. Off-farm work has played a key role in increased farm household income; while farm household income was once below the national average, in 2002 it exceeded the national average by nearly $8,000.[167]

152. Examining specifically the role of off-farm income in farm exits, Hoppe & Korb (2006) explained that:

> Off-farm work has become important to farm operators. About one-third of farmers have worked off the farm *at least 200 days per year*—essentially full-time—since 1978. Off-farm work could hypothetically affect exits in two ways. First, off-farm work may be the first step in an exit from farming, which would be reflected in higher exits for farms the operators of which work off-farm. Second, *off-farm work might lower the probability of exit by providing farm operator households with another source of income.*[168]

153. To date, Brazil has not submitted any literature, study, report, or empirical evidence to contradicts the evidence submitted by the United States regarding the consideration of whole-farm costs and revenues. Nor has Brazil provided any evidence taking into account whole-farm costs and revenues that show that, absent the marketing loan and counter-cyclical payment program, U.S. upland cotton producers would have exited upland cotton farming.

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[166] U.S. First Written Submission, paras. 295-297.

[167] Dimitri, Carolyn et. al., The 20th Century Transformation of U.S. Agriculture and Farm Policy. Economic Information Bulletin Number 3. June 2005, pg. 2-3 (Exhibit US-45).

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

154. When use of USDA's published "total" costs is matched with disregard of an important source of income for the farm,[169] the picture that emerges of the financial viability of U.S. farmers is completely and thoroughly distorted. It results in the attribution to marketing loan and counter-cyclical payment "effects" that they are not in fact having. Such improper attribution is inconsistent with Article 6.3(c) of the *SCM Agreement* and cannot support a finding under that provision.

60. In its Rebuttal Submission, the United States argues that Prof. Sumner's description of the model that appeared in a recent CATO publication is not "appropriate" for use in a WTO dispute involving claims of serious prejudice. Professor Sumner has since introduced "more empirical and institutional detail" to the model used in this dispute. These changes are described in paragraphs 111-117 of Brazil's Opening Statement. Does the United States view these changes as being sufficient to make the model appropriate for use in a WTO dispute involving claims of serious prejudice? If not, what modifications does the United States think should have been made to the model?

155. The United States clarifies that it is Dr. Sumner who has argued in his CATO publication that his model presented therein – which is virtually identical to the one Brazil presents here – "abstract[s] from many complexities that would be important to get more precise estimates" and that "[t]he simple model laid out here does not represent the depth of analysis that would be appropriate to support a trade remedy proceeding or a serious prejudice claim before a WTO panel."[170] The United States has simply agreed with Dr. Sumner.

156. Although Brazil now alleges that Dr. Sumner has made substantive improvements to the original CATO model, the model itself continues to "abstract from the many complexities" that exaggerate substantially the estimates obtained. These are factors that Brazil considered sufficiently important to include and tout in the FAPRI-based model used in the original proceeding. For example, Dr. Sumner's model does not explicitly address the acreage decision with appropriate modeling of the incentives to plant cotton relative to competing crops. While the model analyzes a range of years, it does not incorporate any year-to-year market dynamics in its reported impacts. The United States has addressed these and other fundamental problems with the model in its prior submissions as well as in its oral presentation to the Panel, including that the model:

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[169] Dimitri, Carolyn et. al., The 20th Century Transformation of U.S. Agriculture and Farm Policy. Economic Information Bulletin Number 3. June 2005, pg. 2-3 (Exhibit US-45) ("[A]bout a third of farm operators worked off the farm for at least 100 days in 1930. . . . By 1970, more than half of farms had off-farm income, and by 2000, 93 percent of farms earned off-farm income. Off-farm work has played a key role in increased farm household income; while farm household income was once below the national average, in 2002 it exceeded the national average by nearly $8,000").

[170] Daniel A. Sumner. "Boxed In: Conflicts Between U.S. Farm Policies and WTO Obligations." Center for Trade Policy Studies, The Cato Institute, December 2005. (Exhibit US-108)

- lacks cross-commodity impacts and cross-price elasticities, potentially leading to biased price effects;

- is static with no explicit relationships for changes in cotton stock levels and no stocks equation;

- contains foreign supply elasticities that are different from FAPRI that underestimate the response of foreign producers to changes in world prices;

- treats production flexibility payments and direct payments differently even though they operate in the same way;

- incorporates Step 2 payments directly into the producer revenue function as fully coupled payment; and

- appears to ignore statutory parameters, for example by including counter-cyclical payment rates in each of the various price expectations that sometimes exceed the statutory maximum.

157. These structural and operational flaws are further compounded by the flawed econometric parameters used by the Sumner II model, resulting in even greater exaggeration of any possible effects on prices. As the United States demonstrated, between the original panel proceeding and this Article 21.5 panel proceeding, Brazil's economist *changed every single elasticity estimate in the modeling exercise, except one* (U.S. mill demand elasticity) to substituted an elasticity that would produce even greater impacts on production and prices than would even the elasticities used for purposes of the original modeling exercise.[171]

Supply and Demand Elasticities Used in Sumner I and II

Parameter	Effects of change to Sumner II elasticity (impact on world price due to removal of marketing loans and counter-cyclical payments)	Sumner I (FAPRI)	Sumner II (CATO)
U.S. cotton supply elasticity	**INCREASED IMPACT**	0.361 - 0.466	0.80
ROW cotton supply elasticity	**INCREASED IMPACT**	0.30	0.20
US mill demand elasticity	no change	-0.20	-0.20
US stocks demand elasticity	**INCREASED IMPACT**	-1.40*	no
ROW mill demand elasticity	**INCREASED IMPACT**	-0.25	-0.20
ROW stocks demand elasticity	**INCREASED IMPACT**	-0.463*	no

[171] Of course, many of the elasticities in the model used for purposes of the original proceeding were already overstated.

*Parameter estimate not presented in original Sumner model; estimates drawn from FAPRI model documentation discussed in Annex I to the US Rebuttal Submission, paras 23-25. (Exhibit US-56, Exhibit US-109, Exhibit US-65)

158. United States has also explained that Brazil applies a long-run elasticity for U.S. supply response while imposing very conservative short-run elasticities for international supply and demand response. If the analysis is to be performed in the long run – and the United States considers that it must for the reasons explained at the meeting with the Panel and in response to the panel's questions – then long-run elasticities must be assumed throughout the model. There is no basis for the kind of mix-and-match approach that Brazil has adopted in an effort to exaggerate any possible effects of the marketing loan and counter-cyclical payments.

159. Another key source of bias in Dr. Sumner's analysis is the fact that it does not incorporate, either explicitly or implicitly, any stock behavior.[172] Yet, stock adjustments may have important effects on overall price movements in the short-run. As future prices increase relative to current prices, warehouses will tend to carry more inventory, choosing to sell their cotton in future periods when prices are higher. Likewise, if current prices are high relative to futures prices, sellers find it more attractive to market their cotton rather than holding it for sale in the future. In this way, stocks act to buffer prices. If prices fall, potential sellers will sell less and hold more in stock, thus potentially bolstering prices. If prices rise, inventory holders will sell stocks, thus potentially dampening the increase. Ignoring stockholding behavior in the kind of predominantly short-run assessment that Brazil attempts to conduct exacerbates any possible effects of removal of marketing loans and counter-cyclical payments on world price.

160. In sum, the evidence and arguments before the Panel show that the Sumner II model lacks the rigor or detail to address the complexities of the global fiber market. Brazil's claims that Dr. Sumner has introduced "more empirical and institutional detail" to the model used in this dispute does not alter the fact that it continues to "abstract from many complexities that would be important to get more precise estimates" and "does not represent the depth of analysis that would be appropriate to support a trade remedy proceeding or a serious prejudice claim before a WTO panel."[173]

61. With respect to marketing year 2006, the United States has provided some data on upland cotton exports (Exhibit US-113), planted and harvested area and cotton production (Exhibit US-114), as well as a copy of the National Cotton Council's survey of planting intensions (Exhibit US-115). The data, all of which have been collected through the first half of marketing year 2006, are variously qualified as "estimates" or "projections" or "projected."

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[172] The absence of such an analysis is especially remarkable given Brazil's new theory that it is stocks – not exports – that are suppressing world market prices.

[173] Daniel A. Sumner. "Boxed In: Conflicts Between U.S. Farm Policies and WTO Obligations." Center for Trade Policy Studies, The Cato Institute, December 2005. (Exhibit US-108)

(a) Please clarify, as completely as possible, what these various terms mean as they apply to US upland cotton exports, acreage and production.

161. The data presented in Exhibit US-113, the Weekly Export Sales Reporting Data constitute neither a forecast nor a projection. They are best described as monitoring data. Specifically, U.S. exporters are required to provide information to USDA's Foreign Agricultural Service ("FAS") on the quantity of their sales transactions, the type and class of commodity, the marketing year of the shipment and the ultimate destination. They also report any changes in previously reported information, such as cancellations or changes in destinations. FAS compiles the data and publishes a weekly report. These reports provide a snapshot, on a continuing basis, of the level of U.S. export sales and commitments and allow interested parties to assess export performance, compared to USDA or other export projections.

162. The data provided in Exhibit US-114 is from the USDA's World Agricultural Supply and Demand Estimates (WASDE) report, which provides USDA's comprehensive forecasts of supply and demand for major U.S. and global crops and U.S. livestock. The report gathers information from a number of statistical reports published by USDA and other government agencies, and provides a framework for additional USDA reports. Data for U.S. area and production are provided by USDA's National Agricultural Statistical Service, and are based on periodic surveys. The WASDE typically provides data for 3 marketing years, including production and exports.

163. The terms "projections and projected" – both of which mean the same thing – reflect a lower degree of certainty inasmuch as most numbers in the balance sheet are not yet "estimates.' In May of each year, when the WASDE switches to the new marketing year, the term "estimate" is then applied to the previous year's projections even though these numbers, for most crops, are not yet "final." This is because the previous marketing year is not yet over. For example, in May the wheat marketing year is nearly over while the marketing years for cotton and other spring planted crops have three to five months remaining. For simplicity, and to avoid a crop by crop explanation, the numbers in the balance sheet are referred to as "estimates."

164. The term "estimate" reflects a higher degree of certainty. However, "estimates" and even "final estimates" are subject to change pending better or more complete information. Some estimates may be changed many years after the initial "final estimate" is published.

165. Data for the current marketing year (MY 2006) are labeled as projections because final data for most variables covered are not yet available. Data for the previous marketing year (MY 2005) are mostly final (for example, beginning stocks, acreage, and production) but some data may not be complete (for example, exports and ending stocks). Therefore, these data are still labeled estimates. Data for the prior year (MY 2004) are not labeled estimates or projections and are considered final, but they could still be revised. Because the data in the WASDE come from a variety of sources and could a multitude of products and variables, they are always subject to

change and revision. In May of this year (MY 2006), the figures for MY 2005 will become "final," the figures for MY 2006 will become "estimates," and new figures for MY 2007 will be "projected" (or deemed "projections").

166. The National Cotton Council's (NCC) planting intentions is a projection for the upcoming season based on a survey sent to approximately 40 percent of U.S. cotton farmers. In mid-December through early January, farmers are surveyed regarding their acreage for cotton and primary competing crops in the previous year and their intended plantings in the upcoming year.

(b) Would the United States be able to provide the Panel with some information, based on the average of the past six marketing years or so, of how final marketing year data on these variables, would differ from preliminary estimates, projections and the like, taken at the end of February of the relevant marketing year?

167. The requested data, showing the February projections for the current marketing year compared to the final numbers, are provided in Exhibit US-145.

168. The United States notes that each monthly version of the WASDE provides a reliability assessment of projections for that month compared to the final estimate, based on 25 years of data. For example, for U.S. cotton exports for February 2007, the difference between the February projection and the final estimate has averaged 500,000 bales, or 7.1 percent. The February projection has been below the final estimate 13 times and above the final 11 times.[174]

169. For the NCC survey, percent differences from the final acreage numbered have ranged between a low of 1.1 percent and a high of 8.5 percent. The average error over the past six years in 1.7 percent.[175]

(c) Finally, would the United States be able to update that part of Exhibit US-83 dealing with futures prices so as to provide the panel with as complete as possible average January to March 2007 New York futures prices for upland cotton?

170. A spreadsheet containing the most recent futures data for the December 2007 upland cotton contract is provided in Exhibit US-147. Corn and soybean futures data are also provided in this exhibit.

<u>Questions to Brazil</u>

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[174] *See* February 9, 2007 WASDE (Exhibit US-114)

[175] *See* Exhibit US-146.

62. How does Brazil rebut the argument of the United States that the fact that marketing loan and counter-cyclical payment programmes provide income support when prices are low is not the key question before this Panel and that while, like any other payments to producers, marketing loan and counter-cyclical payments could affect production, Brazil has not provided any evidence of actual production-inducing effects? (Rebuttal Submission of the United States, paras. 222, 287-291; Opening Statement of the United States at the meeting of the Panel with the parties, paras. 62-75; Comments of the United States on Brazil's 'Oral' Presentation in the meeting with the Panel, paras. 42-57)

63. Could Brazil explain whether or not it considers that whether marketing loan and counter-cyclical payments increase acreage is not relevant to the inquiry of whether these payments cause significant price suppression within the meaning of Article 6.3 (c) of the SCM Agreement? (para. 56 of the Opening Statement of Brazil) Could Brazil comment on the points made by the United States in footnote 72 of the Comments of the United States on Brazil's "Oral" Presentation in the meeting with the Panel?

64. Given that Brazil has criticized the new empirical research cited by the United States because it does not deal specifically with the effects of countercyclical payments on upland cotton production, why does Brazil consider that the McIntosh, Shogren & Dohlam study (Rebuttal Submission of Brazil, para. 140) is particularly relevant to this case? Could Brazil comment on the arguments of the United States in paragraphs 248-249 of the Rebuttal Submission of the United States?

65. The United States has cited new empirical research on the production effects of counter-cyclical payments. Could Brazil explain why the fact that these studies do not deal specifically with upland cotton should preclude the Panel from considering the studies as being highly probative?

66. Can Brazil explain the differences between the figures for the amount of counter-cyclical payments allocated to upland cotton provided by Brazil at the meeting of the Panel with the parties (Opening Statement of Brazil, para. 40 and Exhibit Bra 625) and the figures in Table 5 of Brazil's Rebuttal Submission?

67. Please confirm whether or not the Panel's understanding is correct:

"Table 6" in Brazil's First Written Submission was produced using the so-called "Brazil's method" using USDA data.

"Table 5" in Brazil's Rebuttal Submission was produced using the so-called "cotton-to-cotton" methodology using USDA data.

The figures cited in para. 40 of Brazil's opening statement (i.e. "$868 million and $838 million) are produced with the "Brazil's method" as well as the "cotton-to-cotton" methodology, using the data provided by the United States in exhibit US-64.

68. Please comment on the following statement by the US:

> ***"The United States understands that Brazil intends the counter-cyclical payment figures shown in 'Table 5' of Brazil's rebuttal submission to supersede the counter-cyclical payment figures shown in 'Table 6' of its first written submission." (US response to question 4 at para. 15)***

69. How does Brazil address the argument of the United States that "the only evidence that Brazil has submitted purporting to examine the price effects of marketing loan and counter-cyclical payments specifically are the results of the modelling exercise that it has conducted for purposes of this proceeding"? (Opening Statement of the United States, para. 76)

70. How does Brazil respond to the United States' rebuttal that Brazil has not even established a temporal correlation between payment of subsidies and significantly suppressed prices during the life of the FSRI, that is from marketing year 2002 to 2005? More specifically, please address the United States' claim of the stability of US plantings, US share of world production, US share of world exports and the world price of cotton during this period.

71. In the original case, the Panel concluded that the analysis covering "the six-year period from 1997-2002 ... lends itself to an assessment of the medium- to longer-term examination of developments in the United States upland cotton industry" (see para. 7.1354 of the original panel report). Thus, total costs of production were the costs considered appropriate by the Panel. Would total costs of production continue to be relevant should the compliance Panel decide to use only marketing year 2005 as the reference period for analysis? Or would variable costs of upland cotton farming in marketing year 2005 now be the relevant information to consider?

72. Brazil has argued that the adjustment in cotton stocks should not be included in the simulation of a large and permanent reduction in subsidies to cotton. Please respond to the following argument:

> ***If the simulation were a comparative static analysis in which a baseline is compared to a counterfactual outcome in some long-run state, modelling such adjustments would be unnecessary. But such adjustments should be taken into account given that the model is used to simulate the average impact on the world price of cotton (among other variables) on specific periods of time (MY 2002-05 or MY 2006-08) and not in the long run.***

73. How does Brazil respond to the argument made by the United States in paragraph 79 of its Opening Statement that:

> ***"to the extent a counterfactual assessment is undertaken, it is only to assess what the price equilibrium would be at present if marketing loan and counter-cyclical payments had been lower, different or did not exist. Article 6.3(c) does not ask what prices will look like in the short-run adjustment period if the marketing loan and counter-cyclical payments are suddenly eliminated... Brazil's argument that it is necessary to look at the short-run effects of total elimination of the programs cannot be accurate as a textual matter."***

More specifically:

(a) Why did Brazil not consider it appropriate to include simulations that involve reductions rather than elimination of the subsidy programmes?

(b) If simulations of such scenarios are performed, would the current values of the elasticities chosen (particularly the supply elasticities) to simulate the elimination of marketing loan and counter-cyclical programmes continue to be appropriate? Please kindly provide an explanation for the chosen answer.

74. Brazil's view is that the data that the Panel must consider for its claim of present serious prejudice should be that covering the latest marketing year for which complete information is available, MY 2005, and where credible, evidence after 31 July 2006. Since in MY 2005, payments under Step 2 continued to be made by the United States (payments which the original Panel found to have contributed to adverse effects) how shall the Panel ascertain that any adverse effects observed in marketing year 2005 are due solely to the two subsidy measures which are the subject of the present serious prejudice claim –

marketing loan and counter-cyclical payments?

2. Increase in world market share - Article 6.3(d) of the SCM Agreement

Questions to the United States

75. Could the United States explain further the textual basis of its argument that "Article 6.3(d) is not concerned with absolute market share and whether or not in any given year a member's market share would have been lower if subsidies were removed"? (Rebuttal Submission of the United States, para. 401)

171. As the United States noted in its paragraph 401 of its rebuttal submission, the question under Article 6.3(d) is whether "the effect of the subsidy is an *increase* in the world market share of the subsidizing Member . . . as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted." The first part of Article 6.3(d) requires a showing of an *increase – i.e.,* "the action, process, or fact of making or becoming greater."[176] This makes clear that what it at issue is movement, not something static like the absolute level of market share in a particular year. The concern of Article 6.3(d) is the movement from one thing – specifically, "the average share [the allegedly subsidizing Member] had during the previous period of three years" – to another, the level in the year that is the subject of the claim. If upward movement – *i.e.*, "increase" or "growth" – is involved in getting from the former to the latter, and the upward movement is itself proven to be "the effect" of a challenged subsidy – the first element of Article 6.3(d) is satisfied. The question then is whether such an "increase" – again, that is shown to be caused by the subsidy – "follows a consistent trend over a period when subsidies have been granted."

172. By its terms, Article 6.3(d) does *not* address situations where a Members' market share is merely alleged be higher than it would be "but for" subsidies, as Brazil assumes in some of its arguments.[177] That is not "the effect" with which Article 6.3(d) is concerned.

Questions to Brazil

76. What is the view of Brazil on the argument of the United States that an inquiry under Article 6.3(d) of the SCM Agreement requires two distinct elements: first, a demonstration of an increase in the world market share of a Member as compared to the average share it had during the previous period of three years, and, second, a demonstration that this increase in world market share compared to the average share the Member had during the previous period of

[176] *The New Shorter Oxford English Dictionary* at 1350, Volume 1, (2002 Edition) (Exhibit US-148).

[177] *See* U.S. Rebuttal Submission, para. 401 (responding to Brazil's argument that, according to its model, *removal of the marketing loan and counter-cyclical payment programs* would have resulted in lower U.S. market share in MY 2005).

three years is part of a consistent trend over a period when subsidies have been granted? (Rebuttal Submission of the United States, para. 399)

77. In this connection, could Brazil respond to the argument of the United States that Brazil has not shown that either of these elements are met with respect to the marketing loan and counter-cyclical payment programs"? (Rebuttal Submission of the United States, paras. 399-403)

C. CLAIM OF BRAZIL REGARDING THREAT OF SERIOUS PREJUDICE

Questions to both parties

78. Could both parties comment on the statements of Canada that "(a)t issue is whether these programmes....threaten to cause serious prejudice simply by virtue of their existence" and that "(c)ertain subsidy programs, by their very nature, give rise to a constant likelihood of support that results in a permanent threat of serious prejudice"? (Third Party Submission of Canada, paras. 9-10)

173. The United States does not consider Canada's assertion of "the issue" to be accurate. Brazil has asserted that "the appropriate standard of threat in Part III [of the *SCM Agreement*] is one in which there is a significant likelihood, based on the nature of subsidies *and particular conditions of competition*, that serious prejudice will occur in the future."[178] While the United States disagrees that the "significant likelihood" is the appropriate standard for assessing "threat" for the reasons set out in the U.S. rebuttal submission,[179] the United States has understood Brazil to be arguing that the question of threat must be determined on the basis of whether there is a significant likelihood of actual serious prejudice coming about given the particular market conditions and other factors in the future. The United States has not understood Brazil to be arguing that marketing loan and counter-cyclical payment programs "by their very nature, give rise to a constant likelihood of support that results in a permanent threat of serious prejudice," as Canada now argues.

174. To the extent that Brazil now asserts that such a question is "at issue," however, the United States notes the remarkable nature of the claim. In effect, Brazil would be asserting that certain programs are "by their very nature" inconsistent with Article 6.3(c) of the *SCM Agreement*. The United States notes that the *SCM Agreement* does not establish any such a category of measures. If drafters had agreed that there were such measures, they could certainly provided for them, in much the same way that they did in Article 3.1(a) (measures that are contingent upon export performance) and Article 3.1(b) (measures that are contingent on use of domestic over imported goods). The fact that they did not do so in the case of measures that allegedly "by their very nature" give rise to threat of significant price suppression indicates that

[178] Brazil First Submission, para. 253 (emphasis added).

[179] U.S. Rebuttal Submission, paras. 406-413.

they did not consider – and did not agree – that such measures exist.

175. In any event, the question is one of fact. If a Member considers that another Member's measures "by their very nature" give rise to threat of significant price suppression, the burden is on the complaining Member to prove it. And – given the remarkable nature of the assertion (*i.e.,* that certain measures are "by their very nature" WTO-inconsistent – the bar is high. The complaining Member must prove that, even if no subsidies are likely to be provided under the program and regardless of the amount if any that are provided – and regardless of what the market conditions are likely to be like in the future – the responding Member's program necessarily "give[s] rise to a constant likelihood of support that results in a permanent threat of" significant price suppression. Even if Brazil were to have made such an claim, it has offered no empirical basis for such an extraordinary finding here.

79. Could the parties state their views on the analysis of the ordinary meaning of the term "threat" in paras. 15-28 of the Third Party Submission of Canada?

176. Before responding to the Panel's question, the United States notes that Canada's arguments are in support of the assertion that "'threat' may be analyzed both as a temporal concept as in Article 15.7, *and* as a probability of occurrence."[180] However, it appears from a plain reading of Article 15.7 of the *SCM Agreement* that the meaning of "threat" therein incorporates not only a temporal concept ("imminent") but *also* a concept of the probability of occurrence ("clearly foreseen"). Indeed, the United States has submitted that this simply reflects the ordinary meaning of "threat," which includes "an indication of the *approach* of something unwelcome or undesireable"[181] and "a person or thing regarded as a *likely* cause of harm."[182] The meaning of "approach," in turn, is, *inter alia*, "a drawing near in time or circumstances" "be nearly equal to""[b]e so situated or arranged that the parts lie successively nearer to"[183] and, as such, reflects a similar notion of close proximity as the term "imminent." The United States has, therefore, argued that the both concepts are important in assessing "threat of serious prejudice" under Article 5 of the *SCM Agreement*.

177. Canada appears to argue that in the case of "threat of serious prejudice" under Article 6.3(c), one must ignore the temporal aspect of "threat" altogether and – instead – consider some concept of probability alone. Yet Canada offers no explanation for why this key aspect of the term must ignored. Indeed, even its own articulation of the ordinary meaning of "threat" – "an

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[180] Third Party Submission of Canada, para. 10.

[181] *The New Shorter Oxford English Dictionary* at 3290, Volume 2, (1993 Edition) (Exhibit US-104). Brazil appears to agree that this is ordinary meaning of "threat." Brazil First Submission, para. 247 ("The term 'threat' can refer to 'an indication of the approach of something unwelcome or undesireable' . . . .").

[182] *The New Shorter Oxford English Dictionary* at 3291, Volume 2, (1993 Edition) (Exhibit US-105) (emphasis added).

[183] *The New Shorter Oxford English Dictionary* at 102, Volume 1, (1993 Edition) (Exhibit US-106).

indication of *something coming*" – includes the same notion of "drawing near in time or circumstances"and "be[ing] nearly equal to"“[b]e[ing] so situated or arranged that the parts lie successively nearer to"[184] that is reflected in the use of the term "imminent" in Articles 15.7 of the *SCM Agreement*, Article 3.7 of the Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade ("*AD Agreement*"), and Article 4.1(b) of the *Agreement on Safeguards* in describing the meaning of the term "threat."

178. To support its argument that there is no temporal aspect to the term "threat of serious prejudice" in Article 6.3(c), Canada asserts that such a concept would be inconsistent with the "opening phrase of Article XVI:1 of the GATT 1994."[185] According to Canada, that article "makes clear, it is not only the actual grant of a subsidy that allows for serious prejudice to be found. Merely *maintaining a program* that mandates payments deemed to be a subsidy causing adverse effects may therefore cause serious prejudice . . . ."[186] Canada appears to be confusing two distinct issues. The first issue is whether a program itself (*i.e.,* the legislation/regulations providing for payments) may be deemed to constitute a *subsidy* for purposes of the *SCM Agreement* such that the "grant" or "maintenance" of it may be found to cause or threaten serious prejudice. The second issue is whether or not the definition of "threat" of serious prejudice in Article 5(c)/footnote 13 requires a showing that the serious prejudice being "threatened" is not only likely but also is soon to come. The latter is the question that is at issue here in the interpretation of the legal standard in Articles 5 and 6 of the *SCM Agreement*.

179. Canada also argues that "standard for threat of serious prejudice should [not] be imported from Article 15.7" of the *SCM Agreement* because "[w]here a standard from another article or other agreement is to be used, the *SCM Agreement* identifies that standard." Canada incorrectly assumes that the United States has asked the Panel to "import" the standard from Article 15.7 of the *SCM Agreement*. The United States has not done so and, in fact, has expressly clarified this in its rebuttal submission.[187] Rather, the United States has argued that the ordinary meaning of "threat" of certain injurious effects – as reflected in Article 15.7 of the *SCM Agreement*, Article 3.7 of the *AD Agreement*, and Article 4.1(b) of the *Agreement on Safeguards* – provides important contextual guidance in interpreting "threat" of serious prejudice in Article 5(c)/footnote 13 of the *SCM Agreement*.

180. As the United States has explained, interpreting the meaning of "threat" in this way is not only the proper approach under customary rules of treaty interpretation,[188] but it makes sense

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[184] *The New Shorter Oxford English Dictionary* at 102, Volume 1, (1993 Edition) (Exhibit US-106).

[185] Third Party Submission of Canada, para. 18.

[186] Third Party Submission of Canada, para. 18.

[187] U.S. Rebuttal Submission, para. 411.

[188] For example, that treaty terms are to be interpreted "in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." *See United States – Gasoline (AB)*, p. 17 (noting that "[this] general rule of interpretation [codified in Article 31 of the *Vienna*

given that all three provisions serve a similar function – they identify the same narrow circumstance in which it may be appropriate to discipline a Member's measures *notwithstanding* that the measures are not prohibited *per se* and are not necessarily *causing* any injurious effects or prejudice. Under all of these provisions, the Member's measure can be subjected to discipline only if there nonetheless a proper showing of "threat" of injurious effects or serious prejudice sufficient to justify the application of a remedy (whether it is multilateral, in the case of a WTO claim based on Article 5(c)/footnote 13, or unilateral, in the case of an antidumping or countervailing duty or safeguard investigation). The elaboration of "threat" in the latter three contexts – specifically, underscoring the sense of probability and proximity in time, consistent with its ordinary meaning – is undoubtedly important in understanding the use of the same term in the former context.

181. Canada has not explained why – in the context of this proceeding – the customary rules of treaty interpretation should not apply. Nor has Canada explained why a panel must wait for an express cross-reference in order to consult, as context, the meaning of the same term as it is reflected in other provisions of the *same* agreement as well as in provisions of other agreements, all of which deal with analogous questions involving the "threat of material injury" and "threat of serious injury." To the contrary, what Canada's own arguments make clear is that a cross-reference is used in the *SCM Agreement* where a term is given a special meaning in one place – for example, "injury to the domestic industry" in Part V of the *SCM Agreement*, "nullification or impairment" in the GATT 1994, and "serious prejudice to the interests of another Member" in Article XVI:1 of that GATT 1994 – such that it is necessary to clarify when the term is used "in the same sense" elsewhere.

182. By contrast, a panel may consider the ordinary meaning of a term as reflected in one provision to interpret the same term in another provision (especially of the same agreement) without the need for an express cross-reference. Indeed, if a panel could not do so, this Panel would err (as the original panel also would have done) by considering the definition and requirements for an "export subsidy" finding in the *SCM Agreement* as contextual guidance in interpreting the term "export subsidy" in the *Agreement on Agriculture*. There is certainly no "cross-reference" in either agreement that expressly authorizes a panel to consider the former as contextual guidance for the latter, yet no Member has argued that this prevents the Panel from doing so.

183. Indeed, it is curious that while Canada asserts that "one must look to the specific language and context of an agreement to determine the standard to be applied to a given analysis," it asserts that the appropriate analog for "threat" in Article 5(c)/footnote 13 is in Article 10.1 of the *Agreement on Agriculture*, a provision that deals with circumvention of bound

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Convention on the Law of Treaties] has attained the status of a rule of customary or general international law. As such, it forms part of the 'customary rules of interpretation of public international law' which the Appellate Body has been directed, by Article 3(2) of the DSU, to apply in seeking to clarify the provisions of the General Agreement and the other 'covered agreements' of the Marrakesh Agreement Establishing the World Trade Organization. . . .)

export subsidy commitments, not any sort of injurious or adverse effect.[189] Unlike the circumvention provisions in Article 10.1 of the *Agreement on Agriculture*, all four of the provisions mentioned above – threat of serious prejudice in Article 5/footnote 13 of the *SCM Agreement*, threat of material injury in Article 15.7 of the *SCM Agreement*, threat of material injury in Article 3.7 of the *AD Agreement*, and threat of serious injury Article 4.1(b) of the *Agreement on Safeguards* – deal with threat of adverse or injurious effects. Given Canada's own assertion that it is important to consider the language and context of the provision in ascertaining the meaning, it is not clear why the analysis of "threat of circumvention" under the *Agreement on Agriculture* should be more important contextual guidance than these closely analogous provisions of *the SCM Agreement itself*, the *AD Agreement*, and the *Agreement on Safeguards*.[190]

184. Finally, the United States notes Canada's assertion that two GATT reports from 1979 and 1980 support the finding that the "meaning of threat is flexible" such that a "permanent source of uncertainty in world sugar markets . . . gave rise to a threat of serious prejudice in the sense of Article XVI:1."[191] The United States does not agree. There is no discussion whatsoever of the legal standard for "threat" of serious prejudice in either of the two GATT reports cited by Canada (*EC – Sugar (Australia)* and *EC – Sugar (Brazil)*),[192] let alone any assessment of whether there is a temporal aspect of that term (as clearly indicated by its ordinary meaning). Nor – obviously[193] – is there any assessment of the meaning of the term given the particular context (*i.e.,* looking to the use of that term in Article 5/footnote 13 of the *SCM Agreement* in the light of the term threat of material injury in Article 15.7 of the *SCM Agreement*, threat of material injury in Article 3.7 of the *AD Agreement*, and threat of serious injury in Article 4.1(b) of the *Agreement on Safeguards*). Indeed, the analysis in those reports appears to depend on certain assumptions about Members' obligations to *prevent* the sanctioned thing from occurring,[194]

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189 Third Party Submission of Canada, para. 23.

190 Canada's further assertion that "very object and purpose" of the *SCM Agreement* "demonstrates that the standard for threat of serious prejudice may be distinct from that of threat in the case of material injury" does not appear logical. Third Party Submission of Canada, para. 25. The United States is not arguing, of course, that "the standard for threat of serious prejudice" is the same as "that of threat in the case of material injury." Nonetheless, even leaving that aside, one would assume that the same "object and purpose" of the *SCM Agreement* applies to all of its parts. Therefore, if – as Canada asserts – "the object and purpose of the *SCM Agreement* is the establishment of multilateral disciplines 'on the premise that some forms of government intervention distort international trade, [or] have the *potential* to distort [international trade]," one would expect that this would apply to *both* Part III and Part V of the *SCM Agreement*. It is, therefore, unclear how the *same* object and purpose establishes a *different* "standard" for threat in the two contexts.

191 Third Party Submission of Canada, para. 24.

192 Third Party Submission of Canada, para. 24 (citing to *EC – Sugar (Australia)*, BISD 26S/290, para. (h) of conclusion and *EC – Sugar (Brazil)*, BISD 27S/69, at para. (g) of conclusion.

193 Those reports predate these agreements.

194 For example, emphasizing the absence of "pre-established effective limitations on in respect of either production, price, or the amounts of export refunds," the panel in *EC – Sugar (Brazil)* found that "[n]either the system not its application would *prevent* the European Communities from having more than an equitable share of world export trade in sugar. The Panel, *therefore*, concluded that the Community system and its application

obligations that the Appellate Body has since clarified are not an intrinsic part of "threat."[195] The analysis in those reports – what little of it there is – provides little to no guidance in assessing the questions of threat implicated by Brazil's claims in this proceeding.

Questions to the United States

> ***80. How does the United States address the argument of Japan that in view of the different purposes of Parts III and V of the SCM Agreement the standard for determining threat of material injury in Article 15.7 of the SCM Agreement is an inappropriate standard for determining the existence of a threat of serious prejudice under Part III of the SCM Agreement? (Third Party Submission of Japan, paras. 8-12.)***

185. The United States understands Japan's argument to be that there are allegedly different objects and purposes of Parts III and V of the *SCM Agreement* and that these preclude the Panel from considering the ordinary meaning of "threat" of certain injurious effects, as reflected in Article 15.7 of the *SCM Agreement*, Article 3.7 of the *AD Agreement*, and Article 4.1(b) of the *Agreement on Safeguards* as important contextual guidance in interpreting "threat" of serious prejudice in Article 5(c)/footnote 13 of the *SCM Agreement*. The United States does not agree.

186. First, the obligation to interpret treaty terms "in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose" as codified in Article 31(1) of the Vienna Convention "forms part of the 'customary rules of interpretation of public international law' which the Appellate Body [and panels] ha[ve] been directed, by Article 3(2) of the DSU, to apply in seeking to clarify the provisions of the General Agreement and the other 'covered agreements' of the Marrakesh Agreement Establishing the World Trade Organization. . . ."[196] The Appellate Body has explained that:

> [i]t is well accepted that the use of the singular word 'its' preceding the term 'object and purpose' in Article 31(1) of the Vienna Convention indicates that the

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constituted a permanent source of uncertainty in world sugar markets and *therefore* constituted a threat of serious prejudice in terms of Article XVI:1." *EC – Sugar (Brazil)*, BISD 27S/69, at para. (g) of conclusion (emphasis added).

[195] Rejecting Brazil's arguments that a program that allegedly provided "unlimited" subsidies necessarily posed a "threat" within Article 10.1 of the *Agreement on Agriculture*, the Appellate Body explained that

> [W]e are [not] prepared to accept Brazil's suggestion that the concept of 'threat' in Article 10.1 should be read in a manner that requires WTO Members to take 'anticipatory or precautionary' action. The obligation not to apply exports subsidies in a manner that 'threatens to lead to' circumvention of their export subsidy commitments does not extend that far. There is no basis in Article 10.1 for requiring WTO Members to take affirmative, precautionary steps to ensure that circumvention of their export subsidy reduction commitments does not occur"

Upland Cotton (AB), para. 707.

[196] *United States – Gasoline (AB)*, p. 17.

> term refers to the treaty as a whole; had the term 'object and purpose' been preceded by the word 'their', the use of the plural would have indicated a reference to particular 'treaty terms'. Thus, the term 'its object and purpose' makes it clear that the starting point for ascertaining 'object and purpose' is the treaty itself, in its entirety."[197]

187. Japan's analysis does not attempt to interpret "threat" in Article 5/footnote 13 of the *SCM Agreement* "in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of [the] object and purpose" *of the treat itself, in its entirety*. Rather, Japan appears to ascribe a different "object and purpose" to different parts of the treaty. In this case, it asserts that the object and purpose of Part V, in general – and Article 15, in particular – is to "limit the discretion of national authorities and guarantee against misuse." Japan does not specify what the object and purpose of Part III is, but indicates that it is different from that of Part V. According to Japan, "Part III issues are completely devoid of concerns relating to limiting the discretion of national authorities to prevent misuse thereof in the conduct of domestic CVD investigations [as] no national authority is involved." Japan asserts that this alleged difference in the object and purpose of these *parts* of the treaty requires the Panel to *disregard* the "ordinary meaning" of the term threat as reflected in Article 15.7 of the *SCM Agreement*, Article 3.7 of the *AD Agreement*, and Article 4.1(b) of the *Agreement on Safeguards* and the contextual guidance provided by those provisions in interpreting "threat" of serious prejudice in Article 5(c)/footnote 13 of the *SCM Agreement*. The United States submits that this constitutes a serious misapplication of the customary rules of treaty interpretation.

188. Second, Japan has provided no basis for its assertion that the object and purpose of Article 15.7 is to "limit the discretion of national authorities and guarantee against misuse" and that, as a result, the meaning of "threat" in that context is necessarily different from the meaning of "theat" in Article 6.3(c). The United States sees nothing in Article 15.7 that suggests that Members assumed that national authorities would necessarily "misuse" their discretion and that they therefore infused the language in Article 15.7 with special meaning that is not relevant elsewhere. To the contrary, both Article 5/footnote 13 and Article 15.7 of the *SCM Agreement* appear, to the United States, to be consistent with the Appellate Body's explanation of the "object and purpose of the SCM Agreement, which is to strengthen and improve GATT disciplines relating to the use of both subsidies and countervailing measures, while, recognizing at the same time, the right of Members to impose such measures under certain conditions."[198]

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[197] *EC – Chicken Classification (AB)*, para. 238. The Appellate Body has explained that it may be possible to consider the "the object and purpose of particular treaty terms" but only "if doing so assists the interpreter in determining the treaty's object and purpose on the whole" and the focus is on "ascertaining the common intentions of the parties." *EC – Chicken Classification (AB)*, para. 238-239. As noted above, Japan does not even discuss "the treaty's object and purpose of the whole," let alone how the different purposes it ascribes to the parts of the *SCM Agreement* relate to that "object and purpose of the whole" or how the interpretation of "threat" in Articles 5(c)/footnote 13 and 15.7 of the *SCM Agreement* follow from there.

[198] *U.S. – Lumber CVDs Final (AB)*, para. 95.

This recognizes the fact that *SCM Agreement* strikes a balance between the right to maintain subsidies in some circumstances and the right to discipline them in others. Article 5/footnote 13 and Article 15.7 of the *SCM Agreement* both function to establish such a balance. There is no basis for understanding the same terms in the two provisions to have different meanings based on an assumption that national authorities are necessarily prone to "misusing" their discretion whereas WTO panels are not.

189. Third, Japan asserts in support of its argument that "[t]he original Panel in this proceeding properly recognized that ASCM Part V, for a variety of reasons, may not be proper context for interpreting and applying Part III."[199] However, the paragraph of the original panel report to which Japan cites provides exactly the opposite. It states expressly that "[o]n the basis of the text of Part III, and for the reasons that follow, we are of the view that, while *they may provide contextual – and general conceptual – guidance*, the more precise quantitative concepts and methodologies found in Part V of the *SCM Agreement* are not *directly* applicable in our examination of Brazil's actionable subsidy claims under Part III of the *SCM Agreement*."[200] This is precisely what the United States has argued – that the ordinary meaning of the term "threat" as reflected in Article 15.7 of the *SCM Agreement*, Article 3.7 of the *AD Agreement*, and Article 4.1(b) of the *Agreement on Safeguards* is important contextual guidance in interpreting "threat" of serious prejudice in Article 5(c)/footnote 13 of the *SCM Agreement*.

190. The fact that it is appropriate to consult that ordinary meaning has not only been confirmed by the original panel but even by Japan itself. Indeed, shortly following the paragraph noted above in Japan's third party submission, Japan argues that Brazil's preferred "significant likelihood" standard – found nowhere in the text of the *SCM Agreement* – "is incomplete as it does not include an explicit evidentiary requirement. An explicit evidentiary requirement such as that set forth in the first sentence of ASCM Article 15.7 is a crucial component of any 'threat' standard."[201] It is unclear why – if Article 15.7 cannot provide contextual guidance in interpreting "threat" under Article 5/footnote 13 – Japan would note the fact that there is an "explicit evidentiary requirement" included in that provision. Japan's reasoning appears to recognize that an evidentiary requirement is an important aspect of *any* claim of threat, and that the requirements set out in Article 15.7 provide important contextual guidance in determining the evidentiary requirements that must apply in the case of "threat" claims under Article 5/footnote 13. The approach is virtually the same for understanding the ordinary *meaning* of "threat" in those provisions.

81. How does the United States respond to the argument of Australia that "it is beside the point for the United States to argue that the programmes under consideration are due to expire in late 2007"? (Third Participant Oral

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199 Third Party Submission of Japan, para. 10 and n. 12(citing *Upland Cotton (Panel)*, para. 7.1167).

200 *Upland Cotton (Panel)*, para. 7.1167 (emphasis added).

201 Third Party Submission of Japan, para. 13.

Statement of Australia, para. 13)

191. The United States strongly disagrees with Australia's argument that, in assessing threat of serious prejudice, "it is beside the point for the United States to argue that the programmes under consideration are due to expire in late 2007. The programmes have not expired. There is no guarantee that they will not be rolled over or maintained in another form with adverse effect."[202]

192. First, Australia's observation that "the programmes have not expired" misses the point. If they had already expired, Brazil would simply have *no* basis for any claim with respect to those measures in the present compliance proceeding; those programs would already been withdrawn.

193. Second, the Panel's mandate is to address the "matter" before it – namely, to address Brazil's claims with respect to any measures that are measures taken to comply and properly identified in Brazil's request for panel establishment. To the extent that the marketing loan and counter-cyclical payments can be deemed "measures taken to comply" with the recommendations and rulings of the DSB,[203] the question for the Panel is whether Brazil has proved its claims of "threat of serious prejudice" with respect to the measures as identified in Brazil's request for panel establishment. The Panel's mandate does not extend to speculating about whether there may or may not be new measures in place after the marketing loan program and counter-cyclical payment programs in the FSRI Act expire, what the form of those new measures may or may not be, or whether any such other measures may or may not cause adverse effects under market conditions that may or may not exist in the future. Indeed, the original panel explained that where a measure is not in existence at the time that a panel is established, there is no basis for a complaining party to include it in its request for panel establishment and, therefore, it cannot form part of a Panel's terms of reference:

> The 'matter' referred to the DSB by Brazil in document WT/DS267/7 consisted of the measures and claims set out in that document which was dated 6 February 2003. On that date, the Agricultural Assistance Act of 2003 did not exist, had never existed and might not subsequently have ever come into existence. Brazil anticipated adoption of that Act in its panel request and its claim in respect of that Act was entirely speculative. Therefore, Brazil could not refer it to the DSB at that time and it does not form part of the Panel's terms of reference.[204]

194. Third, the original panel explained that "[w]e consider it axiomatic that the nature of a

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[202] Oral Statement of Australia, para. 13.

[203] And for the reasons set out in the U.S. submissions the United States does not consider that they can be so defined.

[204] *Upland Cotton (Panel)*, para. 7.158.

given subsidy may play an important role in determining its effects."[205] The fact that no subsidies may be granted because the program authorizing them is itself due to expire as of a date certain is undoubtedly important in assessing whether "the effect" of the challenged subsidies is threat of serious prejudice as claimed by Brazil. Indeed, to the extent that Brazil's challenge extends to the programs and payments in the future, that fact goes to an even more fundamental question of whether there will even be a "subsidy" in the time period at issue.

195. For the reasons above, Australia's assertion that 'it is beside the point for the United States to argue that the programmes under consideration are due to expire in late 2007" is without merit.[206]

82. Could the United States comment on the projections of marketing loan and counter-cyclical payments in Table 26 of Brazil's First Written Submission and on the projections of prices and subsidy payments in Table 27 of Brazil's First Written Submission? Could the United States explain how the data in these Tables support its argument that producers are likely to expect low or no marketing loan payments in MY 2007? (Rebuttal Submission of the United States, para. 418)

196. As the United States explained in its paragraph 419 of its rebuttal submission, an ICAC market report released on February 1, 2007, projects the A-index at 59 cents/lb in MY 2006 and 66 cents/lb in MY 2007. This would be almost the same level achieved in MY 2003, and higher than the 20-year average for upland cotton.[207] At these price levels, any marketing loan payments – if any – are likely to be small. The United States noted that new Congressional Budget Office projections estimate that "there will be no more than a 2 cents/lb marketing loan payment [in MY 2007] (and by MY 2008, the projection is of no marketing loan payment at all)."[208]

197. The projections of prices and payments by FAPRI – shown in Table 27 of Brazil's First Written Submission – are entirely consistent with the figures cited by the United States and its analysis on the basis thereof. In fact, FAPRI projects an adjusted world price ("AWP") of 51.4 cents/lb, which would result in a marketing loan payment of only 0.6 cents/lb. However, because it provides stochastic projections, FAPRI reports projected marketing loan payments of 1.9 cents/lb – figures virtually identical to the CBO projections used by the United States.

198. Table 26 provides aggregate projections for all marketing loan payments; it does not show how much of a payment per acre U.S. farmers might receive. Although the aggregate

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[205] *Upland Cotton (Panel)*, para. 7.1191.

[206] Oral Statement of Australia, para. 13.

[207] Cotton This Month, ICAC, p. 4 (February 1, 2007) (Exhibit US-107).

[208] CBO January 2007 Baseline for CCC & FCIC (January 22, 2007) (Exhibit US-91).

figures shown for MY2007 are higher than those projected by FAPRI and CBO, it is not clear why this is – whether it is because of differences in projected prices, differences in projected plantings, differences in projected yields or some other factor. It is, therefore, difficult to fit these projections in with the others noted above in discussing the expectations of farmers (whose expectations are developed with respect to their own crops, not an aggregate national figure).

199. To put the CBO and FAPRI projections of at most a 2 cents/lb marketing loan payment in perspective, it is useful to consider what marketing loan payments were in the period considered in the original proceeding (MY 1999-2002). There, the original panel considered significant the fact that marketing loan payments had been made that – in some periods – accounted for close to 30 cents per pound, or almost the same amount as revenue received from the market. The situation here – with marketing loan payments projected at, at most, 2 cents/lb for MY 2007 against a backdrop of prices that are expected to be at very high levels – is substantially different.

Questions to Brazil

83. How does Brazil address the argument of the United States that footnote 13 of the SCM Agreement "does not indicate that where a panel finds that a Member is causing present serious prejudice through the use of a subsidy, the panel automatically also finds that the Member is threatening to cause serious prejudice in the future through the use of the same subsidy"? (Rebuttal Submission of the United States, footnote 624)

84. Could Brazil confirm that its claim of threat of serious prejudice is submitted on a contingent basis i.e., that it does not request the Panel to make a finding on this claim if the Panel make a finding of present serious prejudice? How is the contingent character of this "threat of serious prejudice" claim reflected in Brazil's request for the establishment of a panel?

85. Could Brazil explain its request that the Panel "make factual findings with respect to its 'threat of serious prejudice' claim to allow the Appellate Body to complete the analysis, in case it were to disagree with the compliance panel's interpretation"? (First Written Submission of Brazil, para. 241) What are the precise "factual findings" which Brazil requests the Panel to make in this regard?

86. How does Brazil address the argument of the United States that the definition of "threat" of injurious effects in Article 15.7 of the SCM Agreement and Article 4.1(b) of the Agreement on Safeguards "in terms of their close proximity in time and their high probability of occurring" reflects the ordinary meaning of the word "threat" and that, as such, Article 15.7 of the SCM Agreement and Article 4.1(b) of the Agreement on Safeguards provide "useful contextual

guidance" for the interpretation of "threat" of serious prejudice?

87. Could Brazil comment on the argument of the United States that the standard of "significant likelihood" is without support in the text of the SCM Agreement or in the GATT/WTO dispute settlement reports cited by Brazil? (Rebuttal Submission of the United States, paras. 406, 410,413)

88. Does Brazil agree or disagree with the proposition advanced by the United States that "[a] panel may consider the ordinary meaning of a term as reflected in a particular provision to interpret the same term in another provision (especially of the same agreement) without the need for an express cross-reference." (Rebuttal Submission of the United States, para. 411, footnote 635)

89. Brazil argues that marketing loan and counter-cyclical payments for upland cotton are designed "in such a manner that payments would be made in consistently large amounts". (First Written Submission of Brazil, para. 270)

90. Could Brazil in this regard discuss the data in Table 27 of Brazil's First Written Submission that show an increase in the projected farm price and AWP over the period MY 2006 - 2010 and a decline in projected marketing loan payments?

91. How does Brazil respond to the argument of the United States that "by MY 2008, the projection is of no marketing loan payment at all"? (Rebuttal Submission of the United States, para. 419).

D. EXPORT CREDIT GUARANTEES

1. Outstanding export credit guarantees

Questions to the United States

92. The United States states, in para. 50 of its Opening Statement, that:

> ***... nothing in the SCM Agreement provides that "withdrawing" a "subsidy" allegedly "taking the form of a program" "includes an obligation to abstain from performing on commitments outstanding under that program as of the deadline for implementation." That argument improperly equates "performing on commitments under the program" with the "subsidy" itself. Such an equation was appropriate in Brazil – Aircraft (21.5), where Brazil continued to issue new***

WTO-inconsistent bonds even after the period of implementation on the basis that it had pre-existing contractual obligations to do so. However, it is not accurate here, where <u>the guarantees are not themselves prohibited subsidies</u>.

Would the United States please clarify what it meant in the underlined sentence?

200. In the underlined sentence, the United States is referring to the fact that providing an export credit guarantee does not *per se* equate to providing an export subsidy. Rather, a "subsidy" is only "deemed to exist" under Article 1 of the *SCM Agreement* if there is (a) a financial contribution and (b) a benefit is thereby conferred. Moreover, the subsidy is an "export" subsidy only where it is contingent on export performance within the meaning of Article 3.1(a). Item (j) of the Illustrative List clarifies how this definition applies in the case of export credit guarantees. Specifically, with respect to those measures, an export subsidy exists where the premiums charged under the guarantee program are inadequate to cover the long-term costs and losses of the program.

201. Where, as here, steps are taken so that export credit guarantees are provided at premium rates that are more than adequate to cover the long-term costs and losses of the program, no export *subsidy* is being provided, even though export credit guarantees may still be being provided.

91. In paragraph 342 of its First Written Submission, Brazil indicates that the total amount of guarantees under the GSM 102, GSM 103 and SCGP programs outstanding on 1 July 2005 amounted to $8.5 billion.

(a) Does the United States agree with the figure provided by Brazil?

202. Yes.

(b) Please indicate what proportion of that amount concerns exports of unscheduled products? (please distinguish between principal and interests)

203. The United States does not maintain data related to rescheduled amounts, claims outstanding, or interest arrears by commodity. Based on figures for contingent liability, and estimating from the experience of the administrators of the programs, the United States estimates that approximately 56 percent of the outstanding $8.5 billion was associated with unscheduled products. The United States does not maintain and, therefore, is unable to provide a break-down of principal and interest.

(c) Please indicate what proportion of that amount concerns exports of scheduled products, and in particular rice (please distinguish, in each case, between principal and interest).

204. As noted above, the United States does not maintain data related to rescheduled amounts, claims outstanding, or interest arrears by commodity. Based on figures for contingent liability, and estimating from the experience of the administrators of the programs, the United States estimates that approximately 44 percent of the outstanding $8.5 billion was associated with scheduled products. The United States does not maintain and, therefore, is unable to provide a break-down of principal and interest.

Questions to Brazil

92. Is it of any relevance to the Panel's assessment of Brazil's claims concerning "outstanding" export credit guarantees that what was at issue in Brazil – Aircraft (21.5) was the issuance, after the implementation date, of new bonds, and that bonds which had been issued prior to the implementation date could be redeemed for a number of years thereafter (see para. 46 of the US' Opening Statement at the panel meeting).

93. The Panel notes that Exhibit Bra-516 indicates outstanding amounts for GSM 5 as of 30 June 2006 rather than as of 30 June 2005 as indicated in footnote 523 of Brazil's First Written Submission. Please explain.

2. Legal Bases for Brazil's export subsidies claims

Question to the United States

94. The United States has noted that the original Panel's findings (that the export credit guarantees at issue constituted prohibited export subsidies) were based on item (j). The United States has also asserted that it has based itself on item (j) in implementing the DSB recommendations with respect to export credit guarantees. Please clarify whether the Panel should understand the United States' argument in this respect as an argument concerning the scope of the present proceeding.

205. The U.S. argument does not relate to the scope of the present proceeding except in the sense that the scope of an Article 21.5 proceeding is affected by the nature of the recommendations and rulings by the DSB.

3. "Benefit" under Articles 1.1 and 3.1(a) of the SCM Agreement

Questions to both parties

95. Brazil has taken the position that "different parties to a transaction involving a GSM 102 ECG derive different benefits from the GSM 102 ECG, each of which is potentially subject to assessment under Article 1.1(b) of the SCM Agreement" and has indicated that it is, in this proceeding, "primarily concerned" with the benefit received by the US exporter in the form of below-market fees (para. 404, Brazil's Rebuttal). The United States has challenged Brazil's approach of focusing on fees to the exclusion of other elements of the total cost of the loan. Please explain, referring to the provisions of the SCM Agreement and WTO jurisprudence (if any applicable), your position as to whether: (1) export credit guarantees and other types of subsidies may involve more than one type of benefit and/or recipient; (2) whether it is up to the complaining Member to decide which benefit it chooses to challenge.

206. The United States notes, as a threshold matter, that there is a provision in the *SCM Agreement* that deals with the precise issue of when – in the judgment of Members – export credit guarantees would constitute export subsidies within the meaning of Articles 1.1 and 3.1(a) of the *SCM Agreement*. This is item (j) of the Illustrative List. Moreover, there is a provision in the *SCM Agreement* that describes precisely what – in the judgment of Members – constitutes a "benefit" within the meaning of Article 1 of the *SCM Agreement*. That is Article 14(c) of the *SCM Agreement*.[209]

207. The Panel's question necessarily turns on what significance these provisions have. Can these provisions simply be ignored by a complaining party? Can the complaining party decide to challenge an export credit guarantee on the basis of an alleged "benefit" that is not provided in either provision and that – in fact – would undermine the logic of treating loan guarantees as

[209] The latter – while expressly provided for countervailing duty investigations – has been relied upon in virtually every subsidy dispute involving guarantees (even where they have not been loan guarantees) and has been recognized as important context in interpreting "benefit." *See e.g., Canada – Aircraft (Panel)*, para. 7.397 ("In considering precisely what Brazil must show in order to demonstrate the existence of a 'benefit,' we note the findings of the panel and Appellate Body in Canada – Aircraft. We therefore consider that IQ loan guarantees will confer a "benefit" to the extent that they are made available to Bombardier customers on terms more favourable that those on which such Bombardier customers could obtain comparable loan guarantees in the market. In applying this standard, we are guided by Article 14(c) of the SCM Agreement, which provides contextual guidance for interpreting the term."); *EC-DRAMs*, para. 7.190; *see also U.S. Lumber CVDs Final (Panel)*, para. 7.49, n. 128 ("Articles 14 (b) and 14 (c) SCM Agreement concern the government's provision of a loan and a loan guarantee. In both cases, the benchmark to be used for the calculation of benefit is the 'comparable commercial loan' and the 'comparable commercial loan absent the government guarantee'"). Indeed, the article of which it is part – Article 14 – was one of the main bases for the Appellate Body's reasoning in *Canada – Aircraft*, that the term "benefit" in Article 1.1(a) generally refers to a benefit to a recipient, rather than a cost to the government. *See Canada – Aircraft (AB)*, para. 155.

distinct types of subsidies in Article 14?[210] The United States submits that there is no basis to do so. The fact that the drafters went to the trouble of specifically setting out what constitutes an "export subsidy" in the case of export credit guarantees and what constitutes a "benefit" in the case of loan guarantees must have some meaning. They cannot have drafted these precise provisions simply so complaining parties could overlook them at will.

208. Indeed, the questions of what constitutes a "benefit," "subsidy," or "export subsidy" are not abstract questions that may be answered by a complaining party however it chooses. These are questions that the Members agreed must be asked to identify particular measures about which they shared certain concerns of trade distortion. In the case of export subsidies, the concern – as reflected in the focus on export *contingency* in Article 3.1(a) – is of providing inducements to export because of the structural characteristic that subsidies are made conditional on export. Members agreed that these measures had a structure and nature that trade distorting effects could simply be presumed to exist (and therefore would not need to be proven by the complaining party). When the Members set out how to examine a "benefit" for various types of measures in Article 14, these considerations of trade distortion necessarily informed what they drafted.

209. In the case of Article 14(c), they properly recognized that a loan guarantee is made for the sole purpose of supporting a loan transaction; the guarantee becomes an integral part of that transaction and has no value beyond it. The particular fee assessed for a guarantee is affected by the terms of the underlying loan transaction, who the parties are to the underlying loan transaction, the nature of the goods being purchased and sold, and any number of other factors. In turn, the terms of the underlying loan transaction and the costs and fees associated with that financing may be affected by the fees assessed. Therefore, they expressly provided that "a loan guarantee by a government shall not be considered as conferring a benefit, unless there is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees." In other words, they expressly recognized that an assessment of the total costs of the transaction is necessary to assess whether a "benefit" is *actually* conferred by the guarantee.

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[210] As the United States explained in its oral presentation before the Panel, in the case of government services, Article 14(d) applies and provides that a "benefit" may be calculated only where "the provision [of the service] is made for less than adequate remuneration" which "shall be determined in relation to prevailing market conditions for the . . . service in question in the country of provision (including price, quality, availability, marketability, transportation and other conditions of purchase. . .)." In that context, a comparison of fees for a government service against the fees charged in the market for a comparable service is the proper approach. However, Article 14(c) specifically *precludes* such an approach for loan guarantees. It provides that a government loan guarantee *shall not be considered* as conferring a benefit, *unless* is a difference between the amount that the firm receiving the guarantee pays on a loan guaranteed by the government and the amount that the firm would pay on a comparable commercial loan absent the government guarantee." Brazil argues that this provision deals solely with the *measurement* of benefit. However, by its terms, it also addresses the conditions under which a guarantee may be deemed to be "conferring" a benefit – mirroring the language in Article 1.1(a) of the *SCM Agreement*.

210. The approach of the drafters makes sense not only from a practical standpoint – *i.e.,* considering how guarantees operate and why a comparison of the fee charged for the issuance of one loan guarantee to the fee charged for another may provide an incomplete and distorted picture – but also from the standpoint of the object and purpose of the *SCM Agreement* itself. In particular, one of the main aims of the *SCM Agreement* is the discipline of trade distortion caused by subsidies. In the case of export credit guarantees, Members recognized that the potential for distortion occurs if a government-provided guarantee permits credit to be provided on terms better than would be available on the market. It is that which would have the potential to increase U.S. exports. It is difficult to see how there could be concerns about similar trade distortion where the *same* credit could be obtained on the market even without the government guarantee.[211] And, indeed, Article 14(c) reflects that very reasoning. The United States submits that this reasoning must be respected.

211. A separate example may help to put the issue in perspective. Suppose that a complaining party wishes to challenge the provision by the government of a particular good that is of a higher quality than other goods offered by private actors but for which the government charges a premium that fully accounts for the higher quality. Item (d) of the Illustrative List may apply if the claim is of an export subsidy. And Article 14(d) of the *SCM Agreement* may be relevant if the claim is otherwise. Both indicate that a proper analysis in determining whether a subsidy exists will examine the price at which the product is provided, taking into account such other relevant factors as quality.[212] For example Article 14(d) expressly recognizes that this should take into consideration the "prevailing market conditions . . . (including price, quality)." The United States submits that a complaining party could not, under these conditions, assert that the higher quality of the government-provided product is a "severable benefit" on the basis of which a subsidy should be found to exist. The United States considers that the situation is analogous here.

96. The parties differ as to whether different types of loans can be compared as long as they have the same "average life." What support (economic literature, etc.) exists for your position on this issue?

212. The United States has explained that the average life of a loan is the average number of years that principal is outstanding.[213] In a GSM-102 transaction, CCC requires principal to be payable at least annually. Consequently, on the first anniversary, one-third of principal is paid. After two years, two-thirds is paid. The final payment occurs on the third anniversary. Such a simple declining balance yields an average life of two years for this loan. To put it differently, this is the average amount of time in the loan that the obligor pays interest on a dollar of

[211] Adjusting for the fees paid for the government guarantee, of course, in the comparison.

[212] Item (d) talks about this in terms of the "terms or conditions" of sale and Article 14(d) talks about it in terms of "adequate remuneration."

[213] U.S. First Written Submission, para. 123.

principal and the lender earns interest on a dollar of principal.

213. The United States does not understand Brazil to disagree either with this definition of the average life of a loan or with the fact that a GSM-102 guaranteed loan, to the extent it is a three-year amortizing loan with annual repayment of principal, has an average life of two years.[214] The United States also does not understand Brazil to disagree that a two-year bullet loan also has an average life of two years.[215]

214. Brazil contends, however, that a two-year bullet loan and a GSM-102 guaranteed 3-year loan are not comparable because "the patterns of credit risk to which the lender is exposed are very different in these two cases."[216] Brazil asks the compliance panel to "suppose" – without foundation – with respect to the particular examples offered by the United States "that the borrowing bank's credit outlook is sufficiently positive in the short-term that there is a very low default likelihood perceived in the first two years. But suppose as well that there is more uncertainty about, and a greater likelihood of default in, the third year."[217] In other words, Brazil asks the compliance panel to *ignore* the overall risk reduction arising from the first-year repayment of one-third of principal in the GSM-102 guaranteed transaction[218], adopt Brazil's "assumptions," and conclude that the credit risk on this transaction will be "much higher."[219] Brazil's argument is devoid of logic.

215. The concept of average life is commonly used for price comparability of investments and debt instruments of varying terms. "Average life is commonly used as the measure of investment life for [mortgage-backed securities (MBS)] and the yield of an MBS is typically compared against a Treasury with maturity close to the average life of the MBS."[220] Similarly, "swap dealers routinely price the fixed rate side of an interest rate swap as a spread over United States Treasuries of a similar average life."[221]

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[214] Oral Statement of Brazil, para. 213

[215] Oral Statement of Brazil, para. 214

[216] Rebuttal Submission of Brazil, para. 429; *see also*, Oral Statement of Brazil, para. 219; Brazil's Comments on U.S. Answers, para. 140

[217] Oral Statement of Brazil, para. 220

[218] Brazil asserts without basis that early repayment of one-third of principal shows that "the patterns of exposure in these two types of loans are different,"and therefore supports its position. Brazil's Comments on U.S. Answers, p. 140. To the contrary, it shows only that one-third of the principal is paid fully one year before any principal is paid in the bullet loan. Solely from a risk perspective, more paid sooner can only be better.

[219] Oral Statement of Brazil, para. 221.

[220] *The Handbook of Fixed Income Securities*, 6th ed. (2001), Fabozzi, Frank J. (McGraw-Hill Professional), p. 589 (Exhibit US-149).

[221] Marshall, John F. "Futures Versus Swaps: Some Considerations for the Thrift Industry," *Review of Business*; Winter 1990/1991; 12, 3, p. 17 (Exhibit US-150).

216. As a further example, an offer to invest in credit tenant lease loans extends to a portfolio of loans of "up to 25 years."[222] With loans of varying terms, the investment is indexed to "U.S. Treasury or Swap Index correlating to the average life of the remaining lease term."[223] This is without regard to the extended term of particular loans: "15/15 deal has 9 year average life; use interpolated 9-year U.S. Treasury or interpolated 9-year Swap Rate index. 20/20 deal has 12-year average life; use interpolated -year U.S. Treasury or interpolated 12-year Swap Rate index. 25/25 deal has 15-year average life; use interpolated 15-year U.S. Treasury or interpolated 15-year Swap Rate index."[224]

217. Finally, the United States notes that Brazil asks the compliance panel to "assume" "much higher" risk in year 3 of the GSM-102 transaction. Brazil offers no basis in fact for this assumption with respect to the examples offered by the United States. Brazil's "assumption" is not even sound as a theoretical matter. In a study of medium-term, U.S. government-guaranteed loans, the authors found that "as the medium-maturity loans season the likelihood of default increases initially, peaks in the second year after origination, and declines thereafter."[225] "[I]n general, the hazard curve is a concave function of time: increasing initally, then falling off toward zero as the loans season. The general shape of the hazard, and the time dependency of default implied from this result, is consistent with the expected effect of loan seasoning."[226]

218. The initial hazard of default early in the loan belies Brazil's "assumption" of "very low default likelihood perceived in the first two years."[227] This study also contradicts Brazil's further "assumption" of "much higher risk" in the last year of the GSM guaranteed transaction. Under Brazil's theory, risk would apparently increase over time. This study examined 7-year loans. As the study indicates, however, for these loans, with a tenor 4 years longer than the GSM-102 transactions, defaults "fell off toward zero" as the loans seasoned.

<u>Questions to the United States</u>

97. Assuming that the Panel accepts the United States' argument that "benefit" is

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[222] BSC Bond Street Capital; Credit Tenant Lease Loans - Minimum $10,000,000. http://www.bisonfinancial.com/loans/bsc_ctl.html (Exhibit US-151).

[223] BSC Bond Street Capital; Credit Tenant Lease Loans - Minimum $10,000,000. http://www.bisonfinancial.com/loans/bsc_ctl.html (Exhibit US-151).

[224] BSC Bond Street Capital; Credit Tenant Lease Loans - Minimum $10,000,000. http://www.bisonfinancial.com/loans/bsc_ctl.html (Exhibit US-151).

[225] Glennon, Dennis and Nigro, Peter; "Measuring the Default Risk of Small Business Loans: A Survival Analysis Approach," *Journal of Money, Credit, and Banking*, Vol. 37, No. 5 (October 2005), p. 945 (Exhibit US-152).

[226] Glennon, Dennis and Nigro, Peter; "Measuring the Default Risk of Small Business Loans: A Survival Analysis Approach," *Journal of Money, Credit, and Banking*, Vol. 37, No. 5 (October 2005), p. 935 (Exhibit US-152).

[227] Oral Statement of Brazil, para. 220.

to be assessed on the basis of the "total costs of funds," what do you consider Brazil must establish in order to meet its burden of proof in that respect? Must Brazil prove that a benefit is conferred in all instances (all transactions and all recipients)? In most instances?

219. Brazil bears the burden of proving its claims with respect to every one of the measures it challenges. The United States notes that Brazil continues to equivocate on the question of whether or not it is challenging the GSM 102 export credit guarantee program itself or particular guarantees thereunder.[228] Whatever measure Brazil is challenging, it cannot escape its burden of proof in that regard.

220. If Brazil is challenging the GSM-102 program as such – whether it challenges the entire program or parts of it – it must prove that the program itself (or the challenged part) mandates a breach. As the panel explained in *Korea – Ships* in addressing an analogous challenge against the Advance Purchase Refund Guarantee (or "APRG") program under the *SCM Agreement*, the panel stated that "[t]he issue before us . . . is whether or not the APRG programme mandates the conferral of a benefit by requiring the provision of APRGs on terms more favourable than Korean shipyards could obtain on the market."[229] That panel found that "[n]either Article 18 of the KEXIM Act nor Article 23(1) of the KEXIM Operating Manual even refer to the terms on which KEXIM shall offer APRGs, let alone require below-market guarantees."[230] For this reason, the panel rejected the EC's claim that the APRG program mandated a breach of the export subsidy provisions of the *SCM Agreement*. The same reasoning applies here. Neither the statutory nor regulatory provisions providing for export credit guarantees even mandate that *guarantees* be provided, let alone that they be provided under conditions in which they would confer export subsidies.

221. If Brazil is challenging particular guarantees under the GSM-102 program – e.g., guarantees that the United States has provided in respect of exports of rice and unscheduled products – it bears the burden of showing that each of the guarantees is an export subsidy. In the U.S. view, the proper consideration in this regard is item (j) of the *SCM Agreement* and there is no "other" standard for what constitutes an export subsidy in the case of export credit guarantees. Nonetheless, even if there were some "other" such standard in Articles 1 and 3.1(a) of the *SCM Agreement*, as Brazil alleges, Brazil would bear the burden of proving that each guarantee provides a (a) financial contribution that (b) confers a benefit, and the "subsidy" thereby

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[228] For example, in its rebuttal submission, Brazil claims that it does not "assert that the GSM 102 program itself circumvents the United States' export subsidy commitments, within the meaning of Article 10.1 of the Agreement on Agriculture" or, presumably, that the GSM 102 program as such provides prohibited export subsdiies under the *SCM Agreement*. Brazil Rebuttal Submission, para. 378. But, thereafter, Brazil has indicated that it does not even consider individual guarantees to constitute measures. Brazil Answers to Sections A-C of First Set of Questions, para. 29. Therefore, it remains entirely unclear what measures Brazil is even purporting to challenge.

[229] *Korea – Ships (Panel)*, para. 7.121.

[230] *Korea – Ships (Panel)*, para. 7.121.

provided is (c) contingent upon export performance. Brazil has failed to make such a showing on the basis of a consideration of total costs for any guarantees, let alone for all the guarantees in respect of exports of rice and unscheduled products. Therefore, even under its own theory of an "alternative" standard under Articles 1 and 3.1(a), its export subsidy-related claims fail.

98. Does the United States dispute the accuracy of Brazil's comparison of GSM 102 fees with Exim Bank fees? Does the United States agree that ExIm Bank and GSM 102 guarantees are (at least in certain circumstances) similar or comparable?

222. The United States does not believe that guarantees of the Export-Import Bank of the United States and those of the GSM 102 program are similar or comparable. Brazil has proposed a comparison with two particular products of Ex-Im Bank. These are (1) the Ex-Im Bank Letter of Credit Insurance for Banks ("LCI") and (2) the Ex-Im Bank Medium-Term Export Credit Insurance ("MTI").[231]

223. The United States notes, as a threshold matter, that MTI is available exclusively in respect of capital goods and services.[232] As such, this product and its fee structure are subject to the Organization for Economic Co-operation and Development ("OECD") Arrangement on Officially Supported Export Credits ("OECD Arrangement"). As Japan has noted[233]and Brazil has acknowledged[234], the OECD Arrangement does not apply to agricultural products. As Japan has also noted, the minimum premium rates under the OECD Arrangement are for repayment terms of two years or more.[235] Under the GSM-102 program, hundreds of GSM-102 transactions, totaling hundreds of millions of dollars are in fact for terms of less than 2 years.[236] Therefore, there are important factual distinctions between the guarantees that render them not comparable.

224. These distinctions for relevant for purposes of the subsidy analysis. Recall that –

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[231] Brazil First Written Submission, para. 381

[232] ExIm Bank export credit insurance product description, accessed October 2006 at http://www.exim.gov/products/insurance/index.cfm (Exhibit BRA-533) and ExIm Bank Medium-Term Export Credit Insurance, ExIm Bank online, accessed October 2006 at http://www.exim.gov/products/insurance/medium_term.html. (Exhibit BRA-535).

[233] Third Party Submission of Japan, para. 25

[234] Brazil First Written Submission, para. 442

[235] Third Party Submission of Japan, para. 25

[236] Specifically:
FY 2003: 191 guarantees: $185,296,721
FY 2004: 259 guarantees: $222,967,376
FY:2005: 230 guarantees: $165,350,477
FY:2006: 185 guarantees: $176,414,190
FY:2007 (as of 5 March 2007): 43 guarantees: $46,584,911

typically – the comparison that is made to determine whether or not there is a "benefit" is to what the recipient "could obtain on the market."[237] Here, an exporter who would obtain a GSM 102 guarantee simply could not obtain a MTI guarantee from Ex-Im Bank, because those guarantees are not made in respect of agricultural products and also because the transaction at issue may have short (less than two-year) repayment terms. Therefore, those guarantees are not an appropriate benchmark of what an exporter of agricultural products "could obtain on the market."

225. Equally important, however, is what Brazil has omitted from its comparisons to the Ex-Im Bank products. Brazil asserts that "Brazil's country-specific comparison methodology [] takes account of all of the variables that GSM 102 and ExIm Bank take into account in pricing their products."[238] In fact, Brazil has failed to address at least two highly significant components.

226. The most significant of these is interest cover. Under Ex-Im's MTI product the obligor is required to use a form of promissory note promulgated by Ex-Im, and Ex-Im covers "100 percent of the rate provided in the note."[239] Under Ex-Im's LCI product, "the insured interest rate is generally prime rate minus 0.5% or the rate stated in the credit agreement, whichever is less. Ex-Im Bank uses the prime rate published in the Wall Street Journal, under the table 'Money Rates.'"[240]

227. In contrast, under the GSM-102 program, CCC covers eligible interest, which is calculated as follows: "the per annum rate to be used to calculate eligible interest shall be the lesser of the interest rate specified between the U.S. bank (or exporter) and the foreign bank or 55 percent of the average investment rate of the most recent Treasury 26-week bill auction as announced by the Department of Treasury prior to the date the eligible interest rate is established or adjusted."[241]

228. A comparison of the interest cover of the LCI product[242], which coverage is less than that

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[237] *See e.g., Korea – Ships (Panel)*, para. 7.121 ("The issue before us, therefore, is whether or not the APRG programme mandates the conferral of a benefit by requiring the provision of APRGs on terms more favourable than Korean shipyards could obtain on the market.")

[238] Brazil Rebuttal Submission, para. 434 (emphasis in original).

[239] ExIm Bank Medium-Term Export Credit Insurance, ExIm Bank online, accessed October 2006 at http://www.exim.gov/products/insurance/medium_term.html. (Exhibit BRA-535)

[240] ExIm Bank Letter of Credit Insurance for Banks, ExIm Bank online, accessed October 2006 at http://www.exim.gov/products/insurance/loc.html (Exhibit BRA-531).

[241] Notice to GSM-102 Program Participants: USDA Clarifies Method for Computing Interest Coverage Under GSM-102 Program (15 July 2005) http://www.fas.usda.gov/scriptsw/PressRelease/pressrel_dout.asp?PrNum=0105-05 (Exhibit US-153).

[242] Exhibit US-154 provides the Wall St. Journal prime rates from February, 2000 to the present. http://www.hsh.com/indices/prime00s.html (accessed 20 March 2007).

of the MTI product, with the interest cover under the GSM-102 guarantee shows that the LCI interest cover greatly exceeds that of the GSM-102 guarantee.

229. The United States provides in Exhibit US-155 a comparison of the CCC interest cover (55% of the applicable 26-week T-bill rate[243]) with the LCI interest cover (Wall St. Journal prime minus 0.5%). As of March 1, 2007, Ex-Im interest coverage is 491 basis points higher than the CCC interest coverage (7.75% v. 2.839%). This is an enormous difference, which can be illustrated by a simple example. Assume an export transaction in which ten million dollars is financed at 7.75 percent. Upon default of payment on the anniversary of the credit, Ex-Im would cover the full interest amount of $775,000. CCC, however, would only cover $283,900 of interest. This effect of course multiplies with each year of outstanding unpaid interest.

230. Since July 1, 2005, using the rates in effect on the first business day of each month, the difference in cover has been as much as 499 basis points (October 2, 2006) and never less than 374 basis points (August 1, 2005).[244] As the MTI interest cover is 100 percent of the stated rate in the note, one can only infer that the disparity between CCC interest cover and that product is even greater.

231. Interest cover is a very significant component of a guarantee or insurance product and commensurately affects the fee such products can command. Brazil, however, has made no attempt to include this factor in its comparisons.

232. In addition, with respect to principal coverage, MTI covers 100 percent of the financed portion.[245] The GSM-102 only covers 98 percent. Ex-Im also allows, under the LCI product, that "the insured may arrange recourse or 'pass back' to a third party of all or any part of any uninsured amount."[246] This is not permitted under the GSM-102 program. Upon default the claimant must subrogate to CCC the claim to the entire amount in default, not just the guaranteed portion.[247] CCC then has the right to recover from the obligor all moneys in default.[248] Unlike the LCI product, the holder of the GSM-102 guarantee is therefore unable to sell the unguaranteed portion of the obligation to another party to insulate himself from any exposure to principal default. Under the MTI product, the holder is similarly insulated from any risk because

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[243] Exhibit US-156 sets out 26-week T-bill rates as provided by the U.S. Department of Treasury for the period 1 July 2005 - 20 March 2007 available at http://treasurydirect.gov/RI/OFAuctions.

[244] Comparison of interest rate coverage of CCC GSM-102 export credit guarantees and Ex-Im Bank Letter of Credit Insurance for Banks (1 July 2005 - 1 March 2007) (Exhibit US-155).

[245] Ex-Im Bank Medium-Term Export Credit Insurance, ExIm Bank online, accessed October 2006 at http://www.exim.gov/products/insurance/medium_term.html (Exhibit BRA-535).

[246] ExIm Bank Letter of Credit Insurance for Banks, ExIm Bank online, accessed October 2006 at http://www.exim.gov/products/insurance/loc.html (Exhibit BRA-531).

[247] 7 CFR Section 1493.110(b)(4) (Exhibit US-142).

[248] 7 CFR Section 1493.130(a) (Exhibit US-142).

of the full 100 percent coverage. Inferior coverage of principal relative to the Ex-Im products renders the GSM-102 guarantee less desirable, which is reflected in the price parties are willing to pay. Brazil has also not accounted for the difference in "pass back" policies of the programs in its comparisons.

99. Please comment on Brazil's argument that the GSM 102 fees are not sufficiently scaled to take into account country risk (i.e. they vary only minimally according with country risk) (see, inter alia, paras. 410-412 Brazil's First Written Submission).

233. The United States disagrees with Brazil's assertions as a matter of fact. GSM 102 fees are scaled to take into account country risk and the current GSM-102 fees vary greatly based on this factor. Brazil has offered no basis in the text for its assertion that this scaling is "insufficient." Indeed, the United States is not aware of any provision of the *SCM Agreement* that establishes what constitutes "sufficient" scaling. The only express discussion of sufficiency in the *SCM Agreement* pertains to the adequacy of premia to cover the long-term operating costs and losses of export credit guarantee programs under item (j) of the Illustrative List. This is the standard that the original panel appropriately applied in assessing the consistency of the export credit guarantee programs with the export subsidy provisions in Articles 3.1(a) and 3.2 of the *SCM Agreement*.

234. It was in assessing that broader question that the original panel considered the issue of country risk to be relevant. Specifically, the original panel explained that "in order objectively to assess premiums in relation to long-term operating costs and losses, we believe it is also appropriate for us to take into account aspects of the structure, design and operation of the measure before us."[249] In so doing, however, the original panel was quite clear that it was not looking at individual fees or differences among fees, but rather whether "the total of all premiums would be likely to cover the total of all operating costs and losses under the program."[250] Therefore, neither in the text of the *SCM Agreement* nor in its application in the present proceeding, is there any independent issue of "sufficient scaling" to take into account country risk. The only question is whether the structure, design and operation of the program – including any scaling – when taken as a whole indicate that the premia are *inadequate* to cover the long-term costs and losses of the program. The evidence before this Panel clearly show the adequacy of the premia charged for GSM 102 guarantees.

235. The changes to make fees responsive to country risk confirm the adequacy of the premia. Under the old fee structure, fees varied "only by the guaranteed dollar value of the transaction, the repayment period, and the principal repayment interval (annual or semi-annual)."[251] The

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[249] *Upland Cotton (Panel)*, para. 7.805.

[250] *Upland Cotton (Panel)*, para. 7.805.

[251] *Upland Cotton (Panel)*, para. 7.820

premia were not risk-based at all, and the original panel noted in this regard that "a country's risk classification has no impact on the premiums payable under the United States export credit guarantee programs."[252] By contrast, under the current fee schedule, the difference in premia for the same tenor between the least risky countries and the most risky countries is in all cases between 81.5 percent and 100.6 percent.[253] Moreover, the 22 highest risk countries that were previously eligible are now entirely ineligible and cannot receive a GSM 102 guarantee at any price. This, and other evidence submitted by the United States show that the "the total of all premiums" cover the "total of all operating costs and losses under the program."[254]

Questions to Brazil

100. Assuming the Panel were to agree with the United States that the proper benchmark to determine "benefit" is the "total cost of funds" of the transactions, what elements of evidence has Brazil provided the Panel in this respect (other than evidence from the Regulations that the programme targets situations where no credit would be available on the market)? In answering, please address the United States' argument at para. 133 of its First Written Submission that "Brazil has made no attempt to provide such specific information on individual loan costs and fees or to identify comparable commercial loans and their terms".

101. Brazil argues that "[w]here guarantees are reserved for circumstances in which credit would not otherwise be available, there is no "comparable commercial loan absent the government guarantee," within the meaning of Article 14(c) of the SCM Agreement." (Brazil First Written Submission, para. 375). The Panel understands this argument of Brazil to focus on the foreign obligor. Brazil elsewhere indicates that it is principally concerned, in this proceeding, with the benefit to the US exporter (fees). Are these two arguments at tension?

4. Item (j) of the Illustrative List

Questions to both parties

102. What, in your view, explains the different results achieved by the two methods advocated, on the one side, by the United States in paragraphs 87-89 of its First Written Submission and by Brazil in Exhibit Bra-613 (other than the United

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[252] *Upland Cotton (Panel)*, para. 7.861

[253] GSM-102 Guarantee Fee Rate Schedule, USDA FAS Online, accessed September 2006 at www.fas.usda.gov/excredits/gsm102fees.html (Exhibit BRA-505). Compare GSM 102 Premia, Annual Payment of Principal, 36 month tenor, risk category 0 ($0.561 per US$100 of coverage) and risk category 6 ($1 per US$100 of coverage) and 30 day tenor, risk category 0 ($0.161) and risk category 6($0.323).

[254] *Upland Cotton (Panel)*, para. 7.805.

States' criticism that Brazil has not taken recoveries corresponding to pre-1992 guarantees into account in its "cash basis" accounting calculations, of which the Panel is already aware)?

236. As a threshold matter, it is important to understand what Brazil's cash-basis methodology in Exhibit Bra-613 purports to show. It attempts to depict on a strictly chronological basis, for a finite period of time (FY 1993-2005), cash flows in and out related to the export credit guarantee programs. As Brazil – not the original panel – did in the original proceeding with respect to the finite period 1993-2002, it nets "program receipts against program disbursements on a fiscal year basis."[255]

237. It is also important to note that the credit reform approach was developed and imposed to avoid precisely the kind of anomalies that arise under the strict cash-basis approach that Brazil now advocates. Indeed, as Brazil articulated before the original panel: "[p]rior to passage of the [Credit Reform Act of 1990], loan guarantees were recorded on a cash basis, *which distorted their costs. [R]ecording guarantees on a 'cash basis distorted the timing of when costs would actually be incurred.*'"[256] Accordingly, Brazil championed credit reform accounting as:

> an ideal basis on which to determine whether the CCC's export credit loan guarantee programs are offered at premium rates that are inadequate to cover the long-term operating costs and losses of the programs, within the meaning of item(j) of the Illustrative List of Export Subsidies. It functions as a more sophisticated alternative to constructed cost formulas, and thoroughly accounts for all of the premium and operating cost and loss elements required by item(j). Moreover, it has the virtue of serving as the actual, real-world calculation used by the U.S. Congress, the President of the United States, and federal agencies like the CCC to "measure more accurately the costs of Federal credit programs."[257]

238. Brazil never proposed to the original panel that its cash-basis methodology supplant the credit reform approach. To the contrary, "Brazil emphasizes that it does not intend for this revised constructed formula to replace the formula used by the U.S. government itself to track the costs of the CCC guarantee programs pursuant to the U.S. Federal Credit Reform Act."[258]

239. The United States believes that the disparity between Brazil's approach and the United States approach is largely explained by the fact that the United States' credit reform methodology fully accounts for the net present value of reschedulings, and Brazil's approach

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[255] Brazil Rebuttal Submission, para. 485.

[256] Statement of Brazil - First (Original) Panel Meeting (22 July 2003), para. 128 (emphasis added).

[257] Statement of Brazil - First (Original) Panel Meeting (22 July 2003), para. 129.

[258] Brazil's Answers to Questions Posed by the Panel Following the First Substantive Meeting of the Panel, para. 164 (Question 77) (11 August 2003) (emphasis in original)

only includes cash received. As explained below, the current total net present value of remaining cashflows for cohorts 1992-2005 is $590 million.[259] Exhibit BRA-613 purports to show a cash deficit (loss) of $689,144,000 through fiscal year 2005. The U.S. first written submission (table at paragraph 87) shows a profit through cohort 2005 of $166,549,780. The difference between those two figures is $855,693,780. Although $590 million does not fully explain the disparity, it approaches the appropriate order of magnitude.

240. The re-estimation process under credit reform accounting projects cashflows to and from the government over the life of the cohort, including defaults and recoveries. For the GSM 102, GSM 103 and SCGP programs, Table 1 below sets forth the net present value of the remaining cash flows for each of the cohorts 1992-2005. To the extent any remaining scheduled debt exists, the last fiscal year in which payment is projected for such rescheduled debt is indicated. The net present value of the cashflow is calculated as required under credit reform accounting.[260]

241. The annual reestimate process takes into consideration the estimated net present value of cash flows over the life of the cohort. In contrast, the Brazilian approach only takes into account the cash transactions that have actually transpired to date.

Cohort	Debt Rescheduled Until FY	NPV of Remaining Cashflows ($000)
GSM 102		
1992	2012	$161,655
1993	2012	205,798
1996	2025	57,936
1997	2025	105,664
1998	2007	1,871
1999	2007	1,035
2000	2007	28
2001	2014	110,901
2002	2014	187
2003	2007	-1,787
2004	2008	-31,556
2005	2009	-49,367
Total GSM 102		**$562,365**
GSM 103		
1992	2012	$10,572
1993	2012	15,885

[259] $589,947,000

[260] The United States hastens to note that this does not reflect or adopt the cash-basis approach to rescheduling rejected by the original panel. *See, Upland Cotton (Panel)*, paras. 7.846, 7.847, and 7.851

2000	2008	-122
2001	2008	-241
2003	2010	-155
Total GSM 103		**$25,939**
Supplier Credit		
2003	2010	$1,643
	Total:	**$589,947**

242. For each of the past three fiscal years, actual repayments under rescheduled debt have outperformed the estimates by 226%, 180% and 363% for FY 2004, 2005 and 2006 respectively. The amounts projected under rescheduled agreements and the actual amounts collected are shown in Table 2. For each subsequent reestimate, scheduled payments under rescheduled agreements (from which the repayments are projected) are reduced to reflect amounts already collected.

Table 2 – Projected versus actual recoveries on rescheduled debt

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

103. To what extent is evidence pertaining to guarantees issued under the three programmes (GSM 102, GSM 103 and SCGP) under the prior fee schedule relevant to the Panel's analysis of the revised GSM 102 programme under item (j)?

243. The evidence pertaining to guarantees issued under the prior fee schedule for the three programs (GSM 102, GSM 103, and SCGP) is useful because it helps to put in context the findings and recommendations of the original panel, the bases for such findings and recommendations, and the measures the United States has taken to comply. Moreover, evidence of the adequacy of premiums charged under those programs is relevant in this proceeding because the United States has *improved* the ability of the single remaining program – GSM 102 program – to meet its long-term operating costs and losses. To the extent that premia were charged that were adequate to cover the long-term costs and losses of the programs even *before* the United States implemented changes to increase fees and lower possible long-term costs and losses, this is a highly relevant fact. It supports the U.S. argument that premia charged under the revised fee schedule for GSM 102 guarantees are more than adequate to cover the long-term costs and losses of the program.

244. While disaggregated figures for the three export credit guarantee programs before the 2005 cohort are not available, the aggregated figures are still very helpful in an assessment of the

GSM 102 program alone.[261] Historically, the GSM 102 program has been by far the largest of the three export credit guarantee programs. Brazil has noted that export credit guarantees issued under GSM 103 accounted for only 2.36 percent (by transaction value) of all CCC guarantees, and in FY 2004 and 2005, no guarantees were issued under GSM 103.[262] Indeed, no GSM 103 guarantees have been issued since FY 2003.[263]

245. Similarly, since the inception of SCGP in FY1996[264], total guarantees under SCGP were $2.777 billion. In contrast, total GSM 102 guarantees issued in the same period were for $30.633 billion.[265] GSM-103 guarantees during that time totaled only $396.2 million. As a result, looking at the period since the inception of SCGP, GSM-102 guarantees comprised 90.6 percent of the total value of all CCC export credit guarantees issued. In light of this order of magnitude and the fact that the net lifetime reestimate for every GSM-102 cohort since 1992 is negative, it stands to reason that the relative profitability reflected in the budget data is, at a minimum, proportionately allocable to GSM-102, and that the increase in fees can only enhance that position.

104. Must a risk-based fee necessarily take into account foreign obligor risk? Please discuss and provide any relevant support for your position. Can foreign obligor risk be treated differently than country risk in this respect, and if so, why?

246. Item (j) of the Illustrative List is the only provision of the *SCM Agreement* that deals specifically with export credit guarantees. That provisions simply provides that export credit guarantees are subject to discipline where the premia charged are inadequate to cover the long-term costs and losses of the program. Other than this, neither that provision, any other provision

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[261] Such disaggregation appeared for the first time in the President's 2007 budget, released in February, 2006. See response to Question 110, below.

[262] Brazil First Written Submission, para. 339. Nor were any GSM 103 guarantees issued in FY 2002. See, Summary of Export Credit Guarantee Program Activity in FY 1991-1998 (Exhibit US-41 in the original proceedings) (Exhibit BRA-509). Only $7.6 million were issued in FY 2003. *See* Summary of FY 2003 Export Credit Guarantee Program Activity, USDA FAS Online, September 2003, accessed November 2006 at http://www.fas.usda.gov/excredits/Monthly/2003/03_09_30.pdf (Exhibit BRA-518).

[263] Brazil First Written Submission , para. 339.

[264] *Upland Cotton (Panel)*, para. 7.833; Summary of Export Credit Guarantee Program Activity in FY 1991-1998 (Exhibit US-41 in the original proceedings) (Exhibit BRA-509).

[265] Summary of Export Credit Guarantee Program Activity in FY 1991-1998 (Exhibit US-41 in the original proceedings) (Exhibit BRA-509); Summary of FY 2004 Export Credit Guarantee Program Activity, USDA FAS Online, September 2004, accessed October 2006 at http://www.fas.usda.gov/excredits/Monthly/2004/04_09_30.pdf (BRA-510); Summary of FY 2005 Export Credit Guarantee Program Activity, USDA FAS Online, September 2005, accessed October 2006 at http://www.fas.usda.gov/excredits/Monthly/2005/05_09_30.pdf (BRA-511); Summary of FY 2006 Export Credit Guarantee Program Activity, USDA FAS Online, September 2006, accessed October 2006 at http://www.fas.usda.gov/excredits/Monthly/2006/06_09_30.pdf (BRA-513); and Summary of FY 2003 Export Credit Guarantee Program Activity, USDA FAS Online, September 2003, accessed November 2006 at http://www.fas.usda.gov/excredits/Monthly/2003/03_09_30.pdf (Exhibit BRA-518).

of the *SCM Agreement*, the *Agreement on Agriculture*, or any other covered agreement dictates how a provider of guarantees must calibrate particular fees according to particular risks.

247. For GSM-102 guarantees, CCC imposes graduated fees based on both tenor and the applicable country risk. In addition, CCC imposes strict limits on exposure to individual bank obligors. Brazil dismisses this in arguing that the only way to achieve "prudent fiscal management" is to do it in the exact manner Brazil dictates, requiring not only the tight exposure limits that CCC employs, but also different fees for different banks. Brazil provides no basis in the text for the obligation it asserts.

248. Private sector creditors have individual methodologies for risk-rating and pricing of their products. And there is no reason to assume that the discretion of Members has been eliminated in this regard, especially in the absence of express obligations in the covered agreements to this effect. Indeed, to illustrate the myriad vehicles for risk management available to lenders, the United States provides in Exhibit US-157 the June 12, 2006 remarks of Ben Bernanke, the Chairman of the United States Federal Reserve Board on "Modern Risk Management and Banking Supervision." CCC chooses to manage its risk by setting the fee based on country risk and the relative repayment risk presented over time (tenor risk). To address the potential risk of default from the obligor bank, CCC opts instead to constrain its total potential exposure by establishing rigid limits for each particular obligor.[266] Brazil has provided no basis to reject these choices by the United States.

105. What considerations must guide the Panel's decision to accept or refuse new evidence or arguments on issues that were addressed by the original Panel? Please discuss in light of the following:

(a) The original Panel found that original subsidy estimates, while not reflecting 'actual' figures, nevertheless provide a reliable measure of the United States government's own assessment of the profitability of the export credit guarantee programmes. Is the United States asking the Panel to revisit that conclusion (see paras 108 ff. of the United States' First Written Submission).

(b) The United States presents evidence which, it argues, demonstrates that the three programmes examined by the original panel were operated at no net cost to the US government. Is there any issue as to whether the Panel can or should accept the United States' evidence in this respect?

[266] In this respect, CCC applies the CAMEL approach to its financial analysis, discussed in the response to Question 112, below

249. The United States assumes that the Panel's question above relates to the arguments set out in paragraphs coming before – not after – paragraph 108. The response that follows is based on this assumption.

250. First, the United States does not find any limitation in the DSU on the evidence and arguments that parties may submit in a compliance proceeding. This makes sense given that "Article 21.5 proceedings involve, in principle, not the original measure, but rather a new and different measure which was not before the original panel."[267] The question is simply one of the weight to be given to the evidence and arguments that are presented to the compliance panel. The United States has explained its views on that matter before in response to Question 2 in the first set of questions from the Panel and again under Question 54 above. Specifically, under Article 11 of the DSU, the Panel is tasked with, *inter alia*, making "an objective assessment of the matter before it, including an objective assessment of the facts of the case." In doing so, the panel is not bound by the findings of the original panel. Indeed, according to the Appellate Body, "the relevant facts bearing upon the 'measure taken to comply' may be different from the relevant facts relating to the measure at issue in the original proceedings."[268] Moreover, "the claims, arguments and factual circumstances which are pertinent to the 'measure taken to comply' will not, necessarily, be the same as those which were pertinent in the original dispute."[269] The Appellate Body has, therefore, clarified that:

> the utility of the review envisaged under Article 21.5 of the DSU would be seriously undermined if a panel were restricted to examining the new measure from the perspective of the claims, arguments and factual circumstances that related to the original measure, because an Article 21.5 panel would then be unable to examine fully the 'consistency with a covered agreement of the measures taken to comply,' as required by Article 21.5 of the DSU.[270]

251. Nonetheless, the Panel may well consider that the reasoning of the original panel to be persuasive on points that are apposite.[271] This would be true, for example, where the evidence before this Panel confirms that the same reasoning is appropriate in this proceeding.

252. In the case of export credit guarantees, however, it is especially important to consider the data that is becoming available regarding the actual performance of the programs. Much of this evidence was simply not available at the time of the original panel proceeding. And, in fact, the limited nature of the data available at that point constrained the conclusions that could be

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[267] *Canada – Aircraft (21.5 Brazil) (AB)*, para. 41.

[268] *Canada – Aircraft (21.5 – Brazil) (AB)*, para. 41.

[269] *Canada – Aircraft (21.5 – Brazil) (AB)*, para. 41.

[270] *Canada – Aircraft (21.5 – Brazil) (AB)*, para. 41.

[271] *United States – Shrimp (21.5 – Malaysia) (AB)*, para. 108 (citing *Japan – Alcoholic Beverages (AB)* at 108).

reached. There is no reason why this Panel should be similarly constrained even though fuller and more accurate information about the performance of the programs is now available.

253. Second, with respect to the original panel's findings regarding the original subsidy estimates, the United States notes that the original panel considered the significance of "original subsidy estimates" principally in the context of assessing the past performance of the programs. The original panel recognized that these are "initial estimates," subject to "re-estimations over the lifetime of the guarantees involved."[272] The original panel then proceeded to examine numerous other elements of the evidence on the record, all of which, in the original panel's view, buttressed a determination that the programs in fact did result in a net cost to the United States. This included, in significant respect: (1) the arguments of the parties concerning re-scheduled debt[273], (2) the cumulative re-estimates on a cohort-specific basis that then still showed a positive subsidy of approximately $230 million[274], and (3) the credit guarantee liability figure in the CCC financial statements.[275] Consideration of those factors together led the original panel to conclude that the three programs before it were "run at a net cost to the United States government."[276] In that context, the role of the "original subsidy estimates" was but one factor among an array of factors that, in the aggregate, led the original panel to reach its final conclusion about the profitability of the programs.

254. The facts now before the compliance panel are different and show a clearer and different picture of profitability. Two of the three programs that were at issue before are no longer operational, and the fee schedule and eligibility conditions for the GSM-102 program have been substantially modified. More significantly, as the United States has demonstrated, the subsidy estimate net of reestimate reflects a profit for the programs for all cohorts 1992-2006 of $403,714,701.[277] The original panel did not have – indeed, could not have had – this evidence before it as context in assessing whether not the original subsidy estimates provide a reliable measure of the United States government's assessment of the profitability of the export credit guarantee programmes. The United States has explained that they do not (and *why* they do not).[278] The evidence now fully bears out the U.S. explanations.

255. In any event, in the original panel's conclusions, the original subsidy estimates were not dispositive on the question of whether the three export credit guarantee programs met the test of

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[272] *Upland Cotton (Panel)*, para. 7.843

[273] *Upland Cotton (Panel)*, paras. 7.847, 7.851.

[274] *Upland Cotton (Panel)*, para. 7.852.

[275] *Upland Cotton (Panel)*, para. 7.855.

[276] *Upland Cotton (Panel)*, para. 7.856.

[277] *See* Answer of the United States to Question 111 below, updating the table in paragraph 87 of the U.S. First Written Submission.

[278] *See e.g.,* U.S. First Written Submission, paras. 100-104; U.S. Oral Statement, paras.22-23.

item(j). It was but one factor in the original panel's analysis. The original panel, however, also recognized the significance and relevance of re-estimation and the resulting net subsidy figure, whether positive or negative. An objective assessment of the facts before the compliance panel now indicates that premia under the GSM-102 program are adequate to cover the long-term operating costs and losses of the program.

106. The parties disagree as to whether Brazil should include recoveries for pre-1992 guarantees in its cash basis accounting formula (Exhibit Bra-613). Is the Panel correct in understanding that Brazil's formula does not includes amounts for (1) claims paid after 1992 under pre-1992 guarantees; (2) fees paid on pre-1992 guarantees? If so, please explain the relevance or non-relevance of including recoveries under pre-1992 guarantees in light of the non-inclusion of costs and other revenues related to the same guarantees.

256. The Panel is correct in understanding that Brazil's formula does not include amounts for (1) claims paid after 1992 under pre-1992 guarantees and (2) fees paid on pre-1992 guarantees.

257. Regarding Brazil's cash basis approach, the United States recalls again what the methodology purports to do – namely, to depict on a strictly chronological basis, for a finite period of time (FY 1993-2005), cash flows in and out related to the export credit guarantee programs. As Brazil – not the original panel – did in the original dispute with respect to the finite period 1993-2002, the methodology nets "program receipts against program disbursements on a fiscal year basis."[279] To the extent Brazil's approach is abandoning the credit reform approach and reverting to a strict cash-in, cash-out approach, it would be internally consistent and highly relevant to account for all of the cash in and all of the cash out during the specified finite period. To that end, in addition to the cash numbers presented by Brazil, the United States has noted the additional cash received and the additional cash out during the same time frame (FY1993-2005).[280]

258. The United States also recalls that the U.S. credit reform approach was developed and imposed to avoid precisely the kind of anomalies that arise under the strict cash-basis approach that Brazil now advocates. Indeed, as Brazil articulated before the original panel: "[p]rior to passage of the [Credit Reform Act of 1990], loan guarantees were recorded on a cash basis, which distorted their costs. [R]ecording guarantees on a 'cash basis distorted the timing of when costs would actually be incurred.'"[281]

259. Brazil championed credit reform accounting, instead, as:

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[279] Brazil Rebuttal Submission, para. 485

[280] U.S. Rebuttal Submission, para. 98 and fn. 150.

[281] Statement of Brazil - First (Original) Panel Meeting (22 July 2003), para. 128

> an ideal basis on which to determine whether the CCC's export credit loan guarantee programs are offered at premium rates that are inadequate to cover the long-term operating costs and losses of the programs, within the meaning of item(j) of the Illustrative List of Export Subsidies. It functions as a more sophisticated alternative to constructed cost formulas, and thoroughly accounts for all of the premium and operating cost and loss elements required by item(j). Moreover, it has the virtue of serving as the actual, real-world calculation used by the U.S. Congress, the President of the United States, and federal agencies like the CCC to "measure more accurately the costs of Federal credit programs."[282]

260. Again, Brazil never proposed to the original panel that its cash-basis methodology supplant the credit reform approach. To the contrary, "Brazil emphasize[d] that it does *not* intend for this revised constructed formula to *replace* the formula used by the U.S. government itself to track the costs of the CCC guarantee programs pursuant to the U.S. Federal Credit Reform Act."[283]

261. With respect to the cash-basis methodology that Brazil advances, Brazil accuses the United States of presenting a "skewed picture of the CCC's performance," because it allegedly does not take into account "defaults, write-offs or other losses on the same ECGs."[284] However, as an initial matter, the United States notes that it has never suggested that Brazil's methodology is an appropriate approach to examining the question at issue. It is *Brazil* that has championed the approach of examining cash flows from 1992 forward; the United States has simply identified the flaws in Brazil's analysis.[285] Therefore, it is inexplicable – and entirely disingenuous – that Brazil criticizes the United States for not including recoveries received before 1992 (indeed as far back as *1980*).[286] The methodology is Brazil's preferred approach. The United States considers it to inappropriate *in toto*.

262. Second, Brazil's accusation that the United States has not addressed "write-offs or unspecified 'other adjustments'"[287] is simply without merit. For example, in its oral statement, Brazil mentions specifically a $2 billion write-off in FY 2005 and suggests that the United States has not addressed this. Brazil is wrong. As is clear from the citation that Brazil provides, the cash-basis picture presented by the United States fully accounts for this figure. Brazil cites to

[282] Statement of Brazil - First (Original) Panel Meeting (22 July 2003), para. 129

[283] Brazil's Answers to Questions Posed by the Panel Following the First Substantive Meeting of the Panel, para. 164 (Question 77) (11 August 2003) (emphasis in original)

[284] Oral Statement of Brazil, para. 262.

[285] Brazil Rebuttal Submission, para. 133.

[286] Oral Statement of Brazil, para. 263

[287] Oral Statement of Brazil, para. 262.

"the U.S. Budget, CCC ECG Liquidating Account, FY 2007, p. 118, line 2364."[288] The $2 billion figure is shown as a net downward adjustment in the "Status of Guaranteed Loans." This item reflects a write-off of the outstanding *receivable* in the amount of approximately $2 billion owed from Iraq. This is *not* a cash expense. Indeed, the corresponding cash expense had already been accounted for in the $2 billion in claims that CCC paid and which were previously reflected in the "default claims" line 00.01, referred to in Exhibit Bra-613. The write-off of the *receivable* pertains to the reduction in value of an asset on the balance sheet of CCC. It has no bearing on the cash accounting that Brazil advances. The other two examples Brazil cites in footnote 290 of its Oral Statement are similar instances of a reduction in a receivable, not a cash outlay or expense.[289]

Questions to the United States

107. What can explain the discrepancy between the "credit guarantee liability" recorded in the CCC's financial statements (which suggest that the program is provided at a net cost to the US government) and the evidence presented by the US in para. 87 of its First Written Submission?

108. Please explain why the "liability" figure in the CCC's financial statements should not be considered by the panel to provide, if not the amount of actual losses, at least a reliable estimate of the CCC's own perception of the cost to the government of the programmes since their inception. Is the Panel wrong in understanding that a "credit guarantee liability" in this context means that the CCC considers that the programmes will not cover their costs and losses in the long term?

263. As Questions 107 and 108 are closely related, the United States addresses both together.

264. The "credit guarantee liability" figure recorded in the CCC's financial statements and the evidence presented by the United States in paragraph 87 of its first written submission represent two very different things:

- The "negative subsidy estimate net of re-estimates" in paragraph 87 of the U.S. first written submission represents profit.[290] Brazil has recognized that negative subsidy amounts reflect overall profitability of the program.[291]

[288] *See* Oral Statement of Brazil, para. 263, n.290.

[289] Line 2361 in the 1996 budget explicitly states that it shows "write offs of loans receivable"

[290] U.S. First Written Submission, para. 83, fn. 126, and citations therein.

[291] U.S. First Written Submission, para. 96, fn. 158, and citations therein.

- The "credit guarantee liability" figure, on the other hand, does not reflect either profit or loss. It is a balance sheet entry of liability *for which there is an offsetting balance sheet entry of an asset*. It does not reflect or suggest a "net cost" or "net profit" to the U.S. government. Similarly, as a credit guarantee liability is only on one side of a balance sheet, it does not purport to be an estimate of the ability of CCC to have adequate revenue to cover the costs and losses of the program in the long-term.

265. The U.S. Standard General Ledger provides a uniform chart of accounts and technical guidance to be used in standardizing federal agency accounting.[292] The U.S. Government Standard General Ledger sets forth instructions for all U.S. Government account transactions, including those for the CCC. The particular instruction applicable to credit guarantee liability is instruction C428.[293] That instruction prescribes how "to record loans and interest receivable from non-Federal sources for defaulted guaranteed loans." The instruction directs that upon the occurrence of a default on a guaranteed loan, the government agency is to record a credit for "loan guarantee liability" and an offsetting debit for loans receivable.[294] Instructions for treatment of "loan guarantee liability" are peppered throughout the Standard General Ledger, but each instruction directs an offsetting entry on the opposite side of the ledger.

266. In addition, each agency of the United States government, including CCC, has financial reporting requirements. The Office of the Management and Budget ("OMB") issues guidance and requirements in respect of financial reporting that are applicable throughout the federal government.[295] OMB Circular A-136 sets forth the required form and content of agency financial statements, including the CCC financial statements.[296]

267. Section 9 of the Circular sets forth the parameters for "Notes to the Financial Statements."[297] Note 8 of Section 9 specifically addresses Note Disclosures for "Direct Loans and Loan Guarantees, Non-Federal Borrowers" and the format of that note.[298] This is the portion

[292] Overview : US Standard General Ledger http://www.fms.treas.gov/ussgl/about.html (Exhibit US-158).

[293] Exhibit US-159 reproduces the Standard General Ledger cover; Treasury Financial Manual Transmittal Letter No. S2 06-02 (14 July 2006), which immediately follows the cover, and pages III-146 and III-151 of the Ledger. The Standard General Ledger itself is 1354 pages in length and is available in full in pdf format at: http://fms.treas.gov/ussgl/tfm_releases/06-02/ussgl_06-02.pdf
Pages III-146 and III-151 correspond to pages 972 and 977, respectively, in that format.

[294] In addition, it directs the agency to record a credit for "allowance for subsidy" and a debit for interest receivable. For each defaulted loan the total debits of interest receivable and loans receivable should equal the total credits of allowance for subsidy and loan guarantee liability.

[295] Office of Management and Budget Circular A-136 (Exhibit US-160).

[296] Office of Management and Budget Circular A-136, Overview, pp. 1-2 (Exhibit US-160).

[297] Office of Management and Budget Circular A-136, pp.63-105 (Exhibit US-160).

[298] Office of Management and Budget Circular A-136, p. 70-84 (Exhibit US-160).

of the required financial reporting requirements directly applicable to the "credit guarantee liability" figure.[299]

268. Consistent with the approach reflected in the Standard General Ledger, the instructions for Circular A-136 direct,"for each program with post-1991 Loan Guarantees, report gross receivables from defaulted guaranteed loans assumed for direct collection [] in column 2 [of Section I]."[300] Column 2 of Section I (Defaulted Guaranteed Loans from Post-1991 Guarantees) is entitled "Defaulted Guaranteed Loans Receivable, Gross".[301] The sum of the amounts reported in Section I "shall equal the amount reported on the Balance Sheet as loans receivables [sic] and related foreclosed property, net."[302] These are receivables *on the asset side of a balance sheet*.

269. *On the liability side of the balance sheet* is Section K: "Liability for Loan Guarantees."[303] The instructions for Section K state: "For each program with post-1991 loan guarantees, report in column 3 [of Section K] the present value of the estimated net cash flows (outflows less inflows) to be paid by the entity as a result of the loan guarantees."[304] This figure is then reported in the "total liabilities for loan guarantees (column 4 [of Section K])."[305]

270. ***Consequently, every federal government agency, including CCC, is required to reflect on its financial statements for each defaulted guaranteed loan: (1) an asset of a "gross receivable from defaulted guaranteed loan assumed for direct collection" and (2) an offsetting "credit guarantee liability."***

271. Turning to the Panel's question as to whether the liability figure may be considered a loss, the United States notes the original panel's explanation that a "liability" is defined as "... a probable future outflow or other sacrifice of resources as a result of past transactions or events."[306] The United States considers that this is an accurate and proper definition of liability. The original panel specifically noted that such a "probable future outflow" does not equate with

[299] Compare CCC Notes to Financial Statements, p. 26 (Exhibit BRA-585) with Office of Management and Budget Circular A-136, Schedule for Reconciling Loan Guarantee Liability Balances, p.77 (Exhibit US-160).

[300] Office of Management and Budget Circular A-136, pp. 82, 74 (Exhibit US-160). Analogously, "when the reporting entity has made payments on behalf of borrowers which should be collected from the borrowers, the resulting receivables shall be reported in the same column as loans receivable for either direct loans or defaulted guaranteed loans." Office of Management and Budget Circular A-136, p. 79 (Exhibit US-160).

[301] Office of Management and Budget Circular A-136, p. 74 (Exhibit US-160).

[302] Office of Management and Budget Circular A-136, p. 82 (Exhibit US-160).

[303] Office of Management and Budget Circular A-136, pp. 82, 75 (Exhibit US-160).

[304] Office of Management and Budget Circular A-136, p. 82 (Exhibit US-160).

[305] Office of Management and Budget Circular A-136, p. 82 (Exhibit US-160).

[306] *Upland Cotton (Panel)*, para. 7.855

"loss."[307] Citing the Federal Accounting Standards Advisory Board Statements of Federal Financial Accounting Concepts and Standards, the panel noted that the definition of "loss," in contrast, is "any expense or irrecoverable cost, often referred to as a nonrecurring charge, an expenditure from which no present or future benefit may be expected."[308] CCC clearly has an expectation of recovery on the receivable it has obtained in exchange for its payment for a default on a guaranteed loan. Therefore, the receivables are not properly considered to be "losses."

272. The United States notes in this regard that Brazil has attempted to characterize the credit guarantee liability figure as a "new cumulative loss figure of $220 million" for all export credit guarantees issued after fiscal year 1991.[309] This is simply inaccurate. As discussed above, the credit guarantee liability figure does not in any way depict or purport to depict a retrospective cumulation of loss.

273. On the question of whether or not to consider the credit guarantee liability figure to be some indicator of the U.S. government's perception of the cost of the programmes since their inception, the United States considers that it is not such an indicator for the reasons just explained – namely, it represents only one side of the equation. The original panel appeared to ascribe such significance to it[310] on the understanding that the credit guarantee liability represented a prospective estimate of anticipated experience under the program.[311] While it does provide such an estimate, it cannot be viewed alone without considering the offsetting entries on the asset side, arising from the expectation of recovery on loans receivable as a result of CCC's subrogated position to collect on such loans following default.

109. Please indicate to the Panel whether there have been occurrences of reschedulings prior to the occurrence of defaults and the payment of claims by the CCC.

274. To the best of the U.S. knowledge, the CCC has never rescheduled any obligations guaranteed under the export credit guarantee programs prior to the occurrence of default.

110. Is it possible to calculate the "subsidy estimate net of reestimates" for GSM 102 alone (similar to what the US has done for all three programmes in para. 87)? If so, please provide a table recording the results of this exercise.

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307 *Upland Cotton (Panel)*, para. 7.855

308 *Upland Cotton (Panel)*, para. 7.855, fn. 1030

309 Brazil Rebuttal Submission, para. 484.

310 *Upland Cotton (Panel)*, para. 7.855.

311 U.S. Answers to (Original) Panel's Question 227 Following Second Panel Meeting (22 December 2003)

275. The United States has only maintained and published disaggregated figures for each of GSM 102, GSM 103, and SCGP as of the budget for fiscal year 2007. Before that time the three programs were grouped together for purposes of calculation of the subsidy estimate net of reestimate reflected in paragraph 87 of the U.S. first written submission. To calculate this figure specifically for each cohort of the GSM 102 guarantees would require an original subsidy estimate for each such GSM 102 cohort. Unfortunately, the United States does not have such data for any cohorts before FY 2005. The table below reflects the data for GSM-102 cohorts 2005 and 2006.

GSM-102 Export Credit Guarantee Program
Subsidy Estimates and Reestimates by Cohort
FY 2005 and 2006 Cohorts
(Dollars in Thousands)

Cohort	Original Subsidy Estimate		Total Lifetime Reestimates a/	Subsidy Estimate Net of Reestimates
2005	$142,000	b/	-$92,209	$49,791
2006	71,000	c/	-18,324	52,676

a/ 2008 U.S. Government Budget Federal Credit Supplement: Table 8 – Loan Guarantees: Subsidy Reestimates; p. 45 (Exhibit US-74)
b/ 2007 U.S. Government Budget Appendix: CCC Export Loans Program Account line 233001; p.116 (Exhibit BRA-544)
c/ 2008 U.S. Government Budget Appendix: CCC Export Loans Program Account line 233001; p.105 (Exhibit US-161)

276. Although the subsidy estimate net of reestimates for these very recent cohorts is currently positive, it is important to note the precipitous decline in the subsidy estimate for both cohorts in only the short time that has elapsed since the issuance of these cohorts. The United States has explained why original subsidy estimates are routinely too high.[312] The United States will not repeat its arguments here, but will simply note that the considerations reflected in the U.S. submissions are equally applicable to the 2005 and 2006 cohorts of GSM-102 guarantees. In this context, the United States also refers the Panel to the response of the United States to Question 102 above.

111. In paragraph 7.853, the original Panel stated that it "disagree(d) with the United States that we should 'eliminate' the data for certain, more recent, cohorts in our analysis." Is the United States asking that this Panel eliminate such data for the most recent cohorts (the table at para. 87 of the United States' First Written Submission includes data up to 2005 only). Why should this Panel do what the original refused to do? What would be the result of the

[312] U.S. First Written Submission, paras. 102-104; U.S. Rebuttal Submission, paras. 108-126.

United States "re-estimates" exercise if the original subsidy estimate for the 2006 and 2007 cohorts were included?

277. The United States has not asked this Panel to eliminate data for the most recent cohorts. The data in the table at paragraph 87 of the U.S. First Written Submission includes data up to 2005 only because, as Brazil has noted, that was the most recent year for which full data was available.[313] Enough time has elapsed now to include data for FY 2006. This data is reflected in the table below. As FY 2007 is still on-going, reestimates for that year are not yet available.

GSM-102/GSM-103/Supplier Credit Guarantee Programs
Subsidy Estimates and Reestimates by Cohort

Cohort	Original Subsidy Estimate		Total Reestimates a/	Subsidy Net of Reestimates
1992	$267,426,000		-$783,477,474	-$516,051,474
1993	171,786,000		-364,465,718	-192,679,718
1994	122,921,000		-133,746,048	-10,825,048
1995	113,000,000		-160,155,549	-47,155,549
1996	328,000,000		-390,121,131	-62,121,131
1997	289,000,000		-287,071,897	1,928,103
1998	301,000,000		-290,034,778	10,965,222
1999	158,000,000		-181,797,405	-23,797,405
2000	195,000,000		-210,481,742	-15,481,742
2001	103,000,000		-175,810,225	-72,810,225
2002	97,000,000		-95,302,249	1,697,751
Subtotal 1992-2002	**2,146,133,000**		**-3,072,464,216**	**-926,331,216**
2003	170,000,000		-111,539,816	58,460,184
2004	457,000,000		-199,652,868	257,347,132
2005	152,000,000		2,133,680	154,133,680
2006	71,000,000	b/	-18,324,481	52,675,519
Subtotal 2003-2006	**850,000,000**		**-327,383,485**	**522,616,515**
Total	**2,996,133,000**		**-3,399,847,701**	**-403,714,701**

a/ 2008 U.S. Government Budget Credit Supplement: Table 8 – Loan Guarantees: Subsidy Reestimates; p. 45 Exhibit US-74

b/ 2008 U.S. Government Budget Appendix: CCC Export Loans Program Account line 00.02; p. 105. (Exhibit US-161)

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[313] Rebuttal Submission of Brazil, para. 486.

278. Indeed, the numbers are now even more favorable than as set forth in the U.S. First Written Submission. For cohorts 1992-2002, examined by the original panel, the negative subsidy net of reestimates (i.e., profit) is now $926,331,216 (up from $762,676,594). For all cohorts 1992-2006, the negative subsidy net of reestimates has improved from a profit of $166,549,780 to a profit of $403,714,701.

112. Please explain whether and how the CCC limits risks or control costs of the GSM 102 programme as regards foreign banks' individual credit ratings.

279. Under the GSM-102 program, CCC limits its risk of exposure to default by obligor banks by establishing a particular credit limit for each bank. CCC will not issue credit guarantees in respect of a particular bank beyond its applicable credit limit. In conducting its analysis of individual banks to establish such credit limits, CCC maintains a matrix indicating the correspondence of CCC's categorization of bank risk with that used by various external rating agencies such as Fitch Ratings, Moody's Investor Services, Standard and Poors, and Capital Intelligence. Such external ratings are used as a comparative tool in the establishment of the CCC ratings. Most of the banks for which CCC has established credit limits are not rated by all of these external rating agencies. Some banks, in fact, may not be rated by any of these external rating agencies.

280. In addition, CCC takes the applicable country risk rating into account. In general, the bank does not receive a more favorable rating than the country in which it is domiciled.

281. CCC also conducts an independent financial and risk analysis of each bank as part of the process to establish a risk rating for such bank. To the extent they exist, external agency ratings are an important component of the overall analysis and assessment.

282. CCC uses the traditional CAMEL approach in its analysis.[314] This approach analyzes capital adequacy (C), asset quality (A), management (M), earnings (E), and liquidity (L) of the particular bank. Other factors, such as franchise value, market risk, and operational risk are also taken into consideration.

283. CCC further uses another matrix to assure that credit limits as a percentage of net worth reflect the bank's risk rating - a bank with a better risk rating can have a higher credit limit as a percentage of net worth than a bank with a lower risk rating.

113. Please explain whether and how CCC country risk categories correspond to ICRAS ratings.

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[314] *See, e.g.*, Federal Reserve Board Supervisory Letter SR 94-12 http://www.federalreserve.gov/BOARDDOCS/SRLETTERS/1994/SR9412.HTM (Exhibit US-162); "Applying the CAMEL Framework", Asian Development Bank http://www.adb.org/Documents/Guidelines/Financial part060302.asp (Exhibit US-163).

284. Eligible countries for CCC export credit guarantees are graduated in seven CCC risk grades enumerated 0 through 6.[315] ICRAS provides two risk ratings for each country – a sovereign rating and a non-sovereign rating. Each country is rated on an 11-category scale.[316] ICRAS country risk grades are a significant component in the development of CCC country risk grades.

Question to Brazil

114. Brazil argues that "(t)hat the United States has, on one view of the data, beaten the odds and met its costs and losses over a series of years does not mean that ECG programs are structured and designed to do so" (para. 503, Brazil's Rebuttal). Is Brazil arguing that evidence regarding the actual operation and "profitability" of the programme (i.e. retrospective evidence) is irrelevant to the Panel's analysis under item (j)?

[315] GSM-102 Guarantee Fee Rate Schedule, USDA FAS Online, accessed September 2006 at www.fas.usda.gov/excredits/gsm102fees.html (Exhibit BRA-505).

[316] For further information see Government Accountability Office's report #GAO-04-531 (Exhibit US-164).