

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

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

**Comments of the United States on Brazil's Answers
to the Additional Questions from the Arbitrators**

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***United States – Subsidies on Upland Cotton:
Arbitration under Article 22.6 of the DSU and Article 4.11 of the SCM Agreement
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***United States – Subsidies on Upland Cotton:
Arbitration under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement
(WT/DS267)***

**U.S. Comments on Brazil’s Answers
to the Additional Questions from the Arbitrators to the Parties**

General Comments on Brazil’s Answers

1. Before reaching its specific comments on Brazil’s answers to the Arbitrators’ questions, the United States offers some general comments on those answers to frame the Arbitrators’ analysis.
2. Brazil’s answers confirm that every step in Brazil’s request for countermeasures is characterized either by relying on unprecedented and unfounded requests, unsupported assertions, or exaggerated claims. This has resulted in the huge amounts of countermeasures that Brazil wants the Arbitrators to authorize. Brazil’s choices on legal issues and on calculations both contribute to this maximalist approach.
3. The specific criticisms by the United States reveal the pattern of Brazil’s consistent overreaching, for example:
 - Request for countermeasures for Step 2, when the repeal of this program is uncontested
 - Request for retroactive countermeasures, going back to 2005, even though there is no basis for such countermeasures in the WTO
 - For GSM 102, combination of two separate legal theories (amount of the subsidy and trade effects)
 - For GSM 102, use of unfounded assumptions regarding “creditworthiness” and “additionality,” along with obscure calculations for an enormous result, while providing no evidence of any effects on a single Brazilian sale
 - For marketing loan and countercyclical payments, ignoring the fact that the findings of serious prejudice are with respect to the interests of Brazil – not the entire world – with the result that Brazil seeks countermeasures for an amount more than 25 times what it would be entitled even under its own calculations
 - For marketing loan and countercyclical payments, use of a legally erroneous

counterfactual that narrowly focuses only on the short term reaction to withdrawal of payments and that, as a result of the associated parameter choices, greatly exaggerates the effects of these subsidies

- Use of the resulting enormous numbers to justify cross-sectoral countermeasures, even though Brazil is one of the world's largest economies.

4. Brazil's choices are not based on the applicable legal standards but are driven by a results-oriented approach. Brazil is asking for enormous countermeasures and exceptional cross-sectoral suspension of concessions, while at the same time Brazil has not provided evidence of how the U.S. measures negatively affect Brazil itself. The United States requests that the Arbitrators reject Brazil's persistent over-reaching and prepare an award consistent with the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") and the rules of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement").

Comments on Specific Answers of Brazil

LEVEL OF COUNTERMEASURES IN RELATION TO THE PROHIBITED SUBSIDIES

Notion of "appropriate countermeasures"

To both parties:

69. *Brazil has requested countermeasures based on particular principles. Does the Arbitrator have to agree that the request is justifiable in terms of the principles used, or is within a range of principles which could be justified, before a "burden of proof" is imposed on the US? Would the Arbitrator have to accept any proposal put to it, by Brazil, unless the US disproves it?*

5. The United States agrees with the statement in Brazil's answer to Question 69 that the burden of proof in this proceeding rests on the United States, as the party asserting the inconsistency of Brazil's request for countermeasures, to establish that Brazil's request is inconsistent with the relevant provisions of the SCM Agreement and the DSU. And the United States has met that burden – not even Brazil continues to maintain that its request is consistent with the covered agreements. Brazil has abandoned its original request for countermeasures, and proposed an entirely new methodology in its methodology paper, which it has defended and elaborated in this proceeding. Accordingly, as discussed in the U.S. response to Question 69, the U.S. has satisfied its initial burden of proof.

6. However, Brazil then goes on to state that this means in practice that "the United States is required to establish that Brazil's formula is, and/or the amount of proposed countermeasures resulting from application of that formula are, *inappropriate* and *disproportionate*." By

“formula” the United States assumes that Brazil is referring to its new proposed approach to countermeasures and not to its original, now abandoned, request. In any event, Brazil claims that its statement regarding what this burden means in practice is based on Articles 4.10 and 4.11 of the *Agreement on Subsidies and Countervailing Measures* (“SCM Agreement”). For support, Brazil cites to five arbitrator awards, but none of these supports Brazil’s assertion concerning a “formula.” Four of the awards did not deal with Article 4.10 or 4.11 of the SCM Agreement at all, let alone a “formula,” and the fifth does not support Brazil’s assertion since it also does not refer to a “formula.” Furthermore, there is nothing in Article 4.10 or 4.11 of the SCM Agreement that refers to a “formula.” Brazil’s statement is simply in error.

7. Moreover, when a party challenging proposed countermeasures has satisfied the burden of proof, the task of the Arbitrator is to determine the award for countermeasures under the applicable standard. In this way it is different from the situation before a panel. Brazil’s assertion in paragraph 5 of its response is in error on this point. For prohibited subsidies, the Arbitrator’s task remains determining “appropriate” countermeasures. Further, the United States recalls that Brazil and the United States are each obligated to provide the evidence to support the facts they advance in support of their arguments.¹

70. *What is the role of the Arbitrator in these proceedings? Is it limited to agreeing or disagreeing with either or both of you, or would it extend to proposing an alternative figure, whether based on the principles presented to the Arbitrator or on principles substituted, by the Arbitrator, for those presented to the Arbitrator?*

8. In its response to this question, Brazil highlights the self-described transparency and flexibility of the methodology it has proposed for countermeasures. The United States has several comments in this regard.

9. First, the approach to countermeasures presented by the United States (“net cost to government”) uses the same data that the Appellate Body characterized as “‘compelling’ evidence as to what one should anticipate under the revised GSM 102 program”² and that were used throughout these proceedings to assess GSM 102 guarantees. It is a transparent approach, reflecting budgetary requirements of the U.S. government. Unlike Brazil’s methodology, the U.S. calculation was not created for litigation purposes.

10. Second, as to Brazil’s approach itself, its complexity and the numerous problems that the United States has detailed with the different components of the calculation work against the

¹U.S. Answer to Question 41, para. 50, citing *US-FSC (Article 22.6)*, para. 2.11; *Brazil-Aircraft (Article 22.6)*, para. 2.9; *Canada-Aircraft II (Article 22.6)*, para. 2.8.

²*US-Upland Cotton (Article 21.5) (AB)*, para. 299.

claims of transparency and flexibility. For example, on additionality, the wildly large elasticities that result from Brazil's model – which require the "capping" that the Arbitrator has asked about – is still not explained. Brazil's creditworthiness determinations are still based on an arbitrary line, and the presumed relationship between creditworthiness and additionality is equally arbitrary. In each instance, the problems with Brazil's methodology result in a larger calculation for proposed countermeasures. This underscores the reason that the Arbitrator should reject Brazil's approach: regardless of whether aspects of it are transparent or flexible, the results produced by Brazil's methodology are far too high to be "appropriate" countermeasures.³ (Notwithstanding that the Arbitrator should reject Brazil's approach, the United States has demonstrated various adjustments for the calculation. In particular, the United States recalls that even the simple change of using actual or imputed default probabilities makes the interest rate subsidy component of Brazil's calculation fall by more than half.⁴)

11. Finally, the United States notes Brazil's request that the Arbitrator will offer the parties the opportunity to comment on any "material departures" from Brazil's formula that the Arbitrator wishes to explore. Although the working procedures of this arbitration provide that the Arbitrator may ask questions of the parties at any time during the proceedings, they do not provide for an interim review such as Brazil suggests. However, the United States does not object if the Arbitrators provide for an interim review. And in particular, if Brazil has the opportunity to comment, the United States respectfully requests the opportunity to comment as well. The opportunity for each party to comment should not be tied to whether the Arbitrator is proposing a material departure from one party's approach versus another's.

71. Are the amount of subsidy and trade effects on the complaining Member the only parameters that define "appropriate countermeasures", or could the appropriateness of countermeasures differ depending the circumstances of each specific case? Would it be possible to use calculation principles other than the "amount of the subsidy" and "trade effects" in working out the quantum of the "appropriate countermeasure" under Article 4.10 of the SCM Agreement?

12. Brazil's response to Question 71 distinguishes the two concepts of interest rate subsidy and additionality. The United States concurs that these are two different concepts. Indeed, the fact that they are different concepts supports the U.S. position that "appropriate"

³If the Arbitrator's award provides that Brazil may calculate countermeasures on the basis of a formula, these assumptions, uncertainties, and complexities in its calculations will all be even more significant, particularly if the parties would need to revisit all these details on an annual basis when Brazil determines the amount of concessions to suspend. For transparency, an approach as complex as Brazil's is particularly inappropriate for a use as a formula.

⁴U.S. Answer to Arbitrator Question 81, para. 22.

countermeasures cannot include both interest rate subsidy and trade effects (additionality).

13. Brazil argues that even if the Arbitrator rejects adding the two approaches together in the way Brazil first proposed – that is, because these two approaches allegedly both contribute to the “amount of the subsidy” – it could nonetheless include both components in an award. This is not so.

14. First, the United States notes that Brazil’s new argument is yet another effort to exaggerate the size of the award to which it is entitled. The first exaggeration was contained in its DSB request, which set out a formula (amount of applications received from exporters) which Brazil evidently decided it could not even attempt to justify in this arbitration. The second exaggeration was to label as “amount of the subsidy” the alleged interest rate subsidy as well as trade effects (“additional” U.S. exports). The Arbitrator should recognize Brazil’s latest argument as a third effort to obtain a grossly exaggerated award that has no more merit than the first two.

15. Second, Brazil’s new argument that an award could include both amounts corresponding to the alleged amount of the subsidy *and* trade effects finds no support in previous arbitrations. Arbitrators have relied on the principle of “trade effects” or, in the case of prohibited subsidies, “amount of the subsidy” as the basis for calculations. They have not added two sets of results of calculations as Brazil would do. Where Arbitrators have considered two approaches, it has clearly been an “either/or” choice.⁵ Brazil has presented no argument for why the Arbitrator should not proceed similarly here.

16. Third, to set an amount of countermeasures based on both components would not be “appropriate” because that amount would be “disproportionate” to the level of nullification or impairment suffered by Brazil. Both the general rules of the DSU and the special and additional rules of the SCM Agreement govern the standard for “countermeasures.” The DSU provides the baseline, of “nullification and impairment” to a Member for suspension of concessions, and, in Article 3.8, affirms that inconsistencies under other agreements (such as the SCM Agreement) constitute nullification and impairment. The special and additional rule of “appropriate” and “not disproportionate” in Article 4.11 of the SCM Agreement provides some additional flexibility, but it must be read in context and it still limits possible countermeasures. Past arbitrators on countermeasures for prohibited subsidies have used an “amount of the subsidy” approach, but have presented it as a possible alternative to the trade effects approach. Brazil’s two-part approach combines both the amount of the subsidy and trade effects, with neither component including any calculation of the effect on Brazil. The two components, consistent with the way they have been discussed by past arbitrators, are *alternatives*, not two parts of one

⁵*Canada-Aircraft (Article 22.6)*, para. 3.30; *Brazil-Aircraft (Article 22.6)*, paras. 3.57-3.60; *U.S.-FSC (Article 22.6)*, paras. 6.33-6.34.

calculation of countermeasures. Any countermeasures calculated under this combined approach will be disproportionate.

17. Brazil's approach would permit both components to be included in an award simply because they both may exist and be measured as a matter of economic theory. Brazil calls them "features of the program" and points to the fact that (as the U.S. has acknowledged), academic literature has examined different aspects of export credit guarantees, including interest rate discounts and trade effects. But the fact that different components may exist is not a principle upon which the Arbitrator may award countermeasures. If that were the case, a party might accumulate multiple features of a subsidy (e.g., cost to government, benefit to the recipient, effect on exports) and include them all in the calculation of countermeasures, without regard to whether they are "appropriate" according to a principle such as "amount of the subsidy" or "trade effects."

18. Separately, Brazil points to the purpose for countermeasures of "inducing compliance." Countermeasures are intended to be temporary, and compliance is a goal. But countermeasures must also be "appropriate" and "not disproportionate" in order to meet the standard of Article 4.10/4.11. The goal of inducing compliance cannot be used as the basis to award countermeasures that would exceed this standard.⁶ Indeed, Brazil's frequent refrain that its revised request (under its newest argument) would be "appropriate" because it serves the goal of "inducing compliance" shows that that goal cannot be the basis for judging whether countermeasures are "appropriate" and "not disproportionate". Because a request for countermeasures should only be made when compliance has not been achieved, the goal of "inducing compliance" would permit a request of *any* level as "appropriate" to make the cost of non-compliance sufficiently higher than the cost of coming into compliance. The United States (and to greater and lesser degrees past arbitrators) have explained the standard against which "appropriate" and "not disproportionate" should be measured. And Brazil tacitly concedes that "appropriate" cannot simply be judged against the goal of "inducing compliance" since, if that were the correct comparison, Brazil would simply have defended to the Arbitrator its initial request for DSB authorization, which set out a formula (total value of exporter applications received) that would produce a number *higher* than the formula of alleged interest rate subsidy plus trade effects (additionality).

19. As noted above, Article 4.10/4.11 of the SCM Agreement does provide some additional flexibility compared to the "equivalence" standard in Article 22 of the DSU. Strict "equivalence" is not required, and arbitrators have used principles such as "amount of the subsidy" to assess countermeasures. But countermeasures must still be "appropriate." They cannot be based on cumulating the results of multiple theories (e.g., trade effects plus amount of the subsidy) and they cannot be justified solely on the basis that they may induce compliance.

⁶See U.S. Answer to Question 84, para. 34.

72. *Reference has been made to the ILC's Articles on State Responsibility.*

What exactly is the legal relevance of the notion of “countermeasures” as reflected in the ILC’s Articles on State Responsibility in the context of this Arbitrator’s assessment?

Do these Articles reflect or embody, in your view, rules of public international law?

Please comment on the following passage of the commentaries to the Draft Articles:

in every case a countermeasure must be commensurate with the injury suffered, including the importance of the issue of principle involved and this has a function partly independent of the question whether the countermeasure was necessary to achieve the result of ensuring compliance.

20. As the United States explained in its response to questions,⁷ the ILC articles are not relevant to this proceeding because they are not covered agreements (DSU Article 1.1) and are not relevant to an examination of the meaning of the provisions of the covered agreements at issue in this proceeding under customary rules of interpretation of public international law.⁸

21. Separate from the issues with regard to the status of the ILC Articles, the ILC Articles themselves confirm that they are not relevant for the purposes of this proceeding. Article 55 provides that the Articles do not apply where special rules of international law govern. WTO dispute settlement is such a situation.

22. Brazil’s response to question 72 acknowledges the significance of Article 55, and states that the “ILC Commentaries mention the WTO dispute settlement system as an example of a system involving special rules with respect to “certain remedies.”⁹ In spite of this, Brazil still argues that the ILC Articles have a role in forming an understanding of countermeasures. More specifically, Brazil relies on certain articles of the ILC Articles where it fits their approach to countermeasures. But when they do not – as in the passage from the commentaries that would

⁷U.S. Answers to Arbitrator Questions 67, 72, 112.

⁸Brazil states that the ILC Articles “codify the ‘basic rules of international law’ concerning State responsibility.” But the actual text of the commentaries does not go so far. They state: “These articles seek to formulate, by way of codification and progressive development, the basic rules of international law concerning the responsibility of States for their internationally wrongful acts.”

⁹Brazil Answer to Question 72, para. 18.

require that countermeasures be commensurate with a party's injury¹⁰ – Brazil does not rely on the ILC Articles. This selective approach is only self-serving.

23. As the United States explained in its response to this question, the terms of the DSU and the SCM Agreement provide that countermeasures are limited to the effect on a Member; it is not necessary to turn to the ILC Articles.

24. Brazil also refers to Article 51 of the ILC Articles, which provides for consideration of the “position of other States” in determining countermeasures. It is not clear what “consideration” would mean in light of a standard for countermeasures such as “appropriate” or “not disproportionate.” Regardless, the critical point is not how “consideration” might be interpreted. The critical point is that Article 51 does not govern. The DSU and the SCM Agreement provide the *lex specialis* in this dispute, and the standard by which the Arbitrator will determine countermeasures. This standard does not include consideration of the position of other states.

73. In the event that the Member concerned fails to bring the relevant measure into compliance, Article 22.2 of the DSU envisages that Member entering into negotiations with the complaining Member[s] with a view to developing mutually acceptable "compensation". A similar compensation mechanism is not provided for in the dispute settlement provisions of the SCM Agreement. Might this suggest that the SCM Agreement is not necessarily concerned with "compensating" the complaining Member for the nullification or impairment of benefits accruing directly to it? Please explain.

25. Contrary to Brazil's interpretation, the concept of compensation is not absent from the provisions of the SCM Agreement. As the United States explained in its response to this question, suspension of concessions is a last resort, after the possibility of compensation, in the context of the special and additional rules of the SCM Agreement and under the generally applicable rules of the DSU.

74. Article 3.8 of the DSU provides that an infringement of obligations assumed under a covered agreement, including the SCM Agreement, "is considered prima facie to constitute a case of nullification or impairment". Indeed, the original panel made such a finding of nullification or impairment at para. 8.2 of its Report. What is the relevance, if any, of Article 3.8 of the DSU to the issue of whether or not the scope of countermeasures under the SCM Agreement should necessarily be restricted to nullification or impairment of benefits accruing directly to the complaining Member? In particular, why would Article 3.8 provide for nullification or impairment in the event of a violation of the SCM Agreement if that concept were not to play a role in determining the scope of

¹⁰ILC Commentaries on Article 51.

countermeasures authorized under that agreement? Is there anything about Article 3.8 which tells us that the nullification or impairment is limited to the effect of the non-compliance on the complaining party?

26. As the United States has explained, the concept of nullification and impairment is not absent from the SCM Agreement, even though special and additional rules apply. The special and additional rules are not “instead of” the DSU rules where there is no conflict between the DSU rule (such as that in 22.4) and the special and additional rule. With respect to the concept of nullification and impairment, Article 3.8 of the DSU affirms that it continues to apply in the subsidies context.

27. Brazil's suggestion that “at most” nullification and impairment applies as a floor for countermeasures is in error. The SCM Agreement provides standards as to the amount of countermeasures. These standards inform how high countermeasures may be. Inserting “nullification and impairment” as a floor is contrary to the idea of determining the “appropriate”/ “not disproportionate” countermeasures or the countermeasures “commensurate with the nature and degree of the adverse effects determined to exist” (as the case may be.)

75. Imagine the DS267 proceedings had been initiated by a Member who produces none of the products covered by the subsidy programmes at issue. Imagine also that that Member requested authorization to adopt the exact same countermeasures as those requested by Brazil, on the basis of the findings of WTO-inconsistency already obtained by Brazil in the earlier proceedings. Should the fact that that Member does not suffer any economic disadvantage as a result of the relevant subsidy programmes affect the Arbitrator's determination of whether the proposed countermeasures are "appropriate" and "commensurate with the degree and nature of the adverse effects determined to exist"? Please explain.

28. Brazil responded to this question separately for prohibited and for actionable subsidies. The United States has particular comments on each type of subsidy. To begin, however, we note once again that Brazil's position essentially amounts to allowing a complaining Member to suspend trade concessions on behalf of another Member, even when that other Member has not chosen the “last resort” option in its trade relations with the responding Member, and that this reading is inconsistent with the SCM Agreement read in its broader context. This concern is only heightened where, as in the hypothetical set out in the Arbitrator's question, the complaining Member suffers no economic consequences from the measure at issue (while of course the countermeasures it imposes would create such economic consequences for trade relations more generally).

29. For prohibited subsidies, Brazil suggests that it would be inconsistent with the proper interpretation of the SCM Agreement to adopt a benchmark of the impact of a prohibited subsidy on the complaining Member. To the contrary, although past arbitrators considering

countermeasures for prohibited subsidies have elected the “amount of the subsidy” approach, they have acknowledged that an award could be based on trade effects/nullification and impairment. The two alternatives are both available, and this conflicts with Brazil’s idea that an award based on impact on the complaining Member would be inconsistent with the SCM Agreement.

30. The fact that the SCM Agreement directs Members to withdraw prohibited subsidies does not change this. The question posed by the Arbitrator relates to assessing countermeasures under the applicable standards. The action that a Member may take to comply with DSB recommendations and rulings does not change these standards.

31. For actionable subsidies, Brazil points to the specific provisions of the SCM Agreement, particularly Articles 5 and 6, to challenge the premise of the Arbitrator’s question. Brazil seems to be saying that the situation posed in the Arbitrator’s question would not occur because a finding of adverse effects would always be accompanied by a showing that a complaining Member has an interest in the market at issue.

32. But, the Arbitrator’s question is focused on the Arbitrator’s task of determining countermeasures. Under Articles 7.9 and 7.10, they must be commensurate with the adverse effects determined to exist, and as the United States has explained, these “adverse effects” are the effects on the complaining Member (Article 5). This emphasis on the complaining Member is reinforced by the different provisions of Article 6.3, concerning serious prejudice.¹¹ In other words, the provisions of the SCM Agreement that are most directly on-point for the Arbitrator’s task (Articles 7.9, 5, and 6.3) all demonstrate that the economic damage suffered by the complaining Member (for actionable subsidies, adverse effects) is fundamental to determining countermeasures that are “commensurate” with those effects as required by Article 7.10.

To Brazil:

76. *Do you consider that countermeasures could be authorized under Article 4.10 of the SCM Agreement to any level that would be apt to “induce compliance”? If so, why would the amount of the subsidy necessarily be a good indicator of what it would take to induce compliance?*

33. To support its position on the goal of “inducing compliance,” Brazil cites to *Canada-Aircraft*, where the Arbitrator inflated the amount of the award by 20%.¹² The United States is concerned about the implications of Brazil’s position, and the arbitrator’s award in that dispute.

¹¹U.S. Answer to Question 115.

¹²*Canada-Aircraft (22.6)*, paras. 3.121-3.122.

Canada, among others, expressed such concerns before the DSB. As the minutes record Canada's statements, "Members had never agreed to create a dispute settlement system that imposed penalties on Members. The focus of the Arbitrator in the case on the so-called, 'aggravating factors' reflected a conception of countermeasures as a punitive instrument, a conception that found no support in the SCM Agreement or the DSU."¹³ The European Communities similarly expressed concerns regarding the addition of the 20%, expressing the view that it "should be clear that the amount of countermeasures could not be increased by an arbitrator so as to be punitive."¹⁴

34. Articles 4.10 and 4.11 of the SCM Agreement provide some additional flexibility not found in the general rule of "equivalent" to nullification and impairment in Article 22 of the DSU. But this flexibility is not open-ended: countermeasures must not be disproportionate. The term "disproportionate" necessarily entails a comparison to something. To determine an award – and whether it is disproportionate under the applicable standard – an Arbitrator must use a benchmark or standard. Although the text is not explicit, the "something" or benchmark/standard is nullification and impairment, as evidenced by Article XXIII of the GATT 1994 and by the DSU, both of which also apply to the SCM Agreement. An uplift to an award, merely adding additional inducement to comply, is not based on any such benchmark or principle. Countermeasures determined on the basis of "inducing compliance" are unlikely to be appropriate, and very likely to be disproportionate.

77. *You emphasize the "prohibited nature" of export subsidies.*

(a) Is there anything fundamentally different about the prohibited nature of a subsidy, compared to the prohibited nature of, for example, a prohibited import ban under Article XI of GATT 1994?

(b) Is there anything fundamentally different about an obligation to "withdraw" a subsidy and an obligation to "bring into conformity", for example, a WTO-inconsistent quantitative restriction?

(c) Would you agree that export subsidies are prohibited precisely because they are more inherently prone to produce adverse effects?

35. As an initial matter, there is nothing fundamentally different between a prohibited subsidy and any other measure inconsistent with a covered agreement. Any such measure, including a prohibited subsidy, is "prohibited" in the sense that it is inconsistent with a covered agreement.

¹³WT/DSB/M/145, p. 11.

¹⁴WT/DSB/M/145, p. 11.

And the DSU calls for any such measure to be withdrawn. Furthermore, the fact that a measure may be a prohibited subsidy does not mean that there is some different requirement with respect to compliance – a prohibited subsidy may be brought into compliance not by withdrawing the measure in its entirety, but by removing the contingency that causes it to be prohibited.

36. Brazil exaggerates the difference between the rules for prohibited subsidies, and the other rules of the covered agreements. Brazil cites to several supposed bases to distinguish prohibited subsidies from other types of measures, but none of these bases withstands careful examination. To take each in turn, Brazil cites to:

- (a) use of the term “prohibited” as “unusual” and to indicate the “unambiguously forbidden character” of prohibited subsidies. In reality, this serves simply to differentiate export- and import substitution- contingent subsidies from other types that are “actionable.” Nor is the use of strong terms unique to prohibited subsidies. Under Article VI of the GATT 1994, for example, dumping is “condemned,” but it is not even “prohibited.”
- (b) an “accelerated time frame” for dispute settlement. However, parties have chosen not to use the accelerated time frame for dispute settlement, which certainly seems to indicate that these are not as important as Brazil would make them out to be. Furthermore, an accelerated time frame is not unique to prohibited subsidies. For example, Articles 4.8 and 4.9 of the DSU also provide for expedited dispute settlement for any “case of urgency.”
- (c) the fact that a prohibited subsidy is to be “withdrawn.” However, as discussed above, withdrawal is identified as the “first objective” in Article 3.7 of the DSU for all types of measures. Furthermore, a Member’s obligation with respect to “withdrawal” cannot be separated from the subsidy measure at issue and the finding of WTO-inconsistency with regard to that measure. If a Member removes the WTO inconsistency, it has withdrawn the WTO inconsistent measure and met its obligation under Article 4 of the SCM Agreement. Otherwise, a Member might impose countermeasures where there is no longer any WTO-inconsistent measure.
- (d) the timeframe for withdrawal is “without delay” rather than a “reasonable period.” However, Article 21.3 of the DSU calls for “immediate” compliance in all cases, and the “reasonable period of time” has been interpreted to mean the shortest time under the Member’s system, or essentially “without delay.”
- (e) finally, the remedy of “appropriate countermeasures” instead of suspension of concessions equivalent to the level of nullification or impairment. This has been discussed extensively above and in the U.S. responses to the Arbitrator’s

questions.

37. In other words, the differences for prohibited subsidies and other measures are not as great as Brazil would portray them, and certainly not “fundamentally different.” Nor is there anything inherent to prohibited subsidies that would make them more prone to having adverse effects than any other type of measure. For example, an import ban also certainly has adverse trade effects. Again, the distinction appears to be between prohibited and actionable subsidies, with the SCM Agreement viewing prohibited subsidies as likely more prone to producing adverse effects than actionable subsidies. The term “prohibited subsidies” does not appear intended to be a contrast to other types of measures.

38. All that can be said is that certain special rules determine treatment of prohibited subsidies, including the timing for disputes and the withdrawal requirement. Whatever the reason why the negotiators included these provisions (that is, because they believed that export subsidies are inherently more likely to produce adverse effects than actionable subsidies or for some other reason), the text itself provides the special and additional rules that govern disputes over this type of subsidy.

78. In the event of countermeasures that do not reflect the trade effects of the measure on the complainant, how do you consider that this may affect the rights of other Members? In particular, if another Member were to seek countermeasures subsequently in relation to the same inconsistent measures, how should this be approached?

(a) Could multiple awards each based on the total amount of the subsidy be justified?

(b) Is it conceivable that such Member would be entitled to a lesser amount of countermeasures than might otherwise have been the case, by virtue of the fact that a previous award has been issued in favour of another Member? In what sort of circumstances might this arise?

(c) If this is possible, what would be the basis for the fact that the rights of that Member would be adversely affected by the previous award?

39. Brazil's response to this question is very revealing.¹⁵ It confirms that Brazil considers it could be awarded any multiple of its request and the countermeasures would still be “appropriate” and “not disproportionate.” Brazil argues that every single WTO Member could be entitled to the same level of countermeasures, or a multiple of over 100 times, and still not be “disproportionate.” However, Brazil's approach appears guaranteed to produce a level of

¹⁵ In paragraph 59 of its responses, Brazil states explicitly that: “Thus, ‘multiple awards each based on the full amount of the subsidy’ is permitted by Articles 4.10 and 4.11.”

countermeasures that would be disproportionate. Or, phrased another way, Brazil would read out of Article 4 of the SCM Agreement any limitation on countermeasures, and thus Brazil is urging the Arbitrator to ignore the requirements concerning “appropriate” and “not disproportionate.”

40. Countermeasures for prohibited subsidies, under the special and additional rule of Article 4.11 of the SCM Agreement, must be “appropriate” and “not disproportionate.” This is the standard to assess proposed countermeasures that a Member may take against (counter to) a WTO-inconsistent measure. As the United States has explained (e.g., in the response to question 84), infringement of an obligation under the SCM Agreement constitutes a prima facie case of nullification and impairment. Thus, the principle of nullification and impairment, and the importance of limiting suspension of concessions to the impact on the complaining Member as provided in the DSU, is implicit in the SCM Agreement.

41. If multiple awards were made based on the total amount of the subsidy, without regard for the impact of the measure on the complaining Member, the awards would be duplicative and, in as much as they would necessarily exceed the effect of a subsidy on the complaining Member, disproportionate. Such awards could not meet the standard of Article 4.10. Contrary to Brazil’s suggestion, Article 4.10 does not provide such flexibility.

42. In this proceeding, both Brazil and the United States have presented ways to measure the total amount of the subsidy, and so in order to assure that countermeasures are “appropriate” the total amount of the subsidy must be reduced to the impact on Brazil.¹⁶ But, more generally speaking, the issue is not about a “reduction” in countermeasures, or authorizing a lesser amount as suggested in the Arbitrator’s question. The issue is that for a subsidy that affects Members (and non-Members) worldwide, countermeasures taken by any one Member based on the total amount of a subsidy would not be appropriate.

43. In the particular facts of this dispute, Brazil is the only complainant. Accordingly, countermeasures can only be authorized with respect to Brazil. Brazil invites the Arbitrator to provide it countermeasures for the effects of the subsidy on other Members, and offers to coordinate with other Members if they also choose to bring countermeasures.¹⁷ Such assurances are only that – assurances. They cannot be used as a basis to authorize disproportionate

¹⁶U.S. Answer to Question 45.

¹⁷There is some conflict in Brazil’s position. It first states that multiples of the level of countermeasures are authorized under the SCM Agreement, then offers to “share” any level of countermeasures authorized. Perhaps this is because while Brazil relies on the *FSC* arbitrator’s award for the proposition that multiple levels are allowed, that award admitted that later arbitrators may want to take into account the prior awards and referred specifically to the EC’s offer to “share.” *US – FSC (Article 22.6)*, FN 108 and para. 6.29.

countermeasures or for a departure from the applicable standard. Other Members may bring a dispute and seek the right to countermeasures, but they have not. Brazil is limited to countermeasures appropriate to its own complaint.

44. The situation of more than one Member seeking an award for the same measure is far from hypothetical. In this very dispute, Brazil had challenged U.S. Foreign Sales Corporation measures, measures for which the European Communities had already received authorization for countermeasures based on the total amount of the subsidy. Brazil presumably would have included a request for countermeasures if it were not that the original panel denied Brazil’s claims. There is thus a very real need to consider the consequences if Brazil received an award for the entire amount of the subsidy. If another Member successfully challenged the same U.S. measure, then under Brazil’s approach both Brazil and the other Member would be entitled to the same countermeasures as Brazil – in which case the total countermeasures imposed on the United States would be twice what the Arbitrator in this dispute determines is “appropriate.”

79. What is it about footnotes 9 and 10 of the SCM Agreement that suggests to you that countermeasures under Article 4.10 of the SCM Agreement should be higher than would otherwise be the case?

45. Footnotes 9 and 10 of the SCM Agreement provide an explicit limitation on countermeasures for prohibited subsidies. Specifically, countermeasures may not be “disproportionate.” Brazil’s response to this question highlights the “flexibility” of the footnote, but this emphasis is not correct. It is true that the standard of Article 4 is less rigid than the “equivalence” standard in Article 22 of the DSU. But footnotes 9 and 10 in particular, which are presented in the negative “not disproportionate” are explicit limitations on the amount of countermeasures. Further, the fact that the additional language “in light of the fact that the subsidies dealt with under these provisions are prohibited” confirms the importance of this limitation. Even though the subsidies are prohibited, and special and additional rules apply, countermeasures still must be limited.

80. In relation to what should proportionality be assessed under Article 4.10 of the SCM Agreement? Is it necessarily against the amount of the subsidy? If there is a degree of “flexibility” embodied in Article 4.10, why would proportionality necessarily be assessed in relation to the subsidy itself?

46. Subsidies that have been found inconsistent with WTO commitments *prima facie* cause nullification and impairment.¹⁸ Accordingly, in the first instance “proportionality” under Article 4.10 must be assessed with respect to the impact of a subsidy on the complaining Member. In prior arbitrations on prohibited subsidies, the arbitrators have turned to the amount of the subsidy

¹⁸DSU Article 3.8.

to measure proposed countermeasures (particularly where the amount claimed for nullification and impairment exceeded the amount of the subsidy, which is the exact opposite of Brazil's request.). But this does not change the fact that the baseline is nullification and impairment.

47. Brazil's response to this question states that "appropriate countermeasures" must include "at the very least, all of the commercial and economic advantages that are conferred by a subsidy." Brazil also points to the risk that a Member may continue to provide a subsidy even in light of countermeasures. These considerations have no textual basis in the WTO Agreement (and Brazil does not even seek to offer one). Moreover, they are no baseline at all, and provide no basis for measuring whether a proposed countermeasure is "appropriate" and "not disproportionate" in accordance with Article 4.10 of the SCM Agreement.

48. First of all, the theory of including all possible advantages "at the very least" ignores the fact that the amount of countermeasures is limited. It is limited by the "not disproportionate" language in footnotes 9 and 10, which provides additional clarity to the interpretation of "appropriate" in Articles 4.10 and 4.11. It is also limited by the fact that countermeasures must be limited to the trade impact on the complaining Member. Combining all possible advantages – direct and indirect, regardless of whom receives the advantage – would mean double, triple or more counting and thus calculating countermeasures without regard for these limits.

49. Second, using the amount of the subsidy, as it has been used in the past for prohibited subsidies, is a transparent approach for this dispute. The "net cost to government" approach of the United States is appropriate, given that these calculations have been used throughout the proceedings to assess the WTO-consistency of the GSM 102 guarantees and given that it is the only method of calculating the amount of the subsidy that follows the fact that the DSB's recommendations and rulings are based exclusively on a finding under item (j) of the Illustrative List of Export Subsidies. In other arbitrations, other approaches to "amount of the subsidy" have been used (cost to government, difference in payment streams).

50. Overall, the idea of using amount of the subsidy has the advantage of the well-established, widely understood understanding of subsidies reflected in the definition of subsidy under the SCM Agreement. This definition, in Article 1.1 of the Agreement, requires both 1) a governmental financial contribution; and 2) that a benefit is conferred by this financial contribution. Brazil's suggestion of adding all "advantages," regardless of the type of advantage or how they relate to the subsidy, offers no such basis in principle or in the terms of the SCM Agreement.

51. Finally, the United States will comment on Brazil's concern that a Member may maintain a subsidy even after countermeasures are imposed. The United States notes countermeasures are limited, and it is always possible that a Member may maintain a subsidy. Members negotiated a system that provides the right to countermeasures, and it also allows for these countermeasures to continue if a Member has not complied with the recommendations and rulings of the DSB. It is

true that countermeasures are intended to be temporary, but the amount of countermeasures is not based on the risk that a Member may not immediately withdraw a subsidy. Countermeasures are based on the applicable standard, and there is no such standard in Brazil's idea of total advantages.

"Benefits" (Brazil's approach)

To Brazil:

85. *You describe your proposed countermeasures based on "benefits", as a calculation of the "amount of the subsidy". Are the terms "benefits" and "amount of the subsidy" interchangeable in this context?*

52. Brazil uses the term "amount of the subsidy" to refer to the sum of two completely separate components, 1) an interest rate subsidy; and 2) "additionality." But, appropriate countermeasures cannot be calculated on this basis.

53. An interest rate subsidy, or interest rate discount, is a way to calculate the amount of the subsidy for a loan guarantee. Indeed, it is the method explicitly provided for calculating the benefit of such a subsidy in Article 14 of the SCM Agreement. If Brazil combines both an interest rate subsidy element and an additionality element (on any theory), the resulting countermeasures would be disproportionate.

86. *What is the relevance, for the purposes of your analysis of "benefits", of the definition of "benefits conferred" under the SCM Agreement? In responding to this question,*

(a) please clarify whether you consider that the two elements that you analyze as the "benefits" of the subsidy constitute the "benefits conferred" by the subsidy within the meaning of the SCM Agreement.

(b) please comment on the relevance of definitions under Article 14 of the SCM Agreement, as referred to by the arbitrator in Canada – Aircraft. In that case, the arbitrator examined the meaning of the term "benefits" in the context of a loan programme, and concluded on the basis of that examination that the "benefits" for the purposes of that type of measure should be understood to be only the difference between the loan actually granted and the amount that would have been paid on a comparable commercial loan (see para. 3.60 of the decision of the arbitrator in Canada – Aircraft).

54. Brazil's response to this question treats the terms "advantages" and "benefits" interchangeably. But in the context of the SCM Agreement, "benefit" is a term of art with a particular meaning. Under Article 1.1 of the SCM Agreement, a "subsidy" may only occur

where there is a governmental financial contribution (Article 1.1(a)(1)) and “a benefit is thereby conferred.” In other words, the financial contribution itself provides the benefit. Under Brazil’s approach, merely causing or resulting in a benefit would be sufficient; but the “benefit is thereby conferred” language requires more. For the purposes of the SCM Agreement, the “benefit” of a subsidy has a particular, direct relationship to the governmental financial contribution. Some alleged “advantages” that may result from a subsidy are not “benefits” of subsidies under the SCM Agreement.

55. The SCM Agreement provides further guidance on the “benefit” of loan guarantees for the purposes of countervailing measures. Article 14(c) provides that the “benefit” is the interest rate discount, which means the 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 absent the guarantee. As Brazil points out, this is guidance for domestic authorities. The guidelines are for use by domestic authorities in countervailing duty investigations, and this proceeding involves a determination of “appropriate” countermeasures for a prohibited export subsidy. Yet, this guidance informs the calculation of and understanding of the interest rate subsidy in this arbitration.

56. Brazil provided a basis for countermeasures based, in part, on a calculation of interest rate subsidy, or the benefit of the GSM 102 guarantee. Therefore, the definition of benefit in the SCM Agreement is relevant. The basic definition of subsidy in Article 1.1 defines “benefit” of subsidies for the purposes of the SCM Agreement, and the guidance in Article 14 informs how to understand this calculation for loan guarantees in particular. Under these terms, the interest rate subsidy presented by Brazil is the entire subsidy amount. The additional “advantages” or “benefits” Brazil has included are not grounded in the SCM Agreement, and the Arbitrator should not include them in an award of countermeasures.

57. Consider what would happen if the interest rate subsidy alone were eliminated. If there were no interest rate subsidy, there would be no benefits (by any definition) and the subsidy would be completely withdrawn. No additional actions to extinguish other advantages or indirect benefits would be needed. Given that withdrawal of the interest rate subsidy alone is complete withdrawal of the subsidy, it is plain that the interest rate subsidy by itself – without additionality – is a full measure of the subsidy.

87. Would you accept that your calculation of “benefits” reflects the benefits from the perspective of the seller (IRS) and of the buyer (additionality)?

58. Brazil acknowledges that its methodology combines benefits from the perspective of the seller with benefits from the perspective of the buyer. In other words, Brazil’s approach is based on double-counting. This combination reinforces the problematic nature of the two-part approach that Brazil has used to calculate proposed countermeasures, discussed in the comments on questions 85 and 86 above.

88. *You characterize your proposed amount of countermeasures as representing “the amount of the subsidy”. It seems, however, that this amount includes not only the value of the subsidy (expenditure) but also trade effects of the measure (in the form of additional US exports). How does this second element constitute part of the “amount of the subsidy”?*

59. Brazil’s response to this question challenges the relevance of governmental expenditure to the amount of the subsidy, and it also continues Brazil’s argument that any advantage or benefit that results from a subsidy may be the “amount of the subsidy” for the purposes of calculating countermeasures. Brazil’s approach is incorrect. Its errors are in the failure to ensure that the context of the SCM Agreement and the DSU are taken into account.

60. The standard for evaluating proposed countermeasures limits the amount of countermeasures. Article 4.10/4.11 of the SCM Agreement provide that countermeasures must be “appropriate,” and the limitation on countermeasures is clarified by the admonition that they cannot be “disproportionate” that is found in footnotes 9 and 10. This requires an examination of what the countermeasures must be proportionate to. The United States has explained the importance of this point, and of identifying a baseline for assessing countermeasures, in its submissions, including the Answers to Questions 71, 81, 84, and 104.

61. Brazil’s approach does not provide this examination. Brazil would add together multiple results of a subsidy, without a clear basis on which to include or exclude particular results. This approach would essentially leave the amount of countermeasures to the creativity of the requester.

62. The special and additional rules for prohibited subsidies provide some additional flexibility, but they do not provide such discretion on the amount of countermeasures. The flexibility has been demonstrated by the use of the “amount of the subsidy” principle in prior arbitrations. Although the methodology for determining amount of the subsidy has varied by the facts of the individual disputes, the fact that the SCM Agreement provides a clear definition of subsidy provides context and transparency to any measure of what that amount might be.

63. The definition of a subsidy under the SCM Agreement requires both a governmental financial contribution, and that a benefit it thereby conferred.¹⁹ With respect to financial contribution, government expenditure is a critical concept. For a particular subsidy, “financial contribution” may take different forms (transfer of funds, revenue foregone, provisions of goods/services), but in every case it is this “financial contribution” that determines what the benefit of that subsidy will be. Moreover, in terms of evaluating the amount of the subsidy for the purposes of a request for countermeasures, it may be necessary to directly look at the

¹⁹Article 1.1(a)(1).

financial contribution. This is such a dispute. The basis for the particular subsidy findings in this dispute is item (j) of the Illustrative List of export subsidies, which looks at net cost to government.

64. If a Member or an Arbitrator chooses to evaluate the “amount of the subsidy” from the perspective of the beneficiary, the SCM Agreement provides relevant context. For a loan guarantee, the SCM Agreement refers to the methodology for calculating an interest rate subsidy as the method for calculating the benefit that flows from the financial contribution. Where this approach is used, it would be the full amount of the subsidy benefit.

65. It should be recalled that an approach of “amount of the subsidy” is a departure from the baseline of nullification and impairment. This departure must be based on principles that ensure that the award will not exceed what is permitted under the SCM Agreement or the DSU. Following the guidance set out in the SCM Agreement provides greater transparency and reduces the risk that an award would be “disproportionate” within the meaning of Article 4.10/11 of the SCM Agreement.

89. Would it be correct to characterize the “interest rate subsidy” component of your calculation as representing the expenditure incurred by the government or as the “financial contribution” by the Government in relation to that subsidy?

66. Brazil’s response distinguishes the interest rate subsidy that it uses from the idea of financial contribution/expenditure, pointing to the fact that it has presented an approach from the beneficiary’s perspective. Although the concepts of benefit and financial contribution are different, under the definition of subsidy in Article 1.1 of the SCM Agreement, it is important to keep in mind the relationship between the two terms. The financial contribution itself confers the benefit; without such a contribution there is no basis on which to measure any interest rate subsidy. The fact that a particular approach emphasizes a beneficiary perspective cannot change this.

67. The United States also directs the Arbitrator’s attention to the final paragraph of the U.S. comment on Question 101, concerning the importance of budgetary outlay in measuring an export subsidy.

90. Would it be correct to characterize the “additionality” component of your calculations as relating in fact to the trade impact of the measure, seen from the perspective of the beneficiaries of the subsidy?

68. The Arbitrator’s question correctly suggests the difference between subsidy “benefits” – under the terms of the SCM Agreement – and trade effects of the subsidy. Brazil’s response suggests that any “benefit” that results from a subsidy can be called a benefit. For the purposes of this proceeding, it is necessary to be more precise because of the importance of these concepts

in identifying a principle for an award of countermeasures. "Benefits" are those conferred by the governmental financial contribution. Other results, such as trade effects, may occur. But these are not "benefits" within the meaning provided by the SCM Agreement.

To both parties:

91. *Is there, in your view, any correlation between the "benefits" having accrued to operators in the form of "additional" sales, and any "adverse effects" suffered by other WTO Members in the form of "lost sales" as a result of the measure?*

69. Brazil characterizes a GSM 102-backed transaction as a zero-sum game. That is, every dollar in a GSM 102-backed export is completely additional to the U.S. exporter but is completely at the expense of a foreign exporter. Brazil has not provided any basis for this assumption. Under its theory, Brazil assumes that the obligor bank would not be able to participate in the transaction absent the guarantee, but does not address the question of whether the sale would have occurred anyway (that is, whether the buyer would have been able to find another financial institution to participate or otherwise have been able to finance the purchase). The United States addresses this issue fully in its comments on Brazil's response to Question 93.

70. The United States submitted a review of economic literature to demonstrate that there is no consensus on this characterization.²⁰ This review made clear that any attempt to measure additionality was fraught with difficulty and required key assumptions, such as the presence of a financial constraint, and pass-through of the interest rate subsidy from foreign bank to importer. Brazil assumes GSM 102 offers a significant financial discount to importers, but has both overstated the interest rate subsidy and assumed it was fully passed on to the importer. In fact, the economic literature shows that Brazil's claimed interest rate subsidy is excessively high and that Brazil lacks evidence for the pass-through of the subsidy to the import price. To the extent the demand for GSM 102 commodities is inelastic, which is confirmed by the elasticities used in Brazil's marginal additionality model, these products in particular are more likely to be traded even in the absence of credit, because demand is less responsive to a change in price. For all these reasons, one cannot equate a "benefit" to an exporter with an "adverse consequence" suffered by another WTO member.

"Additionality"

To Brazil:

92. *Brazil argues that the additional sales of US exporters is one of the types of benefits which should be included in assessing the appropriate level of countermeasures.*

²⁰ Exhibit US-92.

Brazil’s methodology calculates the value of these benefits as the value of additional sales to markets in receipt of GSM 102-supported sales.

(a) Is it reasonable to assume that the value of additional sales to these markets can be equated to the value of additional total sales of US exporters, given the possibility that at least some of these sales to subsidised markets might be diverted from commercial markets or, alternatively, could be sold on commercial markets?

(b) The ceiling on the possible additional sales of US exporters is given by the supply response of US producers as well as the demand response of US consumers to any increase in prices in the United States induced by the provision of the GSM 102 subsidies. If the increase in prices, and the supply and demand responses, are all low, then the effect of the subsidy is to reshuffle US exports away from commercial markets rather than lead to additional export sales. How does Brazil’s methodology address the possible displacement effect of GSM-supported exports away from commercial markets?

71. Brazil has consistently asserted but never demonstrated that the removal of GSM 102 would result in the complete loss of all sales backed by GSM 102 credit guarantees. This assertion is supposedly validated by, among other factors, the large interest rate subsidy (IRS). The United States has thoroughly refuted Brazil’s method for determining the IRS in previous submissions. Brazil’s marginal additionality model does not account for aggregate market-wide impacts, as Brazil claims.²¹ In fact, Brazil states that its Methodology Paper “did not explicitly deal with the displacement effect” of GSM 102, which is a market-wide impact.²² Brazil’s model simply backs out the full value of GSM 102-financed exports of particular commodities to a particular country, but no further adjustments occur. Brazil asserts that GSM 102 can “crowd out some commercial transactions,” but offers no proof. The research literature provided by the United States raises all of these points (including liquidity constraints, inelastic demand, IRS pass-through, etc.) as possibly reducing or eliminating any additionality from export credit guarantee programs.²³ So the Arbitrator’s question as to whether GSM 102 sales might simply replace commercial sales, or be sold into a commercial market if there were no GSM 102 guarantee, remains unanswered by Brazil.

72. Brazil has been inconsistent in its conceptual treatment of potential marginal additionality of GSM 102 guarantees. The United States pointed out these conceptual shortcomings of

²¹ Brazil’s Answers to Additional Questions, para 120.

²² Brazil’s Answers to Additional Questions, para 124.

²³ Exhibit US-92, pages 8 - 10.

Brazil’s method in its Oral Statement.²⁴ Brazil repeats these same inconsistencies in response to this question. After noting in many places that the provision of GSM 102 has no effect on U.S. or world prices, Brazil now claims that “the program can raise the price received by all U.S. exporters, including those exporters selling to buyers *not* eligible for GSM 102.”²⁵ This description is completely at odds with any potential effect of GSM 102, which at most provides lower-cost financing for an importer, but has no effect on the commodity price at which the export is sold. As Brazil reminded the United States (to clear up supposed confusion) “about the different impact of *local* and *world price*,” Brazil made clear “a drop in world prices is not an issue in Brazil’s assessment of marginal additionality.”²⁶ “A decrease in the effective sourcing price to a single obligor for a single GSM 102-covered transaction by virtue of the interest rate subsidy cannot be expected to trigger any specific supply or demand reaction in the United States or elsewhere over and above the general reaction to temporary price and volume volatilities.”

73. But now Brazil comes up with a completely different theory to explain the additionality effects of GSM 102. Brazil now claims that U.S. and world prices are affected by the provision of GSM 102 and that some account should be taken of this price effect (that is, “the magnitude of the offset caused by indirect impact of GSM 102 on the U.S. exports destined for *non*-eligible market segments.”²⁷) Brazil now has overall U.S. exports responding to the IRS and U.S. export supply responding to a “price increase.”²⁸ This complete shift in interpretation of the effects of GSM 102 is without foundation and completely contrary to Brazil’s conceptual approach presented in its Methodology Paper that provides the basis for its proposed countermeasures, and completely at odds with its initial characterization of how GSM 102 works.²⁹

93. *Please comment on the argument of the United States that your methodology overstates the value of additional sales to US exporters because it would be open to the*

²⁴ Oral Statement of the United States, March 2, 2009, para. 46 - 50.

²⁵ Brazil’s Answers to Additional Questions, para 122.

²⁶ Written Submission of Brazil, 13 January 2009, para. 229.

²⁷ Brazil’s Answers to Additional Questions, para 123.

²⁸ Brazil’s Answers to Additional Questions, para 123.

²⁹ Brazil’s Methodology Paper treated (at least conceptually) the GSM 102 program as offering a sales discount to particular import markets for a particular commodity. See paras. 45 - 47. The United States has noted that despite Brazil’s conceptual approach that treats GSM 102 as a sales discount to the importer, Brazil in fact incorrectly modeled GSM 102 from the supply side. U.S. Oral Statement, paras. 46 - 50.

ultimate purchaser of the US exports to use a different bank to finance these imports if the GSM program support had not been available to the foreign obligor which actually financed the transaction.

74. Brazil either misunderstands or mischaracterizes the comment of the United States.

75. Brazil argues that nearly all exports under the GSM 102 program constitute a separate benefit as “additionality,” because in the absence of the GSM 102 program “no U.S. exports would otherwise occur”³⁰ or, alternatively phrased, “in the absence of the GSM 102 ECG, credit would not be available and exports would not have occurred”.³¹

76. The United States simply observed, however, that the theoretical absence of the GSM 102 program would not necessarily mean that the export transaction itself would not have occurred. Brazil’s assumption that none of such exports would occur in the absence of the GSM 102 program ignores the possibility that financing to importers could remain available irrespective of the GSM 102 program. As Brazil correctly points out, the foreign obligor in a GSM 102 transaction is the foreign bank, not the importer.³² The ability of certain foreign banks to obtain certain levels of financing for themselves might be impeded by the absence of the program, but that would have no necessary effect on importers or their ability to shop for and obtain financing to consummate import transactions.

77. Brazil characterizes the comment of the United States to go to “distribution of foreign banks, and foreign bank credit risks that would prevail in the absence of GSM 102.”³³ This is not the point.

78. Even without GSM 102, the importer could seek a different bank to facilitate the transaction, or indeed the same bank might facilitate the transaction. Brazil’s own response in fact makes this point. As Brazil correctly points out, “an importer’s borrowing cost cannot possibly depend on the foreign bank’s credit rating.”³⁴ The United States has not suggested otherwise, nor has the United States suggested importers would seek to reduce their borrowing

³⁰Exhibit Bra-797, para. 4

³¹Brazil’s Methodology Paper, para. 42

³² Brazil’s Answer to Additional Question 93, para. 135

³³ Brazil’s Answer to Additional Question 93, para. 137

³⁴ Brazil’s Answer to Additional Question 93, para. 140.

costs by going to “different, higher-rated banks,”³⁵ as the willingness of the foreign bank to provide credit to the importer is presumably wholly independent of the availability of the GSM-102 program. The importer, similarly, is wholly indifferent to the credit rating of any particular bank.

79. As the United States has previously noted,³⁶ the GSM 102 program has no requirement regarding the terms under which the importer must repay its bank, which is the foreign obligor in a GSM 102 transaction. A bank may or may not pass-through the value of any subsidy. Yet, without the pass-through, the notion of additionality fails. As succinctly stated by one study: “Additionality is also nil if the subsidy value of the guarantee is not transmitted to the importer (e.g., because it is captured by the importer’s bank).”³⁷

80. More than one study has raised the issue whether the implicit interest rate subsidy is in fact passed on to the importer,³⁸ contradicting Brazil’s assumption of full pass-through of any interest rate subsidy under the GSM 102 program: “Loan guarantees are typically made for terms up to 3 years. However, these terms (and the implicit subsidy) are not necessarily transmitted by foreign banks to foreign buyers. Rather, the importer’s bank may extend credit at (higher) commercial rates and for shorter terms (e.g., 3-6 months). The U.S. guarantee, in this case, provides a low-cost source of funds to foreign banks, which may not be fully transmitted to

³⁵ Brazil’s Answer to Additional Question 93, para. 140.

³⁶Exhibit US-92, pp. 11-12

³⁷ Dierson, et al, p. 4. Exhibit US-94

³⁸ “However, it should also be recognised that if the importing agent is in fact a private agent, then there may also be competition among multiple private importers. In this case, if competition is as intense in the import market as in the export and banking markets, then a substantial portion of any benefits to be gained by the programme may be lost as importers bid the benefits away. Thus, it is not altogether clear whether allowing for private importers would bias the results of this study, even if data were available to indicate the extent to which this does occur. In practice, the survey data do not provide any information about the importing agent and, even if this information were known, the interest rates of private agents may not be available. On the other hand, there is evidence that some portion of the calculated benefits are not received by importers as banks are able to charge a higher than expected rate. If banks’ opportunity costs of capital are considered to be the best rate that importers can achieve even with a government guarantee, then it might be argued that the minimum rate at which they would loan money is correspondingly higher than the guaranteed rate calculated in this study.” OECD study, para. 40 Exhibit US-C93

buyers that would influence their purchase decisions of U.S. commodities.”³⁹

81. As noted by the OECD in its own study⁴⁰:

“Moreover, the study assumes that all the net benefits of the export credits are passed on to the importers. However, evidence suggests that financial institutions in at least one country do charge a higher interest rate on export credits than the present study would indicate. Thus, some part of the benefits may be lost to additional costs of the transaction or to financial institutions.”⁴¹

82. Consequently, the presence or absence of the GSM 102 program has no necessary effect on the ability of the *purchaser* to secure financing and effect an import transaction. The presence or absence of the GSM 102 program could have a theoretical impact on the ability of a particular foreign bank to obtain credit, but inasmuch as the ability of the purchaser to secure credit is determined independently from the GSM 102 program, the purchaser could simply seek financing from other banks (or possibly even the same bank) to consummate the import transaction irrespective of the availability of the GSM 102 program. The United States’ point is simply that it does not necessarily follow that none of the GSM 102 transactions supported with a GSM 102 guarantee would not occur in the absence of such guarantee.

83. Contrary to Brazil’s assertion that it “has correctly modelled the actual level of subsidy being provided by the program in a given fiscal year,”⁴² Brazil unjustifiedly includes its misplaced theory of “additionality” in its calculation of subsidy.

94. The United States has referred to economic literature on export credit guarantees which it maintains show that Brazil’s methodology and results are not supportable. Among other conclusions drawn by the United States from that literature are that the range of possible interest rate subsidies lies between zero and eleven and there is no support for the claim exports would not occur in the absence of GSM 102 guarantees. Would Brazil be able to refer the Arbitrators to other studies that draw conclusions similar to what it obtains with its methodology?

84. Brazil re-states old arguments as it also avoids answering the Arbitrator’s specific question about any economic literature that supports its overblown IRS and 100 percent

³⁹Dahl et al, Exhibit US-95, page 64.

⁴⁰Exhibit US-93

⁴¹ OECD study, Exhibit US-93, para. 22.

⁴² Brazil’s Answer to Additional Question 93, para. 142.

additionality.

85. First, Brazil notes it uses a standard approach for calculating the IRS, the Ohlin formula, and that the United States did not object to the formula. Brazil is correct that the United States cited economic studies that used the Ohlin formula to calculate an IRS and that the United States agreed that the formula could be an appropriate method. The U.S. objection to Brazil’s approach has been stated clearly and consistently (colloquially, the objection might best be summarized as “garbage in, garbage out”). Brazil’s misuse of the so-called Department of Commerce methodology will not be repeated here, but we note Brazil’s claim that its IRS formula is supported by the economic literature is a smokescreen to absolve Brazil from the invalid parameters and data it inserts into the Ohlin formula.

86. Second, Brazil claims the economic literature cited by the United States is not relevant for assessing Brazil’s calculations of the IRS. Much of what Brazil presents is simply another justification of its invalid method of calculating the market interest rate by mis-using the Department of Commerce method. Brazil says the studies presented by the United States are not relevant because they are an “apples to oranges” comparison. The United States can certainly agree that *no study* can be compared to Brazil’s method because Brazil’s method is untenable and would never be contemplated by an economic researcher.

87. The United States does note that one of Brazil’s complaints is that the economic studies cited by the United States are not relevant because they are not on an obligor basis, but on a country, or sovereign, basis. The United States reminds the Arbitrator that Brazil’s initial IRS estimates were on a country basis, and that Brazil only changed to an obligor basis after U.S. objections. Changing from a country to an obligor basis immediately lowered the IRS from \$260 million to \$237 million, which suggests the studies cited by the United States, which use a country basis, overstate the IRS.

88. Brazil is correct that estimating the counterfactual market interest rate can drive differences in results for the IRS.⁴³ The studies cited by the U.S. use different methods to estimate this variable and none are perfect. But despite the different methods, assumptions, and time periods, none of the studies comes up with an IRS that is anywhere close to Brazil’s inflated estimate. The U.S. has not simply *suggested* that the output of Brazil’s IRS methodology is flawed in comparison with the outputs from previous studies.⁴⁴ The U.S. has clearly demonstrated the numerous flaws in Brazil’s IRS method. Simply using actual or imputed

⁴³ Brazil’s Answers to Additional Questions, para. 161.

⁴⁴ Brazil’s Answers to Additional Questions, para. 163.

default probabilities reduce Brazil’s IRS by subsidy by 57 percent.⁴⁵

89. Brazil attempts to give credence to its over-estimated IRS by citing several studies. But these are truly “apples to oranges” comparisons. The Skully study gives an “Export Subsidy Equivalent” for all U.S. export programs operating in 1987, not just GSM 102. That number clearly bears no relationship to the GSM 102 IRS generated by the Ohlin method, even using Brazil’s flawed approach.

90. The Baron study is also completely irrelevant. The subsidy estimates for Ex-Im Bank were for a sector called “agriculture/construction” so it is not even clear if agricultural products were included or to what extent. The Ex-Im lending was a direct credit, not a loan guarantee and the period of the loan was an average of 10 years. These parameters bear no resemblance to those of the GSM 102 program.

91. The 1992 and 1995 GAO reports are not relevant to Brazil’s methodology. They measure the *cost to government* of the GSM programs, including GSM 103 in the 1992 report, using a completely different method from that used by Brazil. This cost figure is in no way comparable to Brazil’s IRS.⁴⁶ If Brazil criticized the United States for using studies that were done in an earlier period of time, surely these GAO reports fit that description, since they were done in the early days of the Credit Reform Act, when U.S. agencies were grappling with how to implement an entirely new way of accounting.⁴⁷ However, if by invocation of these reports Brazil is implicitly advocating the cost-to-government standard that the United States has long advocated

⁴⁵ U.S. Answers to Additional Questions, para. 22; Exhibit US-116a.

⁴⁶ Exhibit Bra-812. The United States notes the following quote from the GAO report. “The programs’ effect on U.S. agricultural exports worldwide cannot be easily isolated from that of other policies and economic conditions that contribute to U.S. agricultural exports—lower interest rates, other U.S. government assistance, depreciation of the U.S. dollar against competitors’ currencies, production shortfalls, and other changes in global economic conditions. The effect on U.S. exports worldwide, called “worldwide additionality,” is also dependent on the buying and selling decisions of competing exporters and importers. For example, competing suppliers may respond to U.S. competition in countries that benefit from the GSM programs by concentrating their efforts in other countries and displacing potential U.S. sales in these other countries. Thus, while U.S. exports may increase in particular markets in certain program countries, the overall effect on US. exports worldwide is uncertain. If this displacement occurs, these programs may merely reroute trade flows and not necessarily increase total U.S. agricultural exports.”

⁴⁷ Brazil did not provide a reference or exhibit for the Baldwin study (see footnote 138), so the U.S. cannot comment on the study.

is the appropriate basis for the determination of appropriate countermeasures, then the United States has provided abundant current evidence regarding any such calculation on the basis of the negative subsidy net of re-estimates calculated under the Credit Reform methodology.

92. The literature review conducted by the United States was offered to provide perspective on relevant economic studies. The review was not unduly limited; the review encompassed every study the U.S. could locate that spoke to Brazil’s methodology. For example, the U.S. did not “define additionality” as per the OECD study.⁴⁸ The U.S. submitted the OECD study to highlight that there are competing definitions of additionality, as well as different measurement techniques. The question of “global additionality” is highly relevant to these proceedings. If there is global additionality, Brazil is not affected. If there is no global additionality, and only trade diversion, Brazil is likewise not affected. Under Brazil’s approach, GSM 102 sales could simply substitute for non-GSM 102 sales. Brazil’s model does not address this situation. In fact, Brazil’s method does not necessarily capture any additionality. Brazil’s linear displacement model does not capture new demand (“trade creation”), nor does it address the opportunity cost of GSM 102 sales, as noted in Arbitrator Question 28.

93. Brazil has mis-characterized the results of one study submitted by the United States. The Riestra-Munnicha study uses a discounted present value of cost savings from GSM 102 to measure additionality. Interestingly, this cost-savings on imports is used to shift the demand curve to the right, which Brazil did not think appropriate in the OECD study for measuring additionality. The study produces a coefficient for this cost-savings variable as 0.03. Brazil interprets this as a one-percent change in the IRS generating a 3% change in U.S. exports. “In other words, Riestra-Munnicha *et al* find that a removal of GSM 102 would result in a reduction of exports three times the size of the IRS – or additionality of *three hundred percent*.”⁴⁹

94. This is not what the study reported. The model used by the authors, an import demand model, looked at various factors, including import prices, exchange rates, GDP, and domestic production, as well as the discounted cost-savings from GSM 102. What the model showed is that the effect of GSM 102, while positive, is trivial compared to the other factors. The

⁴⁸ Brazil’s Answers to Additional Questions, para. 167.

⁴⁹ Brazil’s Answers to Additional Questions, para. 171. The U.S. submitted a study by Diersen, et al (Exhibit US-94). The Riestra-Munnicha study refers to a Diersen study from 1995 but does not give a reference to that study so the U.S. is not able to comment on Brazil’s alleged 800% additionality. The Diersen study referenced by the United States gave an interest rate subsidy of 5.7 percent and an additionality estimate of about 30%. The U.S. has already commented on why that additionality estimate is overstated. See Exhibit US-92, footnote 29.

coefficient for GSM 102 cannot be interpreted as 300% additionality.⁵⁰

95. Please provide data on the volume and amount of Brazil's exports of unscheduled products, rice, pig meat and poultry meat, by market destination, in calendar years 2005 and 2006.

95. The United States does not disagree with the data presented by Brazil.

To both parties:

99. Could you provide the following data for products supported by GSM-102 export credit guarantees in MY2005.

The value of domestic US production (US\$ dollars)

The value of domestic US consumption (US\$ dollars)

The value of the exports of the product supported by GSM 102 export credit guarantees (US\$ dollars)

96. The United States used the actual GSM 102 registration data to determine the product categories, whereas Brazil used more aggregated product categories, although in most cases the data are broadly comparable. The only category that is significantly different is Pig Meat. Here, the United States used the value of hogs and pig production from the National Agricultural Statistics Service, USDA. Other definitions could reasonably be used.⁵¹

“Net cost to government”

To Brazil:

100. Why does Brazil believe that the “net cost to government” concept referred to in item (j) of the SCM Agreement is the same as “opportunity cost”? Do WTO case law or provisions in the SCM Agreement point to that interpretation?

97. The issues Brazil raises in its response to this question are addressed in other comments, including those on Brazil's Answers to 84, 85, 88, and 101.

⁵⁰ Exhibit US-97, table 2, page 36.

⁵¹To offer further clarification on the respective data of the parties, the United States notes that it provided two data sets for the third part, as both may be of interest to the Arbitrator. The United States notes it also provided data for products not at issue – for example, wheat.

101. Please refer to paras. 4 and 5 of Professor Sumner’s statement. Is a “group” approach wrong *per se* or only because it is inappropriately applied in the actual calculations?

98. Questions 100 and 101 are closely related to the issues raised in question 23.⁵² As a comment the United States offers integrated remarks on Brazil’s responses 100 and 101, noting that it is relevant also for issues with respect to question 23.⁵³

99. The United States notes that Brazil affirms that “proper measurements of ‘benefit’ and ‘cost’ are, mathematically, ‘two sides of the same coin’ that will converge in theory”⁵⁴ and that they are “theoretically equivalent.”⁵⁵ As a result, the United States infers that Brazil does not have a theoretical objection to the use of a calculation of net-cost to government in lieu of a calculation of interest-rate subsidy, but objects that the specific federal credit reform methodology for calculating such cost “does not measure the full economic costs of providing the interest rate subsidy component of GSM 102 guarantees.”⁵⁶ “Properly estimated, the Cost Approach should provide the same answer as the Benefit Approach, the approach Brazil adopts for calculating the interest rate subsidy component of GSM 102 guarantees.”⁵⁷

100. Brazil identifies two alleged problems with the FCRA methodology:

- (1) “a foundational issue involving risk-adjustment” and
- (2) “the ‘aggregative’ way in which the methodology is implemented, which does not

⁵²Indeed, the first paragraph of Brazil’s response to the Arbitrator’s Question 100 refers to Brazil’s response to Question 23. See, Brazil’s Answers to Additional Question 100, para. 179

⁵³Question 23 is as follows: “Brazil sets out a methodology to calculate the value of the benefit of the interest rate subsidy to recipients of GSM 102 guarantees. Would Brazil accept that the value of this subsidy to beneficiaries should bear a relationship to the cost of providing this subsidy to the US government, and that indeed if the same parameters were used in the Ohlin formula, the value of these two concepts should be equal? Can Brazil provide any reasons why the Arbitrator should accept its assessment of the parameter values rather than those used by the US in calculating the net present value of the GSM-102 program?”

⁵⁴ Brazil Answers to Arbitrator Question 23, para. 169.

⁵⁵ Brazil Answers to Arbitrator Question 23, para. 172.

⁵⁶ Brazil Answers to Arbitrator Question 23, paras. 169, 170.

⁵⁷ Brazil Answers to Arbitrator Question 23, para. 182.

take into account obligor-specific characteristics, including obligor-specific risks.”⁵⁸

101. As the United States understands the first alleged problem, a proper present-valuation of future cash flows “requires risk-adjustment of either the discount rate . . . or the probabilities of default.”⁵⁹ Either will suffice.

102. With respect to default probabilities, Brazil states: “the FCRA methodology also appears to use actual default probabilities, rather than risk-adjusted default probabilities. These latter probabilities are based on historical default probabilities, which are then adjusted up or down based on whether it is believed that future rate of defaults will be higher or lower than historical levels. However, it appears that no risk-adjustment is made under FCRA methodology.”⁶⁰

103. Brazil’s assertion is mistaken on two levels:

104. First, the very document that Brazil cites indicates that the FCRA model as imposed by OMB does precisely what Brazil says it does not. Although the first component of the model bases the probability of default on historical (corporate default) data, “the second component of the model uses data on interest rate spreads to make adjustments to the same Moody’s historical default data. . . . [The current model] uses spread information as a signal of how current market conditions might differ from those reflected in the Moody’s historical data. The model is designed to adjust historical default rates by rating category up or down in cases where interest rate spreads in a category are unusually high or low relative to the average spreads for that category. The adjustment in the model gives greater weights to more recent spreads in calculating the averages.”⁶¹

105. Secondly, it appears Brazil is criticizing the FCRA methodology as it applies to the calculation of both initial estimates and the re-estimation process, which yields the critical subsidy estimate net of re-estimates.⁶²

106. The United States infers that Brazil suggests the initial estimates should be even higher.

⁵⁸ Brazil Answers to Arbitrator Question 23, para. 189. *See also*, Brazil’s Answers to Additional Question 101, paras. 182, 187.

⁵⁹ Brazil Answers to Arbitrator Question 23, para. 190.

⁶⁰ Brazil Answers to Arbitrator Question 23, para. 192; *See also*, Brazil’s Answers to Additional Question 101, para. 187.

⁶¹ Exhibit Bra-772 or (same document) Exhibit US-73, p. 17

⁶² Brazil Answer to Arbitrator Question 19, para. 252.

The United States would point out, in contrast, that the Appellate Body has rejected this view: “[R]e-estimates show a consistent downward trend in the estimated costs of the export credit guarantee programmes, thus calling into question the reliability of the initial estimates for purposes of evaluating the programme’s ‘long-term operating costs and losses.’”⁶³ Such unreliability of course pertained to initial estimates *lower* than those Brazil now advocates.

107. Brazil further acknowledges that “initial projections . . . would only be unreliable if the methodology used to generate them suffered from some flaw, for example by overstating the risk of default as compared with actual experience.”⁶⁴ As the United States has explained, however, the initial estimate methodology under FCRA, as applied to the GSM 102 program suffers from such a flaw.⁶⁵ As a result, the United States agrees with Brazil, albeit for different reasons, that initial estimates “calculated using the FCRA formula are not appropriate as a basis on which to assess ‘appropriate countermeasures’, within the meaning of Article 4.10 of the *SCM Agreement*.”⁶⁶ Initial estimates are too high, not too low.

108. With respect to re-estimation, Brazil ignores both the risk adjustment inherent in the re-estimation process and the applicable views of the Appellate Body. Brazil ignores the Appellate Body when it asserts that “netting subsequent FCRA re-estimates against initial FCRA projections is not a valid means of assessing costs.”⁶⁷

109. To the contrary, the Appellate Body observed that “if anything, the re-estimates might be expected to be more reliable [than initial estimates] because they reflect the historical performance of the programme. They also include two closed cohorts (1994 and 1995) for which

⁶³ *US-Upland Cotton (21.5)(AB)*, para. 298.

⁶⁴ Brazil Answer to Arbitrator’s Question 17, para. 222, fn. 166.

⁶⁵ See, U.S. Answer to Arbitrator’s Question 47, paras. 84-87

⁶⁶ Brazil Answers to Arbitrator Questions paras. 228, 248, 251

⁶⁷ Brazil Answer to Arbitrator’s Question 17, paras. 216, 230. The United States also observes that the USDA Office of Inspector General Report (Exhibit Bra-773) that Brazil proffers for the assertion that “initial projections measure more accurately the costs of Federal credit programs than do calculations adjusted to account for the subsequent performance of those programs” says no such thing. It merely notes the undisputed fact that the current fee structure for the GSM 102 program does not by its terms vary based on the individual bank obligor. It makes absolutely no comparative statement or observation concerning initial estimates or re-estimates. *Contrast*, Brazil Answer to Question 18, para. 247 with the cited text in fn. 188 within the same paragraph and with the Exhibit Bra-773 itself.

the data is final. Moreover, the re-estimates data cover a longer period of time and thus provide a basis for a long-term assessment, the very question at issue under item (j).”⁶⁸ “Re-estimates ‘take into account all factors that may have affected the estimate of each component of the cash flows, including prepayments, defaults, delinquencies, and recoveries, to the extent that those factors have changes since the initial estimate was made.’ Consequently, re-estimates are ‘revisions of the subsidy cost estimate of a cohort . . . based on information about the actual performance and or estimated changes in future cash flows of the cohort.’”⁶⁹

110. Unlike the views of Brazil, the views of the Appellate Body reflect comprehension of the risk-adjustment inherent in the re-estimation process. Circular A-11 (2008), of the United States Office of Management and Budget⁷⁰ prescribes the application of the FCRA methodology. It defines “reestimate”: “Reestimates mean revisions of the subsidy cost estimate of a cohort (or risk category) based on information about the actual performance and/or estimated changes in future cash flows of the cohort.”⁷¹ Section 185.6(a) further prescribes how re-estimates are to be calculated:

*“Technical reestimates of the subsidy cost of a cohort of direct loans or loan guarantees must be made after the close of each fiscal year as long as the loans are outstanding, unless a different plan is approved by the OMB representative with primary budget responsibility for the credit account.”*⁷²

“Technical reestimates are made for all changes in assumptions other than interest rates. This type of reestimate compares the subsidy estimate that already includes any reestimate for actual interest rates with a reestimated subsidy using updated technical information (for defaults, fees, recoveries, etc.) as well as actual interest rates.

“The purpose of technical reestimates is to adjust the subsidy estimate for differences between the original projection of cash flows (as estimated at obligation) and the amount and timing of cash flows that are expected based on actual experience, new forecasts about future economic conditions, and other events and improvements in the methods used to estimate future cash flows. Because actual cash flows are experienced every year and the ability to forecast future years also changes, this reestimate must be done after the

⁶⁸ *US-Upland Cotton (21.5)(AB)*, para. 287

⁶⁹ *US-Upland Cotton (21.5)(AB)*, para. 281

⁷⁰ Exhibit US-8

⁷¹ Exhibit US-8, section 185.3(y), p.12

⁷² Exhibit US-8, p. 15. No such different plan applies to the GSM-102 program.

end of every fiscal year as long as any loans are outstanding (except as provided above).
[underline added]

“Reestimates must be made separately for each cohort. If a cohort is divided into risk categories, each risk category within a cohort must be reestimated separately. The reestimate will then be compared with the previous estimate. For this purpose, all details of the previous subsidy estimates by risk category should be retained in program records.”⁷³

111. Accordingly, the FCRA re-estimation methodology incorporates an annual risk adjustment, in addition to that of the initial estimate, which may be up or down, based on “changes in assumptions . . . using updated technical information (for defaults, fees, recoveries, etc.)” As a result, notwithstanding the risk adjustment in fact used in the FCRA calculation of initial estimate, even if such risk adjustment in the *initial* estimate did not exist, the risk adjustment methodology in the re-estimate process would nevertheless achieve the requisite adjustment.

112. As Brazil has noted that its criticism concerning present valuation can be addressed either through risk-adjustment of the discount rate or the probabilities of default,⁷⁴ the discussion of discount rate is moot.

113. The second problem that Brazil alleges is that the FCRA methodology is “aggregative”.⁷⁵ Brazil correctly observes that under FCRA methodology in fiscal year 2006, default probabilities and recovery rates were aggregated at the level of the mandated country-specific rating category and not on a obligor-specific basis. Brazil criticizes the United States for failing to do what it alleges the United States criticized Brazil for not doing in its own methodology.⁷⁶ Unlike Brazil, however, the United States has no obligor-specific information at the beginning of a fiscal year, when initial estimates are calculated and programming commences. Obligor-specific information only becomes available with program participation. In contrast, Brazil had obligor-specific information available to it with the conception of its methodology from which to derive its calculations.

⁷³ Exhibit US-8, p. 16

⁷⁴ Brazil Answers to Arbitrator Question 23, para. 190

⁷⁵ Brazil Answers to Arbitrator Question 23, para. 202; Brazil’s Answers to Additional Question 101, para. 182

⁷⁶ Brazil Answers to Arbitrator Question 23, para. 202; Brazil’s Answers to Additional Question 101, paras. 184, 186

114. In any event, Brazil’s “aggregation” criticism would also appear only to extend to the question of the validity of the *initial* estimate, and any mis-estimation resulting from such country-specific aggregation would be remedied by the risk-adjustment of the re-estimation process.

115. Consequently, the United States submits that the FCRA methodology indeed “captures the full economic costs of providing the financing component” of GSM 102 export credit guarantees. As Brazil recognizes that the “Cost Approach,” if properly calculated, should be “equivalent” to the “Benefit Approach,” and in light of the direct observations of the Appellate Body, the United States submits that the appropriate measure of any alleged interest rate subsidy is properly measured by the net cost of the GSM 102 program to the U.S. government.

116. Brazil argues that “item (j) does not provide the relevant legal standard for these proceedings.”⁷⁷ In addition to the copious submissions of the United States demonstrating that item (j) does provide the appropriate basis for the Arbitrator’s determination of appropriate and proportionate countermeasures, the United States would also note that export subsidy reduction commitments of each Member under the *Agreement on Agriculture* are expressed in Part IV of each Member’s Schedule in terms of “budgetary outlay.”⁷⁸ In the view of the compliance panel, such “budgetary outlay” constitutes the “*total amount of subsidy provided.*”⁷⁹ Export subsidy “reduction commitments are expressed on a budgetary outlay (total amount of subsidy provided) basis as well as on a quantity (volume) basis for each agricultural product concerned. Any export subsidy provided beyond the specific reduction commitments applicable to the agricultural product is prohibited.”⁸⁰ Conversely, any export subsidy provided within the confines of the specific reduction commitments is permitted. Consequently, the measure of the total amount of any export subsidy is governed by the associated “budgetary outlay,” not some alternative view of benefit.

Step 2

To Brazil:

⁷⁷ Brazil’s Answers to Additional Question 100, para. 181.

⁷⁸ See, *Agreement on Agriculture*, Articles 3.1 and 8; Schedule XX United States of America : Part IV: Agricultural Products: Commitments Limiting Subsidization/ Section II: Budgetary Outlay and Quantity Reduction Commitments. Exhibits Bra-83 and US-13 See also, U.S. Submission, para. 85.

⁷⁹ *US - Upland Cotton (21.5)*, para. 14.46

⁸⁰ *US - Upland Cotton (21.5)*, para. 14.46

106. Does Brazil apply a different standard in determining the amount of countermeasures on Step 2 subsidies? Specifically, does Brazil believe that there are no "trade effects" from the prohibited Step 2 payments? Or is it the case that there are "trade effects" from Step 2 payments, but that there are no precise or robust methods for determining those effects?

117. The U.S. notes that Brazil's original request for countermeasures for Step 2 was based on payments in the most recent fiscal year. Obviously, because the program has been repealed, there were no such payments. Therefore, if Brazil had simply maintained its original request, the amount of countermeasures for Step 2 would be zero. Interestingly, Brazil's response to this question uses the present tense to describe Step 2, despite the fact that both parties agree that it has been repealed.

118. Instead of relying on its original request, Brazil proposed an unprecedented, one-time retroactive payment. In the response to this question, Brazil allegedly quantifies "effects" of Step 2 payments, in addition to the past payments themselves that Brazil is currently using as the basis of its request for countermeasures for Step 2. Neither of these approaches can be used to calculate "appropriate" countermeasures for Step 2, because Step 2 has been repealed and there is no WTO-inconsistent subsidy that countermeasures could "counter."

107. You acknowledge that Step 2 was repealed as of 1 August 2006. Would Brazil have been justified in seeking countermeasures on past Step 2 payments in 2007? If so, what would have been the legal basis for Brazil to take such countermeasures against a measure that had ceased to apply?

119. Brazil's response to the Arbitrator's question returns to its theory that it is entitled to countermeasures for Step 2 because of the timing of repeal of the measure. But there is no such basis for countermeasures. Countermeasures may be authorized where a Member has not come into compliance with the DSB's recommendations and rulings. Where a Member has come into compliance – as the United States has with respect to Step 2 – there is no basis for countermeasures.

120. Accordingly, to respond directly to the Arbitrator's question, in 2007 Brazil would have had no basis for countermeasures for Step 2, as it has no basis for such countermeasures today. There is no measure, no WTO inconsistency, and no justification for any award with respect to Step 2.

108. If the legal basis for Brazil's request in relation to past Step 2 payments is non-compliance at the end of the implementation period and Article 22.8 of the DSU is not applicable to this situation as you suggested in your Oral Statement, what is the legal relevance of the fact that the US has enacted "new" subsidies under the 2008 Farm Bill?

121. Brazil has confirmed that it is not seeking countermeasures for measures enacted as part of the 2008 U.S. Farm Bill. As Brazil recognizes in its response to this question, there have been no findings of WTO-inconsistency with respect to any measures under this recent legislation.⁸¹ Accordingly, no countermeasures may be authorized.

122. Notwithstanding Brazil’s recognition that there are no findings with respect to new programs, Brazil has made factual allegations about new programs, and suggests that these programs be given some weight in the Arbitrator’s decisionmaking. However, given the fact that there are *no* findings of WTO-inconsistency with respect to the new programs – indeed, no panel has even examined these programs, nor has Brazil pursued them here (indeed, Brazil makes that point explicit in paragraph 196) – any analysis of the new programs would only be speculation.

123. In effect, Brazil’s assertions with respect to new measures under the 2008 Farm Bill and its request that these new measures be taken into consideration to award countermeasures for the expired Step 2 are requests for countermeasures on these new measures. But these measures have never been before the DSU; Brazil’s request is therefore an effort to suspend concessions without recourse to the rules of the DSU, which would be in contravention of Article 23 of the DSU, and without any basis in findings or recommendations and rulings by the DSB. For Step 2 and for the new programs under the 2008 Farm Bill, there is no basis for any countermeasures.

109. If Article 22.8 of the DSU doesn’t apply to the situation being addressed in these proceedings, are you suggesting that countermeasures can be authorized independently of the existence of any current non-compliance? What would be the purpose of such authorization, if the countermeasures cannot be applied afterwards by virtue of Article 22.8?

124. Brazil’s position has no basis in the text of the relevant agreements or in logic. A Member may only obtain countermeasures where there is a WTO inconsistency with respect to a measure. Otherwise, there would be nothing for the countermeasures to “counter.” In other words, countermeasures of any amount would be disproportionate.

125. Brazil suggests that the use of the term “shall” in Articles 4.10 and 4.11 of the SCM Agreement requires that an Arbitrator award countermeasures regardless of whether a Member has complied with the recommendations and rulings of the DSB with respect to a measure. Brazil appears to recognize that its approach makes no sense when Brazil declines to explain, or even to postulate the existence of an explanation for, the purpose for authorizing countermeasures in such a situation.

110. The 2008 Farm Bill was not considered by the compliance panel. Does this have

⁸¹Brazil Answer to Arbitrator Question 108, para. 196.

an impact on the extent to which the Arbitrator is entitled to consider it in these proceedings?

126. Contrary to Brazil's statement in the response to this question, the fact that the 2008 Farm Bill was not considered by the compliance panel is critical to the Arbitrator's consideration of it. Brazil is asking the Arbitrator to act as though there are DSB recommendations and rulings covering the 2008 Farm Bill. Consequently, Brazil is asking the Arbitrator to overlook the fact that Brazil's request would be inconsistent with Article 23 of the DSU – Brazil is "seeking redress" and "making a determination" concerning the 2008 Farm Bill without having had recourse to the DSU. Because the 2008 Farm Bill was not considered by the compliance panel, there are no findings of the DSB, nor is there any other basis to consider the 2008 Farm Bill in making an award of countermeasures.

111. You consider that it is not within the mandate of the Arbitrator to determine the consistency of the "new" prohibited subsidies that you allege exist under the 2008 Farm Bill. Yet, you seem to ask the Arbitrator to take into consideration the adoption of these measures to determine that the US has not complied with the relevant rulings. Please explain how you reconcile these two arguments.

127. Brazil's answer to this question adds nothing to the answers it gave to the questions above. However, for the reasons explained above, it would be inappropriate for the Arbitrator to take into account the "new measures" in the 2008 Farm Bill in this proceeding.

LEVEL OF COUNTERMEASURES IN RELATION TO THE ACTIONABLE SUBSIDIES

To both parties:

112. You have referred, in your written submissions, to the ILC's Articles on State Responsibility.

(a) What exactly is the legal relevance of the notion of "countermeasures" as reflected in the ILC's Articles on State Responsibility in the context of this Arbitrator's assessment?

(b) Do these Articles reflect or embody, in your view, rules of public international law?

(c) Please comment on the following passage of the commentaries to the Draft Articles:

"in every case a countermeasure must be commensurate with the injury suffered, including the importance of the issue of principle involved and this has a function partly independent of the question whether the countermeasure was necessary to achieve the result of ensuring compliance" (last sentence of the Commentaries to Article 51)

128. The United States refers the Arbitrators to its responses to questions 72 and 112, and to

its comments on Brazil’s response to question 72, which is relevant for this question.

Interpretation of Article 7.9 of the *SCM Agreement*

To both parties:

114. In Article 6.3(c) of the SCM Agreement, who is the “another Member” that is referred to? Is it necessarily the complaining party in a dispute?

129. Brazil’s response relies on a narrow parsing of Article 6.3(c) of the SCM Agreement. But to be interpreted correctly, the provisions of Article 6.3(c) must be read in the context of the SCM Agreement as a whole. The relationship between Article 5 and Article 6 is particularly important to the issue of “another Member.” Article 5 defines “adverse effects.” For each type of adverse effects, the effects in question are the effects on the complaining Member.⁸² Article 6.3 provides ways in which, in a particular dispute, a complaining Member may show the serious prejudice to itself.

130. The first part of 6.3(c), on price undercutting, uses the phrase “of another Member,” and it is not repeated in the second. Nonetheless, for significant price suppression, depression, or lost sales, the interests “of another Member” – specifically, the complaining Member – remain the concern. Note the requirement of the “same market” in this provision, highlighting that the basis for the finding must be with regard to a market where the complaining Member and the Member maintaining the challenged measure compete. Note further Article 6.6, which refers to the use of information regarding the market shares *of the parties to the dispute* in the context of a serious prejudice claim.

131. Finally, the United States notes Brazil’s reference to each Member’s own judgment in whether it chooses to become a complaining Member. This is an important point. Brazil has elected to assert a claim of serious prejudice to its interests, and the provisions of Articles 5 and 6.3 provide the mechanism for the findings of serious prejudice to Brazil. Other Members could, but have not, made the same claims. The Arbitrator’s decision should reflect only the claims that have actually been made and the findings resulting from those claims.

132. The United States also refers the Arbitrator to its response to questions 65 and 117.

To Brazil:

116. In the event of countermeasures that do not reflect the trade effects of the measure on the complainant, how do you consider that this may affect the rights of other Members? In particular, if another Member were to seek countermeasures subsequently

⁸²U.S. Answer to Arbitrator Question 118.

in relation to the same inconsistent measures, how should this be approached?

(a) Could multiple awards each based on the totality of the adverse effects of the subsidy on the world market be justified?

(b) Is it conceivable that such Member would be entitled to a lesser amount of countermeasures than might otherwise have been the case, by virtue of the fact that a previous award has been issued in favour of another Member? In what sort of circumstances might this arise? If you agree that this is conceivable, would the differentiation flow from an interpretation of the word “appropriate” in the context of countermeasures against prohibited subsidies, and of the words “commensurate with the level and degree” in the context of actionable subsidies?

(c) If this is possible, what would be the basis for the fact that the rights of that Member would be adversely affected by the previous award?

133. The United States refers the Arbitrator to its comments on Brazil’s response to question 78. The concerns regarding multiple countermeasures based on the total amount of the subsidy also apply for a possible countermeasure based on the totality of worldwide adverse effects for a subsidy.

117. What relationship is there between the notion of reducing the total effects by that part of the effects constituted by “continuing” effects (ie effects of past subsidies) and a discounting back to account for non-significant effects? In other words, is there any principle involved behind this relationship, that would guide why this would be a proper basis for working out the difference between what is significant and what is not significant?

134. As Brazil acknowledges, there is no principle linking Brazil’s arguments about “continuing effects” and the fact that the Arbitrator’s award must account for the fact that the recommendations and rulings of the DSB relate to the extent to which marketing loan and countercyclical payments result in *significant* price suppression, not to all the effects of these payments.

135. The “lingering effects” and significance issues do have one point in common, however: both relate to amounts that cannot be included in an award of countermeasures. Under Article 7.8 of the SCM Agreement, for actionable subsidies, a Member may comply with the recommendations and rulings of the DSB by withdrawing a subsidy or removing its adverse effects. It is undisputed that withdrawal of the subsidy altogether would be complete compliance with the recommendations and rulings. There is no additional requirement to, in addition to withdrawing the subsidy, also take action to extinguish effects from subsidies in past years. Brazil’s inclusion of continuing effects would do this. Brazil’s counterfactual and the United

States counterfactual both calculate total effects based on removal of the subsidies, and there is no basis to add in additional amounts for lingering effects.

136. For the issue of “significant” price suppression, as the United States has explained, the findings of the DSB concern only the effects of marketing loan and countercyclical payments that result in significant price suppression. Effects on price that do not reach the “significant” threshold are not inconsistent with the WTO and countermeasures based on total effects of the marketing loan and countercyclical payments would not be commensurate with the adverse effects determined to exist. Brazil does not seem to quarrel with this basic point. It acknowledges that not any non-zero number is significant price suppression, and its response to question 117 contemplates a small reduction for the amount of price suppression that is not significant.

137. Accordingly, because neither can be included, the two amounts cannot balance one another out as Brazil suggests.

138. Finally, the United States has also presented rebuttals of the various insupportable ways Brazil has quantified “lingering” effects (e.g., paragraph 32 of the U.S. Oral Statement and comments on question 119 below).

Calculation of the “adverse effects determined to exist”

To both parties:

118. Do you accept that the time period for calculating the trade effects is necessarily post-implementation period, or that it can straddle the end of the implementation period to some degree? If the “adverse effects determined to exist” were determined by the original panel, what basis is there for calculating those effects at a much later time (apart from the fact that this is how previous Arbitrators have approached the issue)?

139. The United States notes Brazil’s mischaracterization of the U.S. position, where it claims that the U.S. position is based on “non-existing recommendations and rulings from the compliance proceeding.” To the contrary, the U.S. position is based on the fact that there are now DSB recommendations and rulings from the compliance proceeding. In its oral statement, to which Brazil cites in its response to Question 118, Brazil erroneously claims: “Thus, the compliance proceeding did not result in any new recommendations and results. Consequently, the very basis for the United States’ argument - the existence of ‘compliance recommendations and rulings’ - simply does not exist.”⁸³ However, the Appellate Body explicitly made a

⁸³Brazil’s Oral Statement, Arbitration Under Article 22.6 of the DSU and Article 7.10 of the SCM Agreement, para. 66.

recommendation: “The Appellate Body recommends that the DSB request the United States to bring its measures, found in this Report, and in the Panel Report as modified by this Report, to be inconsistent with the Agreement on Agriculture and the SCM Agreement, into conformity with its obligations under those Agreements.” Brazil has once again not presented an accurate statement to the Arbitrator.

140. Moreover, contrary to Brazil’s arguments, nothing prevents an Arbitrator from examining a time period after the end of the implementation period for purposes of determining the amount of countermeasures in a dispute. Brazil’s conclusions on this point are not based on the text of the SCM Agreement or the DSU. Indeed, Brazil misrepresents the practice in sequencing agreements. Members have agreed that a request for authorization to suspend concessions could be made years after the end of the reasonable period of time.⁸⁴ In such a case, it would be natural that the request itself would be based on conditions then in existence, including the outcome of any compliance proceedings, and would not be tied to the conditions at the end of the reasonable period of time.

141. In its response to this question, Brazil goes so far as to explicitly state that it believes that if the Arbitrator authorizes annual countermeasures of \$1.037 billion, then Brazil may impose retroactive countermeasures of more than \$3.8 billion. In footnote 208, Brazil asserts its rights to retroactive countermeasures also for countermeasures with respect to GSM 102.

142. Brazil is not entitled to such “cumulative” countermeasures. Suspension of concessions is forward-looking, not retroactive as “cumulative” countermeasures would be. No arbitrator has authorized such an approach, nor could such an approach be authorized. Regardless of whether a “formula” approach is used, suspension of concessions /countermeasures is prospective. The purpose of countermeasures is to rebalance or counter a WTO inconsistent measure. It is not to provide “damages” or compensation for past actions.⁸⁵ Therefore, countermeasures that meet the standards under the WTO only act counter to the WTO inconsistent measure at the time the countermeasure is applied. Otherwise, the countermeasure would be greater than the nullification and impairment to the complaining party, disproportionate to the subsidy findings, and not commensurate with the adverse effects of the subsidy, and trade concessions between the party imposing the countermeasure and the party maintaining a WTO-inconsistent measure would be unbalanced, with the suspension of concessions distorting trade more than the measure found to be WTO-inconsistent.

143. By Brazil’s “cumulation” idea, which supposes Members are entitled under all circumstances to countermeasures going back to the end of the implementation period, one

⁸⁴See, e.g., *US – Offset Act (Byrd Amendment) (Article 22.6) (Canada)*, para. 1.4.

⁸⁵*U.S.-Upland Cotton (Article 21.5)(AB)*, footnote 494.

would have to wonder if a Member could also accumulate (or “bank”) countermeasures from later years by not using them in a particular year. If Brazil received its request for more than \$3 billion in retroactive countermeasures, but did not apply countermeasures in year one, would it be permitted to impose \$4 billion in countermeasures in year 2? Or defer another year and apply \$5 billion in countermeasures in year 3? Clearly, it should not be able to do so – those countermeasures would be disproportionate to the measures in existence at the time.

144. Brazil’s request is without support in the DSU or the SCM Agreement, and plainly contrary to the function of countermeasures in the WTO system. Given the extraordinary over-reaching of Brazil on this point, the United States requests that the Arbitrators’ awards clarify that an annual award for countermeasures does not include these “cumulated” countermeasures.

119. Brazil asserts (in paragraph 286 of its Written Submission) that a short run counterfactual is appropriate “in light of the requirement in Article 7.9 that the defending Member withdraw the subsidy or remove its adverse effects within 6 months”. Would not the adverse effects existing in the reference period be the result of the cumulated impact of the existence of the policy over a number of years, and thus justify a long-term approach?

145. Brazil’s response begins by arguing that the analysis must account for both the effects of past payments, and of payments in a particular period. The United States recalls that the correct way to understand the counterfactual for the purposes of calculating countermeasures does not require any additional calculations regarding “lingering” or “continuing” effects of past payments, because as the Arbitrator correctly notes, the results in a particular reference periods already include the cumulated impact of past policies. Any additional amounts to account for “lingering effects” is simply double-counting.

146. The U.S. notes that both parties provided analysis to the Arbitrator using a counter-factual based on withdrawal of the programs without separately counting “lingering” or “continuing” effects.⁸⁶ The main difference between the parties’ approach to withdrawal of the programs is the amount of adjustment allowed in the analysis by the market participants. The United States will not repeat all of those arguments here, but notes that the U.S. approach of using long-run elasticities, which allow full adjustment by all participants, account for any “lingering” or “continuing” effects. (Given the data availability for two additional marketing years that have occurred after the reasonable period, the United States included them in the analysis to get an average as payments and their effects can vary from year to year depending on market conditions.)

⁸⁶This results in a calculation of “total effects,” which must then be adjusted to reflect only the effects that cause “significant” price suppression and the effects on Brazil.

147. Compare the situation in this dispute with a simple tariff example, and it is evident that if the counterfactual correctly models the situations with the subsidy and without the subsidy, there is no need to account for additional, secondary effects from the past. Suppose that the WTO-inconsistent measure were a tariff that was higher than a Member's bindings. To eliminate the inconsistency and come into compliance with its obligations, a Member could change the tariff to the bound rate. There would be no need to undo or extinguish other effects in the market that might have resulted from the application of the tariff .

148. The remainder of the U.S. comments will address Brazil's new, but still flawed, approach to calculate lingering effects of the marketing loan and counter-cyclical payments.

149. Professor Sumner provides conceptual economic rationales as to how marketing loan and counter-cyclical payments may create lingering effects. Brazil does not, however, provide any evidence that in fact these physical and human capital investments have taken place because of the payments farmers received in these years.

150. Even if one were to accept Brazil's arguments of the lingering effects, the calculation is flawed. Brazil begins with the price and production impacts from their original elasticity assumptions. Brazil provides no evidence, but just assumes that there is a 50 percent increase in the U.S. supply elasticity between the short-run and long-run. Next, the price and production impacts are multiplied by the percentage increase in the U.S. supply elasticity. Therefore, one-half of the initial, or own-year, price and production impacts form the basis for the lingering effects. The final step is to take an arbitrary 6-year average of the alleged lingering effects, and present these as the lingering effects of the 1999 to 2004 programs in MY2005. The assumptions underlying this analysis are highly arbitrary.

151. Looking more closely at Brazil's calculations, the extent of their flaws is even more apparent. Brazil initially offered as its counter-factual that the impact of the removal of the marketing loan and counter-cyclical in MY2005 would increase the world price by 10.75%. Brazil's new approach to calculate lingering effects would suggest that the lingering price effects of the 2002 program on MY2005 was one-sixth of 7.10%, while the lingering effects of the 2004 program on MY2005 was one-sixth of 1.55%. The one-sixth figure results from Brazil's unsubstantiated assumption that the appropriate measure of lingering effects is a 6-year average and that every one of those years contributes equally to effects in MY2005.

152. It is also important to understand that by Brazil's own admission, their estimate of \$950 million as average lingering effects is exaggerated.⁸⁷ Professor Sumner discusses the changes to long-run demand and ROW supply elasticities, but then completely omits those adjustments from

⁸⁷Brazil's Answer to Question 119, para. 268 and exhibit Bra-818.

his analysis.⁸⁸

153. Recall that the overall structure of the model is characterized by a complete lack of dynamics. Professor Sumner's basic model is nothing more than a series of one-year scenarios presented as if they are a multi-year analysis. To further explain this concept, consider that in each year, Professor Sumner removes the U.S. programs. His model, by design, delivers a production and price impact based on the assumed elasticities. Those production and price impacts then generate an alleged economic injury. Using 2002 as an example, Professor Sumner's model generates a price impact of 14.20%. However, the 14.20% price impact has no bearing or impact on the outcome for 2003. It is as if the United States removes the program, then convinces farmers that the program will be reinstated, then only to remove the program again. If the 14.20% impact in 2002 had been allowed to continue through the modeling exercise and form the basis for the MY2003 price expectations, then the MY2003 impacts would have been substantially smaller than the 7.69% offered by Professor Sumner in his approach to the analysis.

120. The compliance panel noted that Brazil's model had been submitted to it for the first time in that dispute, and had to earn the confidence of the Panel. Can the parties point to any literature since then in which the model and its parameters has been discussed or reviewed?

154. The United States agrees that the parameters are of key concern. Accordingly, the United States has offered specific criticisms of the parameters Brazil has chosen.⁸⁹ At the same time, issues other than the choice of parameters are also important. For example, the United States has criticized Brazil's failure to incorporate stocks in its short-run analysis.⁹⁰ Additionally, as the United States argued in its Annex I to its written submission, the model does not include cross-product price effects that may result in overstating the effect of the subsidy removal.

⁸⁸The U.S. also notes that, under the explanation provided at footnote 230 in Brazil's answer to this question, these changes would appear to lower the resulting price effect. This further undermines Brazil's position.

⁸⁹U.S. Written Submission, U.S. Opening Statement, Annex I to U.S. Written Submission and Annex I to U.S. Rebuttal Submission in Article 21.5 Proceedings (resubmitted with Brazil methodology paper).

⁹⁰U.S. Response to Arbitrator Question 5, para. 29, Annex I to U.S. Written Submission and Annex I to U.S. Rebuttal Submission in Article 21.5 Proceedings (resubmitted with Brazil methodology paper).

121. The parties have suggested different values as appropriate for the demand elasticity parameters in the model. Do the parties wish to submit any additional evidence in support of the values which they proposed?

155. The issue for the demand elasticities is the extent to which mills move along their demand curve given changes in cotton prices. Cotton demand at the mill level is a derived demand that is a function of the price of cotton, the price of substitute fibers, the price of other inputs and the output price of the yarn or textile product being produced. As the United States demonstrated in its own response to question 121 and its written submission to the Arbitrator, mills have the ability to switch between fibers and that cotton accounts for a large percentage of costs at the mill, therefore supporting higher demand elasticities than those proposed by Brazil. Brazil seems to confuse movements along the demand curve due to changes in own-price and shifts in the demand curve because of changes in other variables. Brazil's reference to USDA simply acknowledges that the current global economic situation has caused a shift in the demand curve for cotton. That in no way contradicts prior U.S. comments about the slope of the demand curve and the response to changes in cotton prices.

156. Additionally, as the United States recalls that if analysis in a short-run framework, stocks must be accounted for. As the United States explained in Annex I to its written submission and Annex I to its rebuttal submission in the Article 21.5 proceedings (both of which were resubmitted by Brazil with its methodology paper), the Sumner model does not account for stocks and one method to incorporate stocks is through adjusting the demand elasticity

122. Both parties have adverted to the significance of the price suppression in the world market for cotton as something to which the Arbitrator needs to give weight. Would you agree that even small price discounts offered by an exporter/seller in the market can lead to a significant gain in sales for that seller at the expense of others? Would the parties be able to provide studies or market intelligence reports that document how large such price differences need to be in order to achieve a competitive advantage for an exporter?

157. In its answer to this question, Brazil uses information from its cotton market consultant to discuss the price sensitivity of cotton markets. But as Brazil has pointed out, the issue of price sensitivity of a particular sale has nothing to do with the issue of "significant price suppression."⁹¹ The United States pointed out the many factors that can influence a particular sale, noting again that this situation of individual sales transactions, which can be influenced by small discounts depending on the nature of the market, cannot be used to address the issue of significant price suppression. The information presented by Mr. MacDonald is of no relevance to a determination of significant price suppression.

⁹¹ Brazil's Answer to Additional Questions, para. 280.

158. Finally, the United States observes that Brazil also misinterprets and misuses the U.S. Oral Statement. The comment by the United States was to emphasize the importance of considering the extent to which price suppression is significant to the total amount of countermeasures. By contrast, this question concerns the importance of price discounts, and, as noted above, this is an issue of price sensitivity that is different from the legal question of “significant price suppression.”

123. In its Oral Statement on the actionable subsidies dispute, the United States criticized the inclusion of non-WTO Members in Brazil's calculation of the adverse effects of marketing loans and countercyclical payments.

(a) Would the parties be able to identify who these non-WTO members are?

(b) Would the parties be able to provide the volume of production of these non-WTO members for MY 1999-2007?

159. The United States notes that there are some differences between the numbers provided by the United States and by Brazil; these differences in figures are a function of a different data source. The United States notes that its calculations reflected WTO membership as of July 23, 2008.

To Brazil:

124. Brazil provides an estimated set of long-run elasticities in footnote 312 of its Answer to Question 36 from the Arbitrator. What is the basis for these estimates? In the light of your argument that there can be significant supply response in the first year of an announced, permanent policy change affecting just a single commodity, is it reasonable to assume a long run supply elasticity which is considerably higher than the effect in the first year?

160. The United States would agree that in general, long-run elasticities tend to be larger than short-run elasticities. Brazil, however, has assumed the relative size difference with no evidence to support such a conclusion. The assumed 1.2 long-run elasticity is 50% greater than the assumed 0.8 short-run elasticity. If a more reasonable short-run elasticity were used, presumably the long-run elasticity would also be smaller. Brazil attempts to argue that its long-run elasticity of 1.2 is conservative because it only results in a 28 percent reduction in U.S. production and believes the reduction in production should be much greater. Again, this demonstrates Brazil's tendency to first assume an outcome and then select elasticities that generate its assumed outcome.

161. Brazil's support for such a determination is its cost of production analysis it presented during the original and compliance phases of this dispute. While the United States will not

repeat the arguments about why this approach was flawed,⁹² nevertheless, it does not address whether a 28 percent reduction in U.S. production is high, low, or the right level to be expected following the withdrawal of the marketing loan and counter cyclical payment programs. As the United States explained in its response to questions (for example U.S. response to question 129), there are many factors that would limit U.S. farmers exiting from cotton production.

162. Finally, Brazil in its response once again tries to justify its overstated short-run supply elasticity for U.S. cotton farmers. The United States has already made it clear in its written submission, statements during the hearing, and in its response to questions why Brazil's U.S. supply elasticity is baseless and will not restate them here.⁹³ The summary of these arguments is clear: the United States chose elasticities from independent, well-respected organizations with a successful track record of modeling and policy analysis. In contrast, Brazil's choices of elasticities reflect their incorrect, short-run approach to the counterfactual.

125. Could Brazil confirm its answer to Question 38 of the Arbitrator at para. 445.: "Brazil also notes that it would not consider any price suppression, however small, as significant as long as it is greater than zero".

163. The United States agrees that price suppression is not always "significant" for the purposes of a finding of "significant price suppression" under Article 6.3(c) of the SCM Agreement. Indeed, what is important is the *degree* of such price suppression.⁹⁴ At this stage of the proceedings, where the task of the Arbitrator is to determine countermeasures "commensurate with the degree and nature of the adverse effects determined to exist,"⁹⁵ it is critical to ensure that any award is counter to the degree of effects that are the basis for the WTO-inconsistency, and not to the entirety of the effects of a subsidy.

126. Please provide a response to the argument of the United States (in para. 36 of its Oral Statement) that the DSU does not provide a mechanism for a Member to impose countermeasures for the effects on non-WTO Members.

164. As Article 3.3 of the DSU sets out, settlement of situations where a Member considers that "benefits accruing to it . . . are being impaired by measures taken by another Member" is

⁹²U.S. First Written Submission, Dec. 15, 2006, Response to Article 21.5 of the DSU by Brazil, paras 292-302; U.S. Further Rebuttal Submission, Nov. 18, 2003, paras. 117-122

⁹³U.S. Submission, Dec. 9, 2008, paras.256-260; Oral Statement of the United States, March 3, 2009, paras. 13-14.

⁹⁴*Upland Cotton (Panel)*, para. 7.1328.

⁹⁵Article 7.9/10, SCM Agreement.

essential to the WTO and maintenance of the balance of rights and obligations of Members. This is such a situation, and it concerns the complaining Member, Brazil, and the United States. As Brazil acknowledges, other Members' (or non Members') rights are not at issue.⁹⁶

165. Notwithstanding this fact, Brazil is asking for the maximum countermeasures that, under its methodology, could be awarded to the entire world. If the subsidies affect the world market for upland cotton, it is evident that all the effects of the subsidies are not on Brazil. Yet that is the amount that Brazil claims. If Brazil were awarded countermeasures for all the effects of the subsidy, it would create a situation where any other Member's request for countermeasures would be duplicative. Brazil's countermeasures would already have rebalanced all effects of the marketing loan and countercyclical payments, and any other countermeasures would create a more unbalanced situation.

166. In fact, taking into account the issue of non-WTO members, countermeasures for the total adverse effects of marketing loan and countercyclical payments would always result in a more unbalanced situation. Under Article 5 of the SCM Agreement, Members undertake to not cause adverse effects to Members' interests only, there is no obligation with respect to non-Members. Accordingly, to the extent marketing loan and countercyclical payments affect non-Members, there is no WTO-inconsistency no matter what those effects may be. Most production of upland cotton is by WTO members, but a substantial amount is not.

167. In its response, Brazil cites several passages from the original panel Appellate Body report, but these go more specifically to the market that the panel used to examine significant price suppression rather than the extent of serious prejudice suffered by Brazil. The fact that the original and compliance panels used a "world market" to assess significant price suppression does not change the fact that countermeasures must be with respect to the adverse effects on Brazil.⁹⁷ For the purposes of 6.3(c), the important factor is that the United States (the party maintaining the subsidy) and Brazil (the complaining party) compete in the same market. On this basis, the finding with respect to that market may affect Brazil in particular, and serve as the basis for a finding of adverse effects to the interests of Brazil within the meaning of Article 5(c) of the SCM Agreement.

CROSS-RETALIATION (IN RELATION TO BOTH REQUESTS)

To both parties:

133. *If the Arbitrator determines that the provisions of the SCM Agreement only are*

⁹⁶Brazil Answers to Arbitrator Questions, para. 301.

⁹⁷See U.S. Answers to Questions 65 and 117.

applicable to the form of countermeasures, and that the principles of Article 22.3 of the DSU do not apply, as Brazil suggests,

(a) how exactly would the Arbitrator make a single assessment encompassing the level of countermeasures under both proceedings, as suggested by Brazil, given that the applicable standards would be different in relation to each of the amounts?

(b) how might the Arbitrator take into account the amount in the other proceedings, if it made separate assessments?

(c) would an assessment of "appropriateness" of the form of the countermeasures under Article 4.10 or 7.9 of the SCM Agreement involve an analysis very different from that under Article 22.3 of the DSU, or would the "practicability and effectiveness" of the countermeasures be of some relevance to the Arbitrator's determination?

168. As the United States has explained, Article 22.3 of the DSU applies to requests for cross-sectoral countermeasures under the SCM Agreement. Brazil's requests for countermeasures cite to Article 22.3, and its requests should be evaluated under the detailed, hierarchical provisions in that Article.

169. Brazil's response to this question indicates that the factual evidence relevant to the analysis of cross-sectoral countermeasures under Article 22.3 may also be relevant to the analysis even if the Article does not apply.⁹⁸ This underscores the importance of these considerations, and the fact that such countermeasures are exceptional and can only be undertaken in limited circumstances. The United States submits that this supports the fact that Article 22.3 itself directly applies to requests for countermeasures under the SCM Agreement. If the same considerations are important whether or not the SCM Agreement is concerned, it is logical that the Article that provides how to examine these considerations (Article 22.3) always applies.

134. In your view, if the Arbitrator determined that the rules and principles of Article 22.3 of the DSU apply to its determinations in relation to one or both of Brazil's requests for cross-retaliation, should the amount of countermeasure determined by the Arbitrator in relation to the prohibited subsidies and the amount of countermeasure determined in relation to the actionable subsidies be cumulated or aggregated in considering whether it is "practicable or effective" to take countermeasures within the goods sector?

170. With respect to the issue of cumulating the awards under the two arbitrations for the

⁹⁸Brazil Answer to Arbitrator Question 133, para. 314.

purposes of cross-sectoral analysis, Brazil's response proposes that the amounts must be cumulated because the analysis is from the perspective of the complaining Member.

171. However, the analysis is not solely the complaining Member's views – it is also about the applicable standard, and the standards that apply to the amount of countermeasures itself. Accordingly, the United States reiterates that it is important that the Arbitrators' awards account for the separate proceedings. This is particularly important to ensure that if, for example, the United States fully complies with the recommendations and rulings of the DSB with regard to GSM 102 or marketing loan and countercyclical payments, before it is able to comply with the other, the countermeasures that Brazil imposes are still consistent with the legal standards of the SCM Agreement and DSU.

172. The United States disagrees with Brazil's comments disregarding the importance of the amount of countermeasures in determining whether a Member may impose cross-sectoral suspension of concessions. To the contrary, arbitrators have first determined the amount of countermeasures before analyzing whether a Member has met the requirements of Article 22.3.⁹⁹ Brazil also expresses the concern that "lowering the level of authorized countermeasures will make their adoption in relation to trade goods alone less effective." The United States submits that the issue of level of countermeasures is not the point for the purposes of the cross-sectoral analysis; the level is established under the applicable articles of the DSU and Articles 7.9/10 and Articles 4.10/11 of the SCM Agreement. Brazil's notion would have cross-sectoral countermeasures as more likely for smaller awards; this is inconsistent with the analysis of past arbitrators. Moreover, it would create the situation where cross sectoral countermeasures would be the normal course, rather than the exception. (Either they would be permitted because of the small size of the award on Brazil's theory of effectiveness, or they would be permitted because of the large size of the award on the basis of practicability.) Given the number of additional requirements, and arbitrators' statements on this point,¹⁰⁰ it is clear that cross-sectoral countermeasures are intended to be exceptional.

To Brazil:

138. Given that there is nothing explicit in the terms of Article 4.10 and 7.9 of the SCM Agreement about whether cross-sector retaliation should be applied and under what specific conditions, what would be the legal parameters on the basis of which the Arbitrator would assess whether cross sector retaliation is permitted, in relations to prohibited and actionable subsidies, if Article 22.3 of the DSU does not apply?

⁹⁹*U.S.-Gambling*, para. 4.24.

¹⁰⁰*EC-Bananas III (U.S.) (Article 22.6)*, para. 3.7.

173. Brazil's requests for cross-sectoral suspension of concessions was under Article 22.3 of the DSU, which applies to proposed cross-sectoral countermeasures regardless of whether the findings of WTO inconsistency are under the SCM Agreement. Therefore, it is not necessary to explore what the basis for evaluating cross-sectoral suspension of concessions outside the terms of Article 22.3. The United States also notes that in its response to question 133, Brazil acknowledged the similarity of the analysis (hypothetical) outside Article 22.3 to the analysis that is required under Article 22.3.

174. With regard to the specific comments in Brazil's response, the United States notes, once again, that there is no need to turn to the ILC Commentaries; the *lex specialis* of the DSU and the SCM Agreement apply and provide all the necessary guidance for all suspensions of concessions under the WTO.

175. Brazil's remarks add additional considerations that are not found in Article 22.3, nor would apply to any suspension of concessions. In particular, Brazil suggests that the 2008 Farm Bill may somehow be relevant, in the context of Brazil's assumptions about what actions the United States may take in the future. It is not consistent with the SCM Agreement or the DSU to turn to such assumptions or analysis of measures on which there are no DSB recommendations and rulings. The SCM Agreement special and additional rules provide clear direction as to the amount of countermeasures, and the question of cross-sectoral suspension of concessions must be evaluated under the transparent, negotiated rules for this exceptional type of action.

139. If the Arbitrator were to assess Brazil's requests for cross-retaliation under Articles 4.10 and 7.9 of the SCM Agreement only, what would be the relationship between the "level" and the "form" of the countermeasures in this assessment? Do these two elements have any correlation between them or do they represent separate assessments?

176. The level, or amount, of suspension of concessions and the form (whether suspension may be cross-sectoral) are two separate questions, as the Arbitrators recognize in this question. Accordingly, the two questions are separately provided for under the relevant Agreements.

177. Brazil's response to this question emphasizes the flexibility of the SCM Agreement rules, and the complementarity between the two questions. The United States submits that this shows that the SCM Agreement does not provide guidance on cross-sectoral suspension of concessions. Given the detailed nature of the guidance is in Article 22.3 of the DSU, it would not make sense for there to be no similar guidance for such countermeasures under the DSU. It is apparent that the guidance under Article 22.3 applies to proposed cross-sectoral countermeasures under the SCM Agreement.

140. Please comment on paragraph 70 of the US Oral Statement, in which the US has shown certain trade figures to illustrate that Brazil's trade in certain commodities is not so dependent on the imports from the US that if imports from the US were suspended, Brazil could not easily find alternative sources of supply.

178. Brazil’s response to this question focuses on the specific examples provided by the United States, and in so doing looks at the individual trees but misses the forest. The better way to analyze Brazil’s arguments about the purported need for cross-sectoral suspension of concession is to look at the context: the context of all of Brazil’s arguments for cross-sectoral suspension is the enormous size of Brazil’s economy. Brazil’s economy dwarfs the small, developing economies where arbitrators have permitted the exceptional step of cross-sectoral suspension of concessions.¹⁰¹ Brazil is, in fact, one of the ten largest economies in the world.¹⁰²

179. In spite of this, Brazil has claimed that it has an even narrower scope for countermeasures on goods. Recall that in *EC – Bananas (Ecuador)*, the arbitrator looked at consumer goods in particular because suspension of concessions on those goods could not “cause any direct adverse effects on Ecuador’s domestic manufacturing and processing industries.”¹⁰³ The same reasoning would apply for the end-use products that Brazil argues should be off-limits for suspension of concessions. The reasons to disfavor investment and primary goods for suspension of concessions simply do not apply for end use products like books and food.¹⁰⁴

180. Brazil points to the potential costs of changing suppliers as part of its arguments to remove whole categories of goods. But, such costs may always be a result of suspension of concessions. Even in *EC – Bananas (Ecuador)*, the arbitrator recognized that the possibility of welfare losses to end-consumers would not be sufficient to prevent a Member from suspending concessions on goods.¹⁰⁵

181. With regard to the specific categories of goods the United States referred to in paragraph 70, the United States emphasizes that these examples illustrate the fact that Brazil is not constrained to the narrow range of choices that it suggests. The United States was not inviting Brazil to impose countermeasures on specific goods or ascribing unique significance to the

¹⁰¹U.S. Answer to Arbitrator Question 68, Table 5.

¹⁰²U.S. Answer to Arbitrator Question 135, para. 167.

¹⁰³*EC – Bananas III (Article 22.6) (Ecuador)*, para. 100.

¹⁰⁴Brazil Written Submission, para. 516.

¹⁰⁵*EC – Bananas III (Article 22.6) (Ecuador)*, para. 100.

particular examples. In this regard, while the United States regrets any confusion that may have been caused by the way the examples were described (in particular, using the term “salmon” instead of “red salmon,” which was simply an oversight),¹⁰⁶ the point of these examples is unaffected.

182. Brazil’s argument on cross-sectoral suspension of concessions asks the Arbitrator to accept that Brazil has only a very limited range of choices for suspension of concessions on goods. But Brazil is one of the world’s largest economies, and it has many sources of supply. Given the choices Brazil has made and the options before it, the Arbitrators should deny Brazil’s request for cross-sectoral countermeasures.

141. If Article 22.3 of the DSU does not apply to the Arbitrator’s determinations in relation to Brazil’s request for cross-retaliation, should the Arbitrator take into consideration the nature of obligations to be suspended in its assessment of the “appropriateness” of cross-retaliation under Article 4.10 and/or of the “commensurateness” of cross-retaliation under Article 7.9 of the SCM Agreement? If not, why not?

183. As an initial matter, Article 22.3 of the DSU does apply to Brazil’s requests for cross-retaliation. But, the United States believes that even if it did not, the Arbitrators would still take into consideration the nature of obligations to be suspended, in as much as that “nature” is whether the suspension of concessions would be cross-sectoral.

184. As evidenced by the detailed provisions of Article 22.3, cross-sectoral suspension of concessions is intended to be exceptional. Given this fact, it would be surprising if under the SCM Agreement, there were no disciplines at all on whether a Member could take this unusual step. Accordingly, the issue of cross-sectoral suspension of concessions would be a consideration before the Arbitrator in any dispute where a party has made such a request.

142. Should the question of how countermeasures under the TRIPs Agreement might be applied be taken into account in our decision about what is an appropriate countermeasure under Article 4.10 of the SCM Agreement, or what is or is not commensurate with the degree and nature of the adverse effects determined to exist under Article 7.9 of the SCM Agreement? For instance, might the question of the ability to quantify the trade effects of a suspension of certain TRIPs obligations be a relevant consideration?

¹⁰⁶The United States referenced that 0303.11 as “salmon” since this was the only salmon delineated tariff line in table 2, exhibit BRA-754.

185. Brazil’s response emphasizes its confidence in the ability to apply “reasonable methodologies” for TRIPS-related countermeasures and points to the possibility of a Member’s recourse to dispute settlement if the Member considers that suspension of concessions has exceeded what would be permitted by the DSB. The United States notes the difficulty and complexity of the methodologies proposed even in this arbitration, which relates to the amount of proposed countermeasures and the time-consuming nature of resort to dispute settlement.

186. Yet, the Arbitrators’ task is to determine the amount of countermeasures that may be authorized, and whether, under Article 22.3 of the DSU, these countermeasures may be taken in the form of suspension of concessions outside the goods sector. This task does not include exploration of how a Member may proceed with countermeasures, once they are authorized. Thus, Article 22.7 of the DSU confirms that the Arbitrator shall not examine the nature of the obligations to be suspended.

187. For these reasons, particularly because of the discretion of the complaining Member in suspending concessions once an award is authorized, issues such as the uncertainty of how countermeasures might be imposed under the TRIPs Agreement are certainly concerns.

188. No Member has yet imposed cross-sectoral suspension of concessions, and it is not clear how it might be done. Cross-sectoral suspension of concessions is meant to be exceptional, and so it is not surprising that there is such uncertainty. To the extent this uncertainty raises concerns about whether cross-sectoral suspension of concessions would meet the legal standards in this dispute (“appropriate/not disproportionate” and “commensurate with the adverse effects”) it may be a consideration. However, generally speaking, the details of how a Member will act on an authorization for countermeasures are not issues before the arbitrator.