

BEFORE THE
WORLD TRADE ORGANIZATION
APPELLATE BODY

United States – Subsidies on Upland Cotton

(AB-2004-5)

Appellant's Submission of the United States of America

October 28, 2004

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SERVICE LIST

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SHORT TITLE	FULL TITLE AND CITATION
Appellate Body Report, <i>Argentina – Footwear</i>	Appellate Body Report, <i>Argentina – Safeguard Measures on Imports of Footwear</i> , WT/DS121/AB/R, adopted 12 January 2000
Appellate Body Report, <i>Brazil – Aircraft</i>	Appellate Body Report, <i>Brazil – Export Financing Programme for Aircraft</i> , WT/DS46/AB/R, adopted 20 August 1999
Appellate Body Report, <i>Canada – Dairy (Second Recourse to Article 21.5)</i>	Appellate Body Report, <i>Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Second Recourse to Article 21.5 of the DSU by New Zealand and the United States</i> , WT/DS103/AB/RW2, WT/DS113/AB/RW2, adopted 17 January 2003
Appellate Body Report, <i>Canada – Dairy (Recourse to Article 21.5)</i>	Appellate Body Report, <i>Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Recourse to Article 21.5 of the DSU by New Zealand and the United States</i> , WT/DS103/AB/RW, WT/DS113/AB/RW, adopted 18 December 2001
Appellate Body Report, <i>Chile – Price Bands</i>	Appellate Body Report, <i>Chile – Price Band System and Safeguard Measures Relating to Certain Agricultural Products</i> , WT/DS207/AB/R, adopted 23 October 2002
Appellate Body Report, <i>Guatemala – Cement</i>	Appellate Body Report, <i>Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico</i> , WT/DS60/AB/R, adopted 25 November 1998
Appellate Body Report, <i>Mexico - High Fructose Corn Syrup (Recourse to Article 21.5)</i>	Appellate Body Report, <i>Mexico – Anti-Dumping Investigation of High Fructose Corn Syrup (HFCS) from the United States – Recourse to Article 21.5 of the DSU by the United States</i> , WT/DS132/AB/RW, adopted 21 November 2001
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Appellate Body Report, <i>US – FSC</i>	Appellate Body Report, <i>United States – Tax Treatment for “Foreign Sales Corporations”</i> , WT/DS108/AB/R, adopted 20 March 2000
Appellate Body Report, <i>U.S. – Import Measures</i>	Appellate Body Report, <i>United States – Import Measures on Certain Products from the European Communities</i> , WT/DS165/AB/R, adopted on January 10, 2001

Appellate Body Report, <i>US – Lamb Meat</i>	Appellate Body Report, <i>United States – Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat from New Zealand and Australia</i> , WT/DS177/AB/R, WT/DS178/AB/R, adopted 16 May 2001
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Panel Report, <i>Canada – Dairy</i>	Panel Report, <i>Canada-Measures Affecting the Importation of Milk and the Exportation of Dairy Products</i> , WT/DS103/R; WT/DS113/R, adopted as modified by the Appellate Body on 27 October 1999.
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GATT Panel Report, <i>EEC – Dessert Apples</i>	GATT Panel Report, <i>EEC – Restrictions on Imports of Dessert Apples</i> , adopted on 22 June 1989, BISD 36S/93
GATT Panel Report, <i>U.S. – Tuna</i>	GATT Panel Report, <i>United States – Prohibition of Imports of Tuna and Tuna Products from Canada</i> , adopted on 22 February 1982, BISD 29S/91

I. Introduction and Executive Summary

1. Given the number of issues in the U.S. notice of appeal, the number and complexity of measures and claims at issue, the length of the panel report, and the weight of this appellant's submission, the Appellate Body may be under the impression that this appeal is complex. The United States submits, however, that the core issues in this appeal are not complex. We believe that the Appellate Body will come to the conclusion that Brazil has over-reached in several of its claims, stretching WTO disciplines beyond anything Members have agreed, and that the Panel has made interpretive missteps that compel reversal of its findings. The Panel's erroneous legal conclusions can be grouped into three main issues.

2. ***Peace Clause:*** Brazil brought this action prior to expiry of the Peace Clause. In order to find that Brazil could proceed with its subsidies action against the challenged U.S. measures, the Panel had to find the U.S. decoupled income support measures were not green box and that non-green box domestic support measures grant support to a specific commodity, upland cotton, in excess of the support decided in marketing year 1992. In making these findings, the Panel effectively found that the reforms underlying two major legislative efforts undertaken by the United States in 1996 and 2002 had failed to achieve one of their principal aims, to ensure that U.S. measures comply with the conditions set out in the Peace Clause.

3. Each aspect of the Panel's finding that U.S. measures are not exempt from actions under the Peace Clause was in error and relied on a misinterpretation of the relevant provisions. With respect to U.S. decoupled income support measures, the sole basis for the Panel's conclusion that such measures did not conform to the Peace Clause was a misreading of paragraph 6(b) of Annex 2 of the *Agreement on Agriculture*. To make this finding, the Panel had to find that *banning* a recipient from producing a certain range of products was the same thing as conditioning the amount of the payment on the production undertaken by the producer. That is, the Panel found that requiring a payment recipient not to produce a particular product would be inconsistent with paragraph 6(b), despite the fact that the economic literature shows that decoupled payments conditioned in this way satisfy the "fundamental requirement" for green box measures that such

payments have “no, or at most minimal, trade-distorting effects or effects on production.” The Panel itself implicitly recognized that these payments have “at most minimal” effects on production when it found that Brazil had *not* demonstrated that decoupled income support measures stimulate production, resulting in significant prices suppression and serious prejudice.

4. The Panel also erred in finding that U.S. non-green box measures are not exempt from actions under the Peace Clause. The Panel recognized that the Peace Clause text is written so as to allow a Member to establish measures that conform to its requirements. This is accomplished by focusing on the support “decided” by a Member. Nonetheless, the Panel gauged the support that U.S. price-based payments grant using budgetary outlays, which necessarily swell whenever prices, which are beyond a Member’s control, decline. In addition, the Peace Clause comparison of current support to 1992 support is focused on “support to a specific commodity,” but the Panel included payments that are decoupled (not tied to) current production of cotton in its comparison. In fact, the Panel’s erroneous approach led it to find that payments to recipients who do not produce cotton at all is “support to” upland cotton. Correcting for these two simple errors by the Panel, the challenged U.S. measures did not breach the proviso in Article 13(b)(ii) in any marketing year from 1999-2002 – precisely as designed.

5. The completion of the Uruguay Round provided Members the incentive to shift from support that is coupled to production to support that is decoupled from production and prices. In response, the United States eliminated traditional deficiency payments with a high target price tied to upland cotton production and replaced them with payments that are decoupled from upland cotton production. Ironically, Brazil benefitted from these U.S. efforts, which resulted in U.S. domestic support moving away from more highly trade-distorting product-specific forms to non-trade-distorting decoupled payments. Brazil nonetheless launched this action prior to expiry of the Peace Clause while U.S. measures were still “exempt from actions.” The result is that U.S. support to upland cotton during marketing years 1999-2002 was well below the support decided during the 1992 marketing year, and the United States is entitled to Peace Clause protection.

6. ***Serious Prejudice:*** Press accounts of this dispute frequently frame it as a complex dispute over the effect of U.S. payments on world cotton prices. As a result, one might have expected that in 350 pages of findings, more than 4 pages would have been spent analyzing what was “the effect of the subsidy.”¹ The Panel’s analysis of the key issue of causation reflects neither the reasoned analysis necessary for the Appellate Body to affirm the serious prejudice finding nor the reasoned analysis Members should expect from the WTO dispute settlement system. The United States demonstrates at some length that, with respect to numerous findings and conclusions of law, the Panel erred and took an approach that disregarded the text of the relevant provisions, lacked analysis, or made findings that were simply unexplained.

7. Consider the Panel’s key conclusion that U.S. subsidies “numb[] the response of United States producers to production adjustment decisions when prices are low.”² This conclusion is made without any consideration, detailed or cursory, of what cotton farmers’ production decisions are. As both the United States and Brazil agreed, a farmer’s primary economic decision is the decision on what to plant, and the relevant prices at that point are the prices that the farmer *expects* to receive when the crop is harvested, not the currently prevailing price. The Panel simply ignored the planting decision in making its analysis, as if farming were like running a factory line in which “production adjustment decisions” can be continuously made. Thus, the Panel erred as a matter of law in finding that “the effect of” the challenged price-contingent subsidies is significant price suppression is legally erroneous.

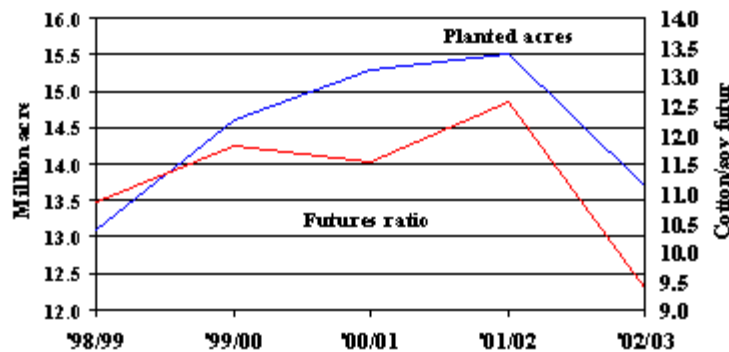
8. Conspicuously absent from the Panel report as well was any acknowledgment that the facts do not demonstrate that U.S. farmers differ from their competitors in the rest of the world in their production decisions. Consider:

¹See Panel Report, paras. 7.1347-7.1356.

²Panel Report, para. 7.1308.

- Acreage and futures price data reveal that U.S. cotton planted acreage did respond to expected market prices of cotton and other competing crops.³ That is, U.S. farmers were responding to market price signals during the period examined by the Panel. The Panel ignored this data.

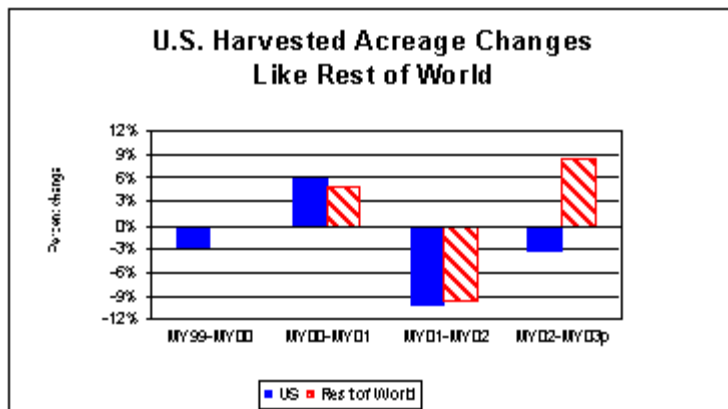
U.S. Cotton Planting Reflects Expected Prices



- Acreage data show that U.S. farmers change cotton acreage commensurately with changes made by cotton farmers in the rest of the world.⁴ That is, U.S. farmers respond to the same market price signals that their competitors in the rest of the world do. The Panel ignored this data as well.

³U.S. Answer to Question 175 from the Panel, para. 110 (October 27, 2003).

⁴See U.S. Comments to Brazil’s Answers to Panel Questions Following the Second Panel Meeting, para. 49 (January 28, 2004).



• In fact, the Panel itself found that the U.S. share of world cotton production has been stable, at about 20.6 percent over the period examined.⁵ Again, the data demonstrate that U.S. farmers respond to market signals as cotton farmers in the rest of the world do. The Panel ignored the import of its own findings on the U.S. share of world production.

Thus, the evidence did not support the conclusion that U.S. payments have insulated U.S. cotton farmers from market forces. Rather than conducting an analysis to support its conclusion that the effect of certain of the challenged payments was to stimulate production and exports, resulting in lower world market prices, however, the Panel contented itself with an assumption.

9. The United States does not believe that the Panel's analysis exhibits the rigor that should be present in any dispute and perhaps particularly a dispute in this area where issues of causation and occurrence of subsidy have already been explored in some detail in other disputes.

10. **Export Credit Guarantees:** The Panel erred in finding that the United States export credit guarantee programs for certain agricultural products are export subsidies under the Agreement on Agriculture and the Subsidies Agreement. Despite Article 10.2 of the Agreement on Agriculture, which specifically addresses export credit guarantees and foresees the imposition of disciplines

⁵Panel Report, para. 7.1282.

after the development of “internationally agreed disciplines,” the Panel nonetheless determined that these guarantees are subject to currently applicable export subsidy disciplines. In so doing, the Panel ignores the intention of the drafters, evident in the text, context, and negotiating history, to treat export credit guarantees differently.

11. Manifest in how Article 10 is written, the Members intended export credit guarantees and international food aid transactions to be disciplined outside the ordinary export subsidy rules. To interpret the Agreements otherwise not only prospectively imperils food aid transactions, but it works a manifest injustice on the United States and other Members, which would have been able to include export credit guarantees within their export subsidy reduction commitments had such practices been included among the export subsidies listed in Article 9.1 of the Agreement on Agriculture. Brazil’s challenge and the Panel’s result does violence to the bargain struck by the Members.

12. **Other errors:** The Panel made numerous other errors as well. For example, it incorrectly concluded that the Step 2 program is simultaneously a prohibited import substitution subsidy and a prohibited export subsidy. It also considered measures that did not fall within its terms of reference, as well as measures in respect of which Brazil had not met the requirement to provide a statement of available evidence.

13. We turn now to a more detailed examination of all these errors by the Panel.

II. The Panel Erred in Finding that U.S. Decoupled Income Support Measures Are not Exempt from Actions under Article 13(a) of the Agreement on Agriculture

A. Introduction

1. The Panel erred in finding that U.S. decoupled income support measures do conform fully with paragraph 6(b) of Annex 2

14. The Panel erred in finding that certain U.S. decoupled income support measures – that is, production flexibility contract payments under the 1996 Act, direct payments under the 2002 Act, and “the legislative and regulatory provisions which establish and maintain the DP programme” – are not exempt from actions under Article 13(a) of the Agreement on Agriculture.⁶ The sole basis for the Panel’s conclusion was its finding that these decoupled income support measures “do not fully conform with paragraph 6(b) of Annex 2 of the *Agreement on Agriculture*.”⁷ However, the Panel erred in finding that the U.S. decoupled income support measures relate or base the amount of payment on the type of production undertaken by a producer.

15. To make this finding, the Panel had to find that *banning* a recipient from producing a certain range of products was the same thing as conditioning the amount of the payment on the type of production. In other words, the Panel converted an explicit refusal by a Member to support a particular type of production into relating or basing the amount of payments on the type of production undertaken by the producer in any year after the base period. The United States is unable to understand how such a ban on support relates the amount of payments made to the amount of production “undertaken” by a producer.

⁶Panel Report, para. 7.413-7.414.

⁷Panel Report, para. 7.388.

16. A proper interpretation demonstrates that paragraph 6(b) permits such a ban on support. Indeed, ensuring that measures do *not* support particular crops serves the fundamental requirement of Annex 2, that measures have no more than minimal trade-distorting effects and effects on production. Thus, U.S. decoupled income support measures do conform fully with paragraph 6(b) of Annex 2.

2. The “planting flexibility” provisions at issue

17. The Panel focused its analysis of the conformity of U.S. decoupled income support measures with paragraph 6(b) of Annex 2 on the “planting flexibility” provisions of those U.S. measures. Recipients of production flexibility contract payments under the 1996 Act and direct payments under the 2002 Act are not required to produce any particular crop in order to receive payments (which are based on the farm’s historical acreage and yields during a base period). In fact, recipients are free not to produce any crop at all. These planting flexibility provisions allow recipients the freedom to produce no, one, or multiple commodities.⁸

18. With respect to farmland equivalent to the amount of the farm’s base acreage (that is, the number of payment acres that historically had produced certain crops during the base period), farmers are permitted to plant any commodity or crop, subject to certain limitations concerning the planting of fruits and vegetables.⁹ Direct payments are either eliminated or reduced if producers plant these crops on base acres, unless they are destroyed before harvest, subject to certain exceptions. Additionally, producers must use the land for an agricultural or conserving use and not for a non-agricultural commercial or industrial use and abide by conservation compliance requirements. Otherwise, direct payments are not affected by what is produced on base acreage nor by whether anything is produced on it at all. The same description holds for the expired production flexibility contract payments.

⁸For additional detail on these decoupled income support measures, please see Annex I to this submission.

⁹See Panel Report, paras. 7.222, 7.375-7.382.

19. The uncontraverted evidence on the record shows that the material effects of the fruit and vegetable restrictions are minimal. First, producers can plant fruits and vegetables on any available farmland in excess of base acres, without violating the requirement not to produce fruits or vegetables on acreage equivalent to base acres. Indeed, as the evidence on the record shows, in marketing year 2002 alone, U.S. farms that reported upland cotton base acreage planted 1.2 million acres of fruits and vegetables.¹⁰

20. In addition, the uncontroverted evidence on the record shows that, in marketing year 2002, upland cotton base acreage rose after the base updating permitted under the 2002 Act in every U.S. State but California.¹¹ This is of interest because, according to Brazil, the reduction or elimination of decoupled income support payments if a recipient plants fruits, vegetables, or wild rice, would tend to increase upland cotton production. For example, according to Brazil, fruits and vegetables are potentially important alternative crops in the San Joaquin Valley of California, and by restricting a farmer’s planting alternatives, decoupled income support payments would result in more upland cotton production. However, Brazil offered no facts to support its theory, and the available facts do *not* support Brazil’s contention. There was no increase in upland cotton base acreage in California, and the acreage planted to upland cotton in marketing year 2002 was, in fact, over 60 percent lower than the upland cotton base acreage.¹² Thus, the facts do not support Brazil’s allegation that the requirement *not* to produce certain crops on acreage equivalent to base acreage as a condition of payment has had the effect of increasing upland cotton production. Indeed, the Panel made no finding supporting Brazil’s contention.

¹⁰See U.S. Comments on the February 18, 2004, Comments of Brazil, para. 48 n. 89 (citing data file “DCP02-2W.xls” (“Grand Total (Farms A - C)” row)) (March 3, 2004).

¹¹U.S. Opening Oral Statement at the Second Panel Meeting, para. 58 (October 10, 2004) (as delivered); Exhibit US-95.

¹²U.S. Opening Oral Statement at the Second Panel Meeting, para. 58 (December 4, 2004) (as delivered); Exhibit US-95.

21. Further, the evidence on the record demonstrates that recipients of decoupled income support payments for upland cotton base acres do utilize their planting flexibility. Fully 47 percent of farms receiving decoupled income support payments for upland cotton base acres in marketing year 2002 planted no upland cotton at all.¹³ That is, nearly half of traditional upland cotton farms participating in U.S. farm programs have shifted away from upland cotton production entirely. This is additional evidence supporting the view that the requirement *not* to produce certain crops on acreage equivalent to base acreage as a condition of payment does *not* have the effect of increasing upland cotton production.

B. The Panel Erred in Finding that U.S. Decoupled Income Support Measures Do not Conform with Paragraph 6(b) of Annex 2 to the Agreement on Agriculture

22. The Panel erred in finding that U.S. decoupled income support measures “do not fully conform with paragraph 6(b) of Annex 2 of the *Agreement on Agriculture*.”¹⁴ The Panel’s error stems from its erroneous interpretation of that provision. The Panel’s reading does not make sense of the text in its context and in light of the object and purpose of the Agreement. The Panel effectively concluded that a Member’s *banning* a recipient from producing a certain range of products – that is, an explicit decision not to support a particular type of production – relates the “amount” of payments made (with respect to a particular commodity, upland cotton) to the type of production “undertaken” by a producer (of an entirely different commodity, a fruit or vegetable). The U.S. interpretation of paragraph 6(b), that a Member may condition payments on a recipient’s *not producing* certain products, does make sense of the text and context of paragraph 6(b). Indeed, a condition that a recipient not produce certain products serves the

¹³Comments of the United States of America on the February 18, 2004, Comments of Brazil, para. 26 (March 3, 2004); *id.*, n. 55 (citing Brazil Further Rebuttal Submission, para. 23, which presented data showing that 46, 45, and 45 percent of farms receiving decoupled payments for upland cotton base acres received no upland cotton marketing loan payments (Brazil’s proxy for upland cotton production) in 2000, 2001, and 2002, respectively).

¹⁴Panel Report, para. 7.388.

fundamental requirement of Annex 2, that measures have no more than minimal trade-distorting effects and effects on production.

1. Paragraph 6(b), interpreted properly, does not prevent a Member from conditioning payment on not producing certain products

23. The Panel’s finding that U.S. decoupled income support measures do not fully conform with paragraph 6(b) of Annex 2 stems from an erroneous interpretation of that provision.

Paragraph 6(b) reads:

(b) The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period.

24. **Ordinary meaning:** The Panel focused on the phrase “related to” and reasoned that this “denotes a mere connection between the amount of such payments and the type of production after the base period. This word is not limited to a connection that is positive or negative, or absolute or partial. It appears to include all types of relationship between the amount of such payments and the type of production after the base period, whether the amount increases or decreases and whether the difference in the amount is proportional to the volume of production or not.”¹⁵

25. The United States agrees that the ordinary meaning of the term “related to” is “[h]aving relation; . . . connected. (Foll. by *to*, *with*.)”¹⁶ which could encompass a positive connection or a negative connection or both. However, the ordinary meaning of the term does not identify which

¹⁵Panel Report, para. 7.366.

¹⁶*The New Shorter Oxford English Dictionary*, vol. 2, at 2534 (1993 ed.).

connection is meant; reference to the remainder of the provision (which the Panel ignored) and its context is necessary to determine its meaning.¹⁷

26. First, the United States notes that paragraph 6(b) speaks of “the amount of such payments” not being related to or based on the type or volume of production. The Panel assumes that the “amount of such payments” can be related to the current type of production (that is, of fruits or vegetables) because in some circumstances a recipient that produces fruits or vegetables receives less payment than that recipient otherwise would have been entitled to.¹⁸ However, in that case, the only “amount” that is even arguably “related to” current production is “zero” – that is, for a base acre which could otherwise receive payment,¹⁹ the “amount” of payment is zero. In the ordinary sense of the terms,²⁰ the “amount of such payments” (the “quantity” of “an amount paid”) does not relate to fruit or vegetable production since for that base acre there would be *no payment at all*.

27. Second, we note the use of the term “undertaken” (payments shall not be based on or related to the type or volume of production “undertaken by the producer in any year after the base period”). In its ordinary meaning, “undertake” means “to take on oneself, as a task, performance, etc.; attempt.”²¹ Here, the planting flexibility provisions that ban a recipient from producing a certain range of products with respect to base acreage, thereby carving out support for particular

¹⁷The Panel implicitly recognizes that the U.S. reading of paragraph 6(b) is valid on the face of the text when it writes: “There is little doubt that *in general* the ‘amount’ of PFC and DP payments is not ‘related to, or based on, the type or volume of production ... undertaken by the producer in any year after the base period’.” Panel Report, para. 7.383. The Panel goes on to discuss reduction in payments that may result from planting fruits or vegetables on acreage equivalent to base acreage.

¹⁸See Panel Report, para. 7.383.

¹⁹For fruit or vegetable production on acreage *in excess of* a farm’s base acreage, there would be no violation of the fruit or vegetable restriction and no non-payment. For example, if a farm has 20 acres of farmland, 10 base acres, and up to 10 acres planted to fruits or vegetables, there is no violation. It is only fruit or vegetable production on an amount of acreage *greater than* the farmland beyond base acreage that is at issue – for example, if the farm just described planted more than 10 acres to fruits or vegetables.

²⁰“Amount” means “quantity; measure”. *The Random House Dictionary of the English Language*, at 49 (1983 ed.; unabridged). “Payment” means “something that is paid; an amount paid”. *The Random House Dictionary of the English Language*, at 1059 (1983 ed.; unabridged).

²¹*The Random House Dictionary of the English Language*, at 1546 (1983 ed.; unabridged).

commodities, would not relate the amount of payments to production “attempted” by the recipient. Rather, the amount of payment is related to or based on the type of production *not* “attempted.”

28. Taken together, the ordinary meaning of the terms “the amount of such payments” and “production . . . undertaken” indicate that payments are not “related to” current production within the meaning of paragraph 6(b) merely because a Member conditions payment on a recipient’s *not producing* certain products.²² To further illustrate the point, imagine a payment recipient with a one acre farm and one base acre of upland cotton that has planted a fruit or vegetable on that acre. If no exception applied, the recipient would receive no payment for that base acre. How could the farmer regain eligibility for payment? The farmer need not undertake any production at all; rather, she need simply desist from producing the fruit or vegetable. Thus, receiving an “amount” of “payment” for that base acre is related to *not undertaking* fruit or vegetable production, rather than producing those products.

29. ***The context provided by the first sentence of Annex 2 confirms this reading:*** The context of paragraph 6(b) confirms this reading, particularly the “fundamental requirement” set out in the first sentence of Annex 2 for green box measures. Annex 2, paragraph 1, provides that domestic support measures “for which exemption from the reduction commitments is claimed shall meet the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production.” The second sentence of paragraph 1 goes on to explain that, “[a]ccordingly, all measures for which exemption is claimed shall conform to [certain] . . . basic criteria” as well as detailed “policy-specific criteria and conditions” as set out in the Annex.

²² This is not intended to preclude examination of a situation in which a Member effectively permitted production of only one crop, for example, by banning the production of all other crops. That is not the situation presented here, however.

30. “Fundamental” means “[s]erving as the base or foundation” and “primary, original; from which others are derived.”²³ A “requirement” is “[s]omething called for or demanded.”²⁴ Thus, the “fundamental requirement” that green box measures have “no, or at most minimal, trade-distorting effects or effects on production” is “something called for or demanded” “from which others are derived.”

31. As suggested by the use of the word “fundamental” (“from which others are derived”) and the structure of Annex 2 (that is, beginning the second sentence with the word “accordingly”),²⁵ compliance with the requirement (“something called for or demanded”) of the first sentence will be demonstrated by conforming to the basic and applicable policy-specific criteria, which are “derived” from the fundamental requirement. Thus, the “fundamental requirement” of the first sentence provides important context to any reading of the basic or policy-specific criteria in Annex 2, including paragraph 6(b).

32. On its face, the “fundamental requirement” of Annex 2, by requiring “no, or at most minimal, . . . effects on production,” appears to be concerned with *positive effects* on production, which could, in turn, have trade effects of concern to Members. A commonsense reading of the fundamental requirement also suggests that *negative effects* on production are not at issue as it is difficult to envision green box measures that are perfectly production neutral – that is, have no positive *or* negative effects on production – nor is it clear why Members would only want to allow production-neutral measures to qualify for the green box.

33. In fact, the text of Annex 2 expressly contemplates that measures with *negative effects* on production may qualify for the green box. For example, Annex 2, paragraph 9, sets out criteria for structural adjustment assistance provided through producer retirement programs. Such

²³*The New Shorter Oxford English Dictionary*, vol. 1, at 1042 (1993 ed.)

²⁴*The New Shorter Oxford English Dictionary*, vol. 2, at 2557 (1993 ed.)

²⁵The ordinary meaning of “accordingly” is “[i]n accordance with the logical premises; correspondingly.” *The New Shorter Oxford English Dictionary*, vol. 1, at 15 (third definition).

payments are “conditional upon the total and permanent retirement of the recipients from marketable agricultural production.”²⁶ Such payments have as their express intent *negative* effects on production and, since they are “derived” from the fundamental requirement of Annex 2, must have “no, or at most minimal, . . . effects on production.”

34. Similarly, Annex 2, paragraph 11, sets out criteria for structural adjustment assistance provided through resource retirement programs. Such payments are “conditional upon the retirement of land from marketable agricultural production for a minimum of three years.”²⁷ Such payments also have as their express intent *negative* effects on production and, since they are “derived” from the fundamental requirement of Annex 2, they too must have “no, or at most minimal, . . . effects on production.”

35. Thus, Annex 2 establishes that the fundamental requirement that green box measures must satisfy is to have no or at most minimal positive effects on production. The criterion in paragraph 6(b), which is derived from the fundamental requirement, must be read in light of this context. Consistent with the ordinary meaning of its terms and with the context of the first sentence of Annex 2, paragraph 6(b) is concerned that the amount of payments not be related to or based on the type or volume of production undertaken by a recipient. When a measure conditions payments on a recipient’s *not producing* certain products, however, there is no positive inducement to produce. That condition may have *negative* effects on production (by relating the amount of payment to production *not* undertaken) but does not have the *positive* effects at issue for purposes of Annex 2.

36. ***The Panel found that U.S. decoupled income support measures have negative effects on production, not positive effects:*** In fact, the Panel found that the condition that decoupled

²⁶Agreement on Agriculture, Annex 2, para. 9(b).

²⁷Agreement on Agriculture, Annex 2, para. 11(b).

income support recipients *not* produce certain products had *negative* effects on production but not positive effects:

Firstly, the Panel notes that the planting flexibility limitations provide a monetary incentive for payment recipients *not to produce* the prohibited crops.²⁸

Thus, the Panel’s own finding suggests that the planting restrictions in U.S. decoupled income support measures further the fundamental requirement that such measures have “no, or at most minimal, trade-distorting effects or effects on production” because recipients are “provide[d] a monetary incentive not to produce” certain crops, which would have a negative effect on production of those crops.

37. The importance of reading paragraph 6(b) in light of the fundamental requirement of Annex 2 is further highlighted by considering the Panel’s findings with respect to these decoupled income support measures in the serious prejudice portion of this dispute. There, the Panel concluded that Brazil had not established that the effect of U.S. decoupled income support payments was significant price suppression.²⁹ The Panel found that, “in the particular facts and circumstances of this dispute, the combination of these elements indicates to us that these particular subsidies are more directed at income support”³⁰ – as opposed to the “price-contingent” subsidies that it found “ha[ve] enhanced production and trade-distorting effects” and “stimulate production and exports” of upland cotton.³¹

- That is, the Panel implicitly found that decoupled income support measures do *not* have “more than minimal” trade-distorting effects or effects on production – a finding

²⁸Panel Report, para. 7.386 (italics added).

²⁹See, e.g., Panel Report, para. 7.1355.

³⁰Panel Report, para. 7.1307.

³¹See, e.g., Panel Report, para. 7.1294. The United States appeals the Panel’s serious prejudice finding with respect to these “price-contingent” measures in Section IV, *infra*.

consistent with the consensus view in the economics literature that such payments have no more than minimal effects.³²

Thus, the interpretation of paragraph 6(b) set out above would ensure that paragraph 6(b) permits measures, such as U.S. decoupled income support measures, that in fact satisfy the fundamental requirement of Annex 2.

38. ***The context provided by paragraph 6(e) also confirms this reading:*** Important context for reading paragraph 6(b) is also provided by paragraph 6(e), which reads: “No production shall be required in order to receive such payments.” However, as the Panel agrees, paragraph 6(e) by its terms does not preclude a Member from requiring *non-production*.³³ It follows that:

- As a Member may, under paragraph 6(e), *require* a recipient *not to produce* a particular product, it would not make sense to then prohibit a Member, under paragraph 6(b), from making the *amount of payment* contingent on *fulfilling that requirement* not to produce the prohibited product.

Such a reading of paragraph 6(b) would set the two provisions at cross purposes and undermine the authority in paragraph 6(e). Thus, the context found in paragraph 6(e) demonstrates that the phrase “related to, or based on, the type or volume of production” in paragraph 6(b) is *not* meant to capture making payments contingent on fulfilling requirements not to produce. Rather, this phrase ensures that the “amount of such payments” is not used to induce a recipient to produce a particular type or volume of production by offering incentives for production.

³²In fact, all of the agricultural economics literature the United States surveyed estimated acreage impacts from such decoupled payments of no more than one percent and typically far less – by any standard, a minimal effect. *See, e.g.*, U.S. Rebuttal Submission, para. 59-64 (August 22, 2003).

³³Panel Report, para. 7.368 (“Paragraph 6(e) does not concern a negative requirement. It only prohibits a positive requirement, i.e.[,] a requirement of production.”).

39. **Conclusion:** Thus, the U.S. reading of paragraph 6(b) as *not* preventing the conditioning of payment on fulfilling a requirement not to produce certain crops makes sense of the text and context of the provision and furthers the fundamental requirement of Annex 2. Paragraph 6(b) ensures that the amount of payments is not used to induce a recipient to produce a particular type or volume of production. Thus, U.S. decoupled income support measures, under which payments are based on or relate to *historical* production during a base period and conditioned on *not producing* certain crops on acreage equivalent to a farm’s base acreage, do satisfy the requirements set out in paragraph 6(b) of Annex 2.

2. The Panel’s interpretation of the context of paragraph 6(b) is deficient

40. The Panel seriously erred in its examination of the context of paragraph 6(b). The United States explains why the Panel’s reading of the context provided by paragraph 6(e) and paragraphs 11(b) and 11(e) is deficient and does not support its interpretation of paragraph 6(b).³⁴

41. **Paragraphs 6(b) and 6(e) impose very different requirements:** For example, the Panel examined paragraph 6(e) and reasoned that, “[i]f paragraph 6(b) could be satisfied by ensuring that no production was required to receive payments, paragraph 6(e) would be redundant. The drafters would have had no reason to include it in the list of criteria. This confirms that paragraph 6(b) must be interpreted to require more than that one prohibition.”³⁵ However, the United States believes that paragraph 6(b) does require more than that one prohibition.

³⁴The Panel also looks to paragraph 6(a), (c), and (d) and notes that these “do not distinguish between positive and negative programme requirements, in the sense of requirements concerning what the payment recipient must, or must not, do.” The Panel concludes that this “confirms the ordinary meaning of [paragraph 6(b)’s] terms, which also prohibit negative requirements not to engage in certain types of production.” Panel Report, para. 7.367. However, the Panel does not examine the text of each of those provisions to determine their meaning and the context they provide. The Panel is merely asserting that the same meaning it found in the absence of a distinction between positive and negative requirements in paragraph 6(b) can also be found in these other provisions. But this is little more than an assertion; it is not an interpretation of what these provisions mean and how they relate to paragraph 6(b).

³⁵Panel Report, para. 7.368 (footnote omitted).

42. The two provisions serve different, though complementary, purposes. Paragraph 6(e) prohibits production requirements but is silent as to whether the amount of payments may relate to production. Paragraph 6(b) prohibits creating production incentives by making the amount of payments related to or based on the current type or volume of production.

- A measure that does not require production would not necessarily satisfy paragraph 6(b); if such a measure also increases the amount of payment in relation to any production undertaken, it would be consistent with paragraph 6(e) but inconsistent with paragraph 6(b).

Thus, the U.S. interpretation of paragraph 6(b) – the amount of payments may not be related to or based on the current type or volume of production but may be conditioned on *not* producing particular products – would not render paragraph 6(e) redundant.

43. ***Paragraphs 11(b) and 11(e) use different language than paragraph 6(b) because they relate to a different obligation:*** The Panel derived contextual support for its reading of paragraph 6(b) from paragraph 11(b) – which is identical to paragraph 6(b) but for a concluding phrase “other than as provided for under criterion (e) below” – and paragraph 11(e) of Annex 2. The Panel concluded that the explicit exception in paragraph 11(e) for requirements not to produce³⁶ suggests that the absence of such an express exception in paragraph 6(b) must mean that the latter provision was not intended to permit such a negative requirement not to produce.³⁷ However, in reaching this conclusion, the Panel provided *no* reading of the text or context of paragraph 11(e), instead immediately jumping to a reading of paragraph 11(b) that simply tacks on the concluding phrase of paragraph 11(e).³⁸

³⁶This provision reads: “The payments shall not mandate or in any way designate the agricultural products to be produced by the recipients except to require them not to produce a particular product.” Agreement on Agriculture, Annex 2, para. 11(e).

³⁷Panel Report, para. 7.369-7.370.

³⁸Panel Report, para. 7.370 (“Paragraph 11(b) therefore provides, in effect, that the amount of certain payments shall not be related to the type of production undertaken by the producer after the base period except that the payments may require recipients not to produce a particular product.”).

44. The Panel asserts that “[t]here is nothing in the context that would explain why it was necessary to express the exception in paragraph 11(e) if it was already implicit in paragraph 11(b).”³⁹ This is a wholly inadequate effort at interpretation as the Panel has not provided *any* reading of the text of paragraph 11(e), much less its context. Had the Panel examined paragraphs 11(e) and 11(b) closely and in their context, it would have seen that these provisions differ importantly from their counterparts in paragraph 6, explaining why the exception in paragraph 11(e) was necessary.

45. Paragraph 11 of Annex 2 is titled “Structural adjustment assistance provided through investment aids.” As the title and paragraph 1 suggest, these are payments “to assist the financial or physical restructuring of a producer’s operations”; thus, it is contemplated that the aid is provided to producers who *will* remain in operation. Paragraph 11(e) imposes an important constraint on such payments: the payments “shall not mandate or *in any way designate* the agricultural products to be produced by the recipients except to require them not to produce a particular product” (italics added). That is, although the payment is designed to assist in the restructuring of a recipient’s operations, this paragraph prohibits a Member from mandating or “in any way” designating the products to be produced.

46. A requirement *not* to produce certain products could also be understood to be precluded by the broad prohibition on “in any way designat[ing]” the products to be produced. But presumably because a requirement not to produce serves the fundamental requirement of ensuring that these measures have “no, or at most minimal, trade-distorting effects or effects on production,” paragraph 11(e) clarifies that a requirement not to produce particular products *is* permitted.

³⁹Panel Report, para. 7.370.

47. Similarly, in light of the broad prohibition on “in any way designat[ing]” the products to be produced under paragraph 11(e), the requirement in paragraph 11(b) that the amount of payments not be related to or based on the type or volume of production could be understood to *preclude* conditioning payment on not producing certain products since this could be understood as in some way *designating* the products to be produced, undermining the prohibition in paragraph 11(e). Thus, the cross-reference in paragraph 11(b) to the exception in paragraph 11(e) makes clear that conditioning payments on *not* producing does not undermine the prohibition under paragraph 11(e) on “designat[ing] in any way” the products to be produced. The Panel’s analysis hinges on the fact that “[p]aragraph 6(b) does not set forth such an exception,” but this is unremarkable: paragraph 6 contains no language similar to that in paragraph 11(e) concerning mandating or in any way designating the products to be produced. Thus, there is no need for an express exception in paragraph 6(b) for requirements related to *not* producing particular products.

48. In light of the significance it attached to paragraphs 11(b) and 11(e), it is notable that the Panel failed to ask: why would a requirement not to produce be permitted under paragraph 11(e), and why would the amount of payment be allowed to be conditioned on that requirement under paragraph 11(b), but the same requirements be precluded under paragraph 6?

- That is, how could these conditions under paragraph 11 *serve* the “fundamental requirement” of Annex 2, but the identical conditions under paragraph 6 *undermine* that requirement?

The answer is that paragraph 6, properly interpreted, does not preclude a requirement *not* to produce nor conditioning payment on fulfilling that requirement. Such requirements help ensure that green box measures fulfill the fundamental requirement of Annex 2 that they have “no, or at most minimal, trade-distorting effects or effects on production.”

49. It is also notable that paragraph 5 of Annex 2 requires that any direct payment not otherwise specified conform to the requirements of paragraphs 6(b) through (e). Paragraph 5 thus makes 6(b) through (e) the “general” criteria to cover all unspecified direct payments. Yet the Panel’s interpretation would mean that paragraph 6(b) would be narrower in scope than paragraph 11(b). If the Panel’s interpretation were correct, then the drafters would have chosen the narrower provision to be the “general” rule. That would make paragraph 11 an “exception.” Nothing in the text indicates that this was intended. The Panel’s interpretation unnecessarily creates conflict among the paragraphs of Annex 2 and should be reversed.

3. The Panel’s stated reasons for rejecting the U.S. interpretation of paragraph 6(b) do not withstand scrutiny

50. *The Panel’s reading puts paragraph 6(b) and the fundamental requirement of Annex 2 in conflict:* In this regard, the United States recalls its argument before the Panel that “the interpretation of paragraph 6(b) should permit decoupled income support that requires recipients to engage in production of no crops at all ‘because such a measure necessarily can have no trade-distorting effects or effects on production’.”⁴⁰ The Panel’s analysis was that “paragraph 6(b) permits such a condition because it only prohibits the amount of payments being related to the type or volume of production undertaken by the ‘producer’, which by definition excludes those who are required not to produce anything.”⁴¹ However, the Panel has misunderstood the argument.

51. If a decoupled income support measure makes payments on the basis of historical production of certain crops on base acres, and the measure requires recipients not to produce any crops at all, that measure will necessarily have no effects on production. However, it does not follow that the recipient is necessarily not a “producer” (as the Panel asserts) since there are

⁴⁰Panel Report, para. 7.372 (footnotes omitted).

⁴¹Panel Report, para. 7.372 (footnotes omitted).

numerous agricultural products that are not “crops”⁴² which a payment recipient may be producing. Therefore, under the Panel’s reading, paragraph 6(b) would preclude a Member from establishing a measure that meets the “fundamental requirement” of Annex 2.

52. The criteria in paragraph 6 are designed to ensure that green box measures fulfill the fundamental requirement that they have “no, or at most minimal, trade-distorting effects or effects on production.” The Panel’s interpretation leads to a conflict between paragraph 6(b) and the fundamental requirement of the first sentence of paragraph 1 and should be avoided.

53. ***The Panel’s reading would require payments even if a recipient’s production was illegal:*** The United States also argued to the Panel that the reading advanced by Brazil (and subsequently adopted by the Panel) would seemingly require a Member to make payments even if the recipient’s production was illegal, for example, the production of narcotic crops such as opium poppy, or the production of unapproved biotech varieties, or environmentally damaging production (for example, planting on converted rain forest or wetlands).⁴³ That is, on this reading, paragraph 6(b) would prohibit a Member from reducing or eliminating payments for any of these prohibited types of production.

54. The Panel’s response to this U.S. argument was simply: “This is not an issue before this Panel and it is not incumbent upon the Panel to decide it.”⁴⁴ With respect, while these specific facts were not before the Panel, the logical implications of Brazil’s and the Panel’s interpretations were. The Panel simply refused to acknowledge that its interpretation would have untenable results. If the Panel was concerned that its interpretation could have unreasonable results, that could have led to further interpretive steps under customary rules of interpretation of

⁴²See, e.g., Panel Report, paras. 7.1150-7.1151 (“Crop insurance subsidies are generally available for most crops but they are not generally available in respect of the entire agricultural sector in all areas.”)

⁴³The Panel recast the U.S. argument as: “The United States also argues that the interpretation of paragraph 6(b) should permit decoupled income support that prohibits recipients from producing illegal crops, such as opium poppy or unapproved biotech varieties, or engaging in environmentally damaging production.” Panel Report, para. 7.373 (footnote omitted).

⁴⁴Panel Report, para. 7.373.

public international law.⁴⁵ Or perhaps had the Panel conceded the implications of its interpretation it would have re-examined whether a better interpretation was available to it.

55. But the implications remain: on the Panel’s interpretation of paragraph 6(b), the amount of decoupled income support payments could not be conditioned on not producing narcotic crops, not producing unapproved biotech varieties, or not engaging in environmentally damaging production. Such drastic and far-reaching implications are not a necessary outcome of a proper interpretation of paragraph 6(b), read in its context and in light of the object and purpose of the Agreements.

4. Conclusion

56. The Panel erred in finding that certain U.S. decoupled income support measures are not exempt from actions under Article 13(a) of the Agreement on Agriculture.⁴⁶ The sole basis for the Panel’s conclusion was its finding that these decoupled income support measures “do not fully conform with paragraph 6(b) of Annex 2 of the *Agreement on Agriculture*.”⁴⁷ However, as demonstrated above, the Panel erred in its legal interpretation of paragraph 6(b) and erroneously concluded that the U.S. decoupled income support measures relate or base the amount of payment on the type of production undertaken by a producer within the meaning of that provision. Therefore, the Panel’s finding that U.S. decoupled income support measures are not exempt from actions under Article 13(a) of the Agreement on Agriculture is in error and must be reversed.⁴⁸

⁴⁵For example, Article 32 of the Vienna Convention on the Law of Treaties states that “[r]ecourse may be had to supplementary means of interpretation” to determine the meaning of a treaty when the interpretation under Article 31 “leads to a result which is manifestly absurd or unreasonable.”

⁴⁶Panel Report, para. 7.413-7.414.

⁴⁷Panel Report, para. 7.388.

⁴⁸Panel Report, para. 7.413-7.414, 8.1(b).

III. The Panel Erred in Finding that U.S. Non-Green Box Domestic Support Measures Are not Exempt from Actions under Article 13(b) of the Agreement on Agriculture

A. Introduction

57. The Panel erred in finding that U.S. non-green box measures are not exempt from actions under Article 13(b) of the Agreement on Agriculture. Specifically, the Panel found that those measures did not satisfy the proviso in Article 13(b)(ii) that reads: “provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year.”⁴⁹ The Panel concluded that the challenged U.S. measures breached the proviso in each year from marketing year 1999-2002. However, the Panel’s finding is fatally flawed by numerous errors of interpretation.

58. On its face, the proviso in Article 13(b)(ii) calls for a comparison between support in different years.⁵⁰ If the support current measures grant is not “in excess of” the support “decided during the 1992 marketing year,” the challenged U.S. measures are exempt from actions during the implementation period. The United States focuses on two principal interpretive errors by the

⁴⁹Brazil did not allege, and the Panel did not find, that any portion of Article 13(b) other than the proviso in Article 13(b)(ii) was breached; therefore, the United States does not address the remainder of Article 13(b) in this submission. The text of Article 13 relevant to Article 13(b)(ii) reads:

During the implementation period, notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and Countervailing Measures (referred to in this Article as the “Subsidies Agreement”):

... ;

(b) domestic support measures that conform fully to the provisions of Article 6 of this Agreement including direct payments that conform to the requirements of paragraph 5 thereof, as reflected in each Member’s Schedule, as well as domestic support within *de minimis* levels and in conformity with paragraph 2 of Article 6, shall be:

... ;

(ii) exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year[.]

⁵⁰Panel Report, para. 7.418 (“The task of the Panel is therefore to assess whether the United States domestic support measures grant support to a specific commodity in excess of that decided in the 1992 marketing year. This calls for a comparison. The two quantities to be compared are the extent to which ‘such measures (...) grant support to a specific commodity’ and ‘that decided during the 1992 marketing year’.”).

Panel relating to this comparison of support, namely *how to calculate the amount of support and what support to compare*.

59. ***How to calculate the amount of support – “Grant” and “Decided”:*** First, the Panel did not properly measure the support granted and decided by U.S. measures.⁵¹ The Panel’s approach allows the possibility that a Member could breach the Peace Clause despite deciding to keep the identical price-based domestic support measure in place. That is, that one measure could be deemed to grant more support in one year than was decided in 1992 simply because market prices had fallen, leading to higher expenditures. This interpretation not only does not reflect the support a Member “decided,” it also removes Peace Clause compliance from a Member’s control.

- A proper reading of the Peace Clause proviso must compare the support according to what a Member has decided and not according to factors (such as prices) beyond a Member’s control.

60. In the case of price-based marketing loan payments, under which the United States ensures that producers will receive income up to the loan rate of 52 cents per pound of harvested upland cotton should calculated market prices fall below that rate, the only AMS methodology that reflects the support “decided” by the United States is a price-gap calculation. By calculating support as the difference between the applied administered price set by a Member and a fixed external reference price,⁵² this methodology eliminates movements in prices as a component of the measurement of support and focuses solely on those elements a Member can control.

⁵¹The United States notes that in determining whether challenged measures “grant support” in excess of the level decided during the 1992 marketing year, the Panel erred in considering support *granted* during previous marketing years – that is, marketing years 1999-2001. The annually recurring subsidies at issue expired during the marketing year for which they were provided and therefore could not “grant support” in the marketing year in progress (marketing year 2002) when the Panel was established. The United States separately addresses the Panel’s finding that such expired payments were subsidies that could be having present effects. See Part IV, *infra*. Here, we note that, under a proper interpretation of the Peace Clause proviso, U.S. measures did not breach the Peace Clause in any year between marketing year 1999-2002.

⁵²Agreement on Agriculture, Annex 3, para. 10.

61. The Panel simply did not decide whether a price-gap methodology was inappropriate, preferring instead to use budgetary outlays for purposes of measuring the support price-based measures “grant” and “decided.” As the Panel noted, however, the rules for calculating an Aggregate Measurement of Support in Annex 3 of the Agreement on Agriculture – which the Panel determined to apply⁵³ – “permit[] either the use of a price gap methodology or budgetary outlays for non-exempt direct payments dependent on a price gap.”⁵⁴ Thus, the fact that the United States has used budgetary outlays in its WTO domestic support notifications does not mean there is no longer an ability to use a price gap approach. Under a proper interpretation of the terms “grant” and “decided,” only a price gap methodology is appropriate because it “filters out the effect of fluctuation in market prices”⁵⁵ and therefore reflects the support a Member has decided to provide.

62. ***What support to compare – “Support to a specific commodity”:*** Second, the Panel erroneously interprets the phrase “support to a specific commodity,” leading the Panel to deem the entire amount of payments made for acres that historically produced upland cotton during a base period (“upland cotton base acres”) as support to that commodity, even though these payments are decoupled from upland cotton production. In fact, it is uncontested that approximately 45 percent of the recipients of such payments, receiving approximately 25 percent of the payments made for upland cotton base acres, *did not plant even a single acre of upland cotton*.

- That is, the Panel deemed certain payments to recipients that *did not produce upland cotton at all* as “support to a specific commodity,” upland cotton.

⁵³See Panel Report, para. 7.550-7.554.

⁵⁴Panel Report, para. 7.561.

⁵⁵Panel Report, para. 7.554.

It should go without saying that a payment to a recipient that does not produce any upland cotton cannot be deemed to grant “support to” upland cotton.

- A proper reading of the Peace Clause proviso compares *only* the support that actually is “support to a specific commodity” and not that is support to whatever a recipient chooses to produce – be it no, one, or multiple commodities.

63. **Conclusion:** Under a correct interpretation of the Peace Clause proviso, the United States did not grant support to upland cotton in any marketing year from 1999 to 2002 in excess of that decided during the 1992 marketing year. The completion of the Uruguay Round provided Members the incentive to shift from support that is fully coupled to production to support that is non-product-specific (decoupled from production of a specific commodity) or fully decoupled (decoupled from production and prices).⁵⁶ In response, the United States eliminated traditional deficiency payments with a high target price tied to upland cotton production and replaced them with payments that are decoupled from upland cotton production.⁵⁷ The result is that U.S. support to upland cotton during marketing years 1999-2002 was well below the support decided during the 1992 marketing year.

**B. The Panel Did not Properly Compare the Support Current Measures
“Grant” to That “Decided” During the 1992 Marketing Year**

⁵⁶Under Article 6.1 and Annex 2, fully decoupled support – that is, decoupled from production and prices – is exempt from a Member’s domestic support reduction commitments. Under Article 6.4(a)(ii), non-product-specific support – that is, decoupled from production of a specific commodity – is subject to its own *de minimis* calculation; if *de minimis*, such support is excluded from a Member’s calculation of its Current Total Aggregate Measurement of Support.

⁵⁷That is, payments are made on acres that historically produced upland cotton during a base period, and no upland cotton production is required to receive payment. For example, under the 2002 Act, direct payments are fully decoupled from production and prices while counter-cyclical payments are decoupled from production but linked to prices.

1. Legal interpretation: To make an apples-to-apples comparison, “grant” and “decided” must be read in harmony, according to the factors which a Member can control

64. **Text, Context, and Object and Purpose:** The Peace Clause proviso calls for a comparison of the “support to a specific commodity” that challenged measures “grant” to “that [support to a specific commodity] decided during the 1992 marketing year.” The Panel correctly notes that the “proviso calls for a comparison which necessarily requires the two halves of the comparison to be expressed in the same units of measurement.”⁵⁸ The two halves of the comparison are governed by different verbs: for challenged measures, the verb is “grant”; for 1992 marketing year support, the verb is “decided.” Neither “grant” nor “decided” are defined terms in the Agreement on Agriculture. These terms must be read according to their ordinary meaning, in their context, in light of the object and purpose of the Agreements.

65. The ordinary meaning of “grant” is to “bestow as a favour” or “give or confer (a possession, a right, etc.) formally.”⁵⁹ The ordinary meaning of “decided,” is “[d]etermine on as a settlement, pronounce in judgement” and “[c]ome to a determination or resolution *that, to do, whether.*”⁶⁰ Read in their context, as two halves of a comparison, these terms must be read in a manner that allows the relevant “support” to be compared. The Panel notes that “[t]his occurrence of the verb ‘decided’ with the direct object ‘support’ is unique in the *WTO Agreement* . . . and is a curious usage of the verb “decide” which rarely takes a direct object such as ‘support’ without a preposition such as ‘on’.”⁶¹ That “unique” and “curious” choice must inform the interpretation of the Peace Clause proviso. Thus, the phrase “grant support,” read in light of

⁵⁸Panel Report, para. 7.435.

⁵⁹*The New Shorter Oxford English Dictionary*, vol. 1, at 1131 (fourth & fifth definitions); Panel Report, para. 7.474.

⁶⁰*The New Shorter Oxford English Dictionary*, vol. 1, at 607 (first and third definitions) (italics in original); Panel Report, para. 7.434.

⁶¹Panel Report, para. 7.434.

the verb “decided,” means the support that measures determine to “bestow” or “give or confer” formally.

66. In sum, the focus of the Peace Clause comparison is on the support a Member decides. The Panel essentially agrees with this interpretation of the relevant comparison when it reasons:

The Panel’s interpretation enables WTO Members to ensure that their domestic support measures satisfy this additional condition, since the *Members are responsible for what their measures clearly and explicitly define, and how much they grant. Were this not so, and the proviso focused on where support was spent due to reasons beyond the control of the government, such as producer decisions on what to produce within a programme, it would introduce a major element of unpredictability into Article 13, and render it extremely difficult to ensure compliance.*⁶²

Thus, the Panel and the United States (but not Brazil) agree that the Peace Clause proviso compares the support a Member determines through its measures, not “support [that] was spent due to reasons beyond the control of the government.”

67. As the Panel notes, if the measurement of support under the Peace Clause depended on factors beyond a Member’s control:

It is not clear how Members providing support would ever be able to ensure that their domestic support measures satisfied this additional condition. The additional condition would become an impenetrable barrier for other Members who wished to challenge support provided by a Member who, unlike the United States, did not maintain detailed records about payment recipients. This would undermine the security and predictability

⁶²Panel Report, para. 7.487.

of the multilateral trading system, which would be at odds with the function of the WTO dispute settlement system as set out in Article 3.2 of the *DSU*.⁶³

Thus, the U.S. interpretation of the terms “grant” and “decided” in Article 13(b) furthers the security and predictability of the multilateral trading system.

68. We do note the Panel’s interpretation does differ somewhat with respect to the verb “grant.” While citing the same dictionary definition as presented above, the Panel then argues that the Appellate Body in *Brazil – Aircraft* has “interpreted ‘grant’ to mean ‘something actually provided.’”⁶⁴ However, the Appellate Body statement quoted by the Panel related to the verb “granted” as used in footnote 55 of Article 27.4 of the Subsidies Agreement. The Appellate Body expressly stated that, “[t]o us, the word ‘granted’ *used in this context* means ‘something actually provided.’”⁶⁵

- The Panel does not explain why the meaning of the word “granted” as “used in this context” (that is, footnote 55 of the Subsidies Agreement) would necessarily shed light on the meaning of the word “granted” as used in the context of Article 13(b) of the Agreement on Agriculture.
- The Panel also does not explain why a footnote in another Agreement would provide *more* relevant context than the other half of the Peace Clause comparison – that is, the use of the term “decided” in Article 13(b) itself.

In short, the Panel provides no basis to conclude that footnote 55 of the Subsidies Agreement provides relevant context for the interpretation of “grant” in Article 13(b)(ii), which must be read in light of the context provided by the word “decided.”

⁶³Panel Report, para. 7.487.

⁶⁴Panel Report, para. 7.474-7.475.

⁶⁵Appellate Body Report, *Brazil – Aircraft*, para. 148 (italics added).

2. Application to U.S. measures: If an AMS calculation is made, the support price-based measures “grant” and “decided” must be calculated using the price-gap methodology of Annex 3

69. *Support for price-based measures using a price-gap methodology:* The issue of how to measure the support challenged measures “grant” versus “that decided” during the 1992 marketing year is crucial to an evaluation of price-based U.S. measures. In the 1992 marketing year, those measures were deficiency payments and marketing loan payments. Between marketing years 1999-2002, those measures were only marketing loan payments (deficiency payments were eliminated in the 1996 Act).

70. A proper interpretation and application of the Peace Clause must reflect the way in which the United States “decided” support in marketing years 1992 and 2002⁶⁶ – and, in the case of U.S. measures, the support to upland cotton as “decided” was a rate of support.⁶⁷ However, the United States acknowledges that the Panel considered that there were difficulties in comparing the support where the challenged measures and marketing year 1992 measures provide support in some cases via a rate and in others via outlays.⁶⁸ Therefore, the United States considers that the Panel could have recourse to the rules for calculating the Aggregate Measurement of Support set out in Annex 3 of the Agreement on Agriculture, so long as the appropriate calculation method was applied.⁶⁹

⁶⁶The measures (payments) provided with respect to marketing years 1999-2001 were no longer in existence at the time of Brazil's panel request and panel establishment. These payments are subject to a separate claim of legal error.

⁶⁷In the case of deficiency payments during the 1992 marketing year, the rate of support was 72.9 cents per pound (the target price) – that is, generally speaking, upland cotton producers received payments equal to the difference between the target price and the effective price on eligible production. In the case of marketing loan payments during the 1992 marketing year, the rate of support was 52.35 cents per pound (the loan rate). For marketing loan payments during marketing year 2002, the rate of support was 52 cents per pound of harvested upland cotton (the loan rate). During marketing years 1999-2001, the rate of support for marketing loan payments was 51.92 cents per pound.

⁶⁸See Panel Report, para. 7.559.

⁶⁹This is without prejudice to the U.S. view that the support current measures grant and the support decided during the 1992 marketing year should be calculated using the rate of support decided in the measures themselves.

71. In the case of price-based measures, Annex 3, paragraph 10, permits two different approaches: “non-exempt direct payments which are dependent on a price gap shall be calculated *either* using the gap between the fixed reference price and the applied administered price multiplied by the quantity of production eligible to receive the administered price, *or* using budgetary outlays” [italics added]. Since Annex 3 allows either to be used, the U.S. use of budgetary outlays in its WTO notification cannot amend the Agreement so that U.S. support can no longer be measured using a price gap methodology. In the context of Peace Clause, if an Aggregate Measurement of Support calculation is made, the price gap methodology is the only appropriate approach to use for price-based measures, for the reasons below. If the United States has not breached the Peace Clause under a price gap methodology, then the U.S. measures are exempt from actions under Article 13(b).

72. The only AMS methodology that reflects the support “decided” by U.S. price-based measures, such as deficiency payments (1992) and marketing loan payments (1992, 1999-2002), is a “price-gap” calculation set out in paragraphs 10 and 11 of Annex 3.⁷⁰ This methodology for calculating support for “non-exempt direct payments which are dependent on a price gap” eliminates movements in market prices as a component of the measurement of support and focuses solely on those elements a Member can control.⁷¹

⁷⁰Annex 3, paragraphs 10 and 11, provide, in full:

10. Non-exempt direct payments: non-exempt direct payments which are dependent on a price gap shall be calculated either using the gap between the fixed reference price and the applied administered price multiplied by the quantity of production eligible to receive the administered price, or using budgetary outlays.

11. The fixed reference price shall be based on the years 1986 to 1988 and shall generally be the actual price used for determining payment rates.

⁷¹See, e.g., Panel Report, paras. 7.554, 7.562.

73. By using an external reference price, the price gap methodology eliminates the effect of prevailing market prices on the calculation of support. Instead, paragraphs 10 and 11 designate that the support be calculated by multiplying the quantity of eligible production by the gap between the applied administered price (for example, the marketing loan rate) and the *fixed reference price* (that is, the actual price for determining payment rates for the years 1986 to 1988).⁷² Thus, by holding the reference price “fixed,” support measured using a price gap calculation shows the effect of changes in the level of support (applied administered price) decided by a Member, rather than changes in outlays that may result from movements in market prices that a Member does *not* control.

74. ***The Panel ignored its own rationale and erred in failing solely to use a price-gap methodology:*** The Panel determined that “it is unnecessary for the purposes of this dispute for the Panel to decide whether the price gap methodology is inappropriate” for purposes of calculating the support decided under deficiency payments and marketing loan payments during the 1992 marketing year and the support the challenged marketing loan payments grant.⁷³ Instead, the Panel simply used budgetary outlays for all payments.⁷⁴ However, the Panel’s approach allows the possibility that a Member could breach the Peace Clause despite deciding to keep the identical price-based domestic support measure in place.

⁷²The methodology for calculating marketing loan payments using the “price gap” method uses the formula: Marketing loan payments = Price gap * Eligible production. The price gap equals the Applied administered Price - Fixed reference price (1986-88 average). The applied administered price is the loan rate. The fixed reference price is the average of the Adjusted World Price (AWP) (USDA) for 1986-88. Eligible production is total production of upland cotton.

Since the average AWP for 1986-1988 is 53.65 cents per pound and thereby higher than the loan rate for each of the years relevant in the proceedings (51.92 cents per pound for 1999-2001; 52.00 cents per pound for 2002), the price gap is always negative. To be conservative, rather than apply a negative number to the AMS calculation as might be implied by the price gap methodology, we have simply entered a “0” for marketing loan payments (marketing loan gains, certificate exchange gains, and loan deficiency payments) in each crop year AMS calculation in paragraphs 129 through 133 of the U.S. answer to Question 67.

⁷³Panel Report, para. 7.567.

⁷⁴See Panel Report, para. 7.562.

- That is, that one measure could be deemed to grant more support in one year than was decided in 1992 simply because market prices had fallen, leading to higher expenditures.

This interpretation not only does not reflect the support a Member “decided,” it also removes Peace Clause compliance from a Member’s control.

75. In fact, earlier in its report, the Panel correctly reasoned that the Peace Clause proviso focuses not “on where support was spent due to reasons beyond the control of the government, such as producer decisions on what to produce within a programme,” but rather on “what [a Member’s] measures clearly and explicitly define, and how much they grant.”⁷⁵ The Panel went on:

This consideration is manifest in the domestic support disciplines of the *Agreement on Agriculture*. Domestic support is often provided in a way dependent on market prices, either in the form of market price support or direct payments dependent on a price gap. *Market prices of agricultural products are generally beyond the control of a government.* The *Agreement on Agriculture* provides a methodology to measure domestic support which filters out the fluctuations in market prices, by using the gap between a fixed external reference price and the applied administered price multiplied by the quantity of production eligible to receive the applied administered price (“price gap methodology”). It does not filter out changes in the volume of eligible production. *This confirms that a prime consideration of the drafters was to ensure that Members had some means of ensuring compliance with their commitments despite factors beyond their control.*⁷⁶

That is, the Panel expressly set out a rationale that demonstrates that *only* a price-gap methodology will determine the support a price-based measure grants according to what a

⁷⁵Panel Report, para. 7.487.

⁷⁶Panel Report, para. 7.488 (italics added).

Member decides (the applied administered price and volume of eligible production).⁷⁷ Thus, because the Peace Clause proviso is meant to compare the support decided by a Member through its measures, for price-based measures only a price-gap methodology as set out in Annex 3 for calculating AMS may be used for purposes of the Peace Clause comparison.

76. **Results of price gap calculation for price-based measures:** Although the Panel did not conclude that a price gap methodology must be used for purposes of calculating the support under price-based measures, the Panel did make findings with respect to the results of those calculations. The results of those calculations were:

- The Panel found that the support decided during the 1992 marketing year using a price gap calculation for deficiency payments was \$867 million.⁷⁸
- For marketing loan payments, the Panel found the support under a price gap calculation was negative in all years because the applied administered price (loan rate) in 1992 and 1999-2002 was lower than the fixed reference price.⁷⁹ The United States proposed entering a zero for marketing loan payments in each year, but the Panel calculated the support for marketing loan payments using the price gap methodology as “MY 1992: \$-84 million; MY 1999: \$-133 million; MY 2000: \$-136 million; MY 2001: \$-162 million and MY 2002: \$-130 million.”⁸⁰

⁷⁷Indeed, the Panel elsewhere noted that: “Marketing loan programme payments form part of the measurement of support in the benchmark and every year under review. There is no practical impediment to using either price gap methodology or budgetary outlays to measure them. The difference is that the use of a price gap filters out the effect of changes in market prices up to the loan rate on the calculation of this one component of support.” Panel Report, para. 7.562.

⁷⁸Panel Report, para. 7.564.

⁷⁹Panel Report, para. 7.565. The Panel noted the U.S. explanation that “ the average adjusted world price [fixed reference price] for 1986-1988 was 53.65 cents per pound and thereby higher than the loan rate for each of the years in the reference period.” The marketing loan rate was 52.35 cents per pound in marketing year 1992, 51.92 cents per pound in marketing years 1999-2001, and 52 cents per pound in marketing year 2002.

⁸⁰Panel Report, para. 7.565 n. 727.

The Panel erred in not using these values for purposes of comparing the support to upland cotton that challenged measures grant to the support to upland cotton decided during the 1992 marketing year. Because the Panel’s comparison of support under the proviso to Article 13(b) was legally erroneous, the finding that U.S. measures grant support in excess of that decided during the 1992 marketing year fails and must be reversed.

77. ***Brazil’s objection to the price-gap calculation has no foundation in the Peace Clause text:*** Before the Panel, Brazil insisted that all support must be measured using budgetary outlays.⁸¹ There is nothing in the text of the Peace Clause proviso that suggests that “support” must be measured using budgetary outlays. However, Annex 3 (on calculating the AMS) makes clear that “support” need not be measured using budgetary outlays. In fact, for one type of measure, “market price support,” Annex 3 *requires* the use of a price-gap calculation and states that “[b]udgetary payments made to maintain this gap, such as buying-in or storage costs, shall *not* be included in the AMS.”⁸² Further, “budgetary outlays” are a defined term in Article 1(c) of the Agreement on Agriculture; thus, the use of “support” in the Peace Clause proviso rather than “budgetary outlays” suggests that the use of the latter is not mandated.

78. Brazil also objected to the use of price gap methodology for marketing loan payments on the grounds that the United States has notified marketing loan payments in its domestic support notifications using budgetary outlays.⁸³ However, conformity with U.S. domestic support reduction commitments is not at issue so the way in which the United States has notified support for purposes of its reduction commitments is irrelevant.⁸⁴ Rather, what is relevant is the support the United States decided to grant via the measures at issue.

⁸¹Panel Report, para. 7.555.

⁸²Agreement on Agriculture, Annex 3, para. 8 (italics added).

⁸³Panel Report, para. 7.566.

⁸⁴Annex 3 provides a Member with the discretion to calculate support for non-exempt direct payments dependent on a price gap on the basis of a price gap calculation or using budgetary outlays. Agreement on Agriculture, Annex 3, para. 10.

79. Brazil sought to have budgetary outlays be the sole method of measuring support precisely so that it could claim the United States had determined to increase support simply because market prices had fallen. We recall the Panel’s statement, however, that “[w]ere . . . the [Peace Clause] proviso focused on where support was spent due to reasons beyond the control of the government, . . . it would introduce a major element of unpredictability into Article 13, and render it extremely difficult to ensure compliance.”⁸⁵ Commenting specifically on the issue of market prices in the context of price-based measures, the Panel further noted:

Market prices of agricultural products are generally beyond the control of a government. The *Agreement on Agriculture* provides a methodology to measure domestic support which filters out the fluctuations in market prices. . . . This confirms that a prime consideration of the drafters was to ensure that Members had some means of ensuring compliance with their commitments despite factors beyond their control.⁸⁶

The United States agrees entirely with this statement. The use of budgetary outlays to measure the support under price-based measures reflects changes in market prices that are beyond a government’s control. Only a price gap methodology reflects only those elements decided by a Member. Thus, the use of budgetary outlays to calculate support for price-based measures is not appropriate under the Peace Clause proviso, and the Panel erred in using budgetary outlays for deficiency payments and marketing loan payments.⁸⁷

⁸⁵Panel Report, para. 7.487.

⁸⁶Panel Report, para. 7.488.

⁸⁷Panel Report, para. 7.596.

C. The Panel erred in finding that decoupled payments provide “support to a specific commodity” even though payment recipients need not – and some do not – produce upland cotton at all

1. Introduction

80. Having seen that the Panel erred in interpreting how to calculate the amount of support, the next issue is the issue of what support to compare – that is, the meaning of the phrase “support to a specific commodity.” The United States interprets this phrase according to the ordinary meaning of *all* its terms as “assistance” or “backing” “for” a “precise, exact, definite” “agricultural crop.” Read in its context, this phrase also can be read to mean “support . . . for a basic agricultural product in favour of the producers of the basic agricultural product,” the definition of product-specific support given in Article 1(a).

81. We note that the Agreement on Agriculture fundamentally distinguishes between product-specific and non-product specific support and uses different terms to express that concept. In fact, “product-specific support” – although commonly referred to by the parties and the Panel – is not a defined term in the Agreement, so when this concept is used in Annex 3, paragraph 1, and Article 6, one must go back to other definitions in Article 1 to understand what the concept means. If this is true for Annex 3 and Article 6, why should it not also be so for Article 13(b)? There is no reason not to do the same and examine the definitions in Article 1 for relevant context to understand Article 13(b). It is hard to credit that “support to a specific commodity” in Article 13(b) means something other than product-specific support as explained in Article 1(a).

82. Particularly perplexing was the Panel’s decision to ignore Article 1 as providing any relevant context and instead to find that in Article 13(b) the fundamental distinction between product-specific and non-product-specific support is no longer relevant.⁸⁸ In determining that

⁸⁸See, e.g., Panel Report, para. 7.503.

some new, undefined concept was intended by Members, the Panel essentially had to invent a new meaning not set out in the Agreement – one shared neither by Brazil⁸⁹ nor the United States.

83. Furthermore, even under the Panel’s new concept, U.S. programs that are decoupled from production would *not* be support to a specific commodity because they do not “clearly or explicitly define a commodity as one to which they bestow or confer support.”⁹⁰ The Panel erred by finding that such measures that are decoupled from production of upland cotton nonetheless currently “grant” support to a specific commodity. The nature of the Panel’s error can be seen in the fact that it found that payments to recipients that *did not produce upland cotton at all* were “support to a specific commodity,” upland cotton.

2. Legal Interpretation: The Panel Fails to Interpret the Text According to Its Ordinary Meaning, in Its Context, in Light of the Object and Purpose of the Agreements

84. The United States begins by interpreting the phrase “support to a specific commodity,” which is not a defined term in the Agreement. Thus, the phrase should be interpreted using the customary rules of interpretation of public international law.

85. **Ordinary meaning:** The ordinary meaning of the terms in this phrase are as follows:

- “Support” means “assistance, backing” and “[t]he bearing or defraying of a charge or expense.”⁹¹

⁸⁹See Panel Report, para. 7.580 (the Panel’s methodology “was the original approach submitted by Brazil”). Compare Panel Report, para. 7.573 (Brazil’s initial approach), *with id.*, para. 7.574, 7.577 (revised Brazilian methodologies).

⁹⁰Panel Report, para. 7.579.

⁹¹*The New Shorter Oxford English Dictionary*, vol. 2, at 3152-53 (definition I.1a & 1e).

- “To” is used to indicate the indirect object of the verb “grant”.⁹²
- “Specific” means “[s]pecially or peculiarly pertaining to a particular thing or person, or a class of these; peculiar (*to*). Also as 2nd elem. of comb”⁹³ and “Clearly or explicitly defined; precise, exact, definite.”⁹⁴
- “Commodity” means a “thing or use of value; *spec.* a thing that is an object of trade, *esp.* a raw material or agricultural crop.”⁹⁵

Thus, the ordinary meaning of “support to a specific commodity” would be:

- “assistance” or “backing” “specially . . . pertaining to a particular” “agricultural crop” or “assistance” or “backing” for a “precise, exact, definite” “agricultural crop.”

The ordinary meaning of the phrase also indicates that “support to a specific commodity” is *not* assistance or backing that is *not* for a “precise, exact, definite” “agricultural crop.”

86. We note that the Panel only provides the ordinary meaning of the terms “specific”⁹⁶ and “commodity.”⁹⁷ It does not provide the ordinary meaning of “support” (but does provide a contextual reading).⁹⁸ Thus, the Panel never indicates that the ordinary meaning of the phrase “support to a specific commodity” would convey the meaning of “assistance” or “backing” for a precise, exact, definite agricultural crop.

⁹²*The New Shorter Oxford English Dictionary*, vol. 2, at 3323 (definition 3.a: “(Indicating aim, purpose, intention, or design) for”; definition 8.b: “Used in the syntactical construction of many tr. vbs, introducing the indirect or dative object. (See also preceding senses, and the vbs themselves.)”).

⁹³*The New Shorter Oxford English Dictionary*, vol. 2, at 2972 (second definition).

⁹⁴*The New Shorter Oxford English Dictionary*, vol. 2, at 2972 (fifth definition).

⁹⁵*The New Shorter Oxford English Dictionary*, vol. 1, at 452 (fourth definition).

⁹⁶See Panel Report, paras. 7.481-7.482.

⁹⁷See Panel Report, para. 7.480.

⁹⁸See Panel Report, paras. 7.420-7.423.

87. **Context in Article 1 and Annex 3:** Relevant context may be found in other provisions of the Agreement on Agriculture (the most immediate context for the Peace Clause) that contain the operative terms in the phrase “support to a specific commodity” – that is, “support,” “specific,” and “commodity.”⁹⁹

88. Context for the phrase “support to a specific commodity” may be found in two provisions of Article 1, namely, Articles 1(a) and 1(h). The Panel correctly notes that, in the context of the Agreement on Agriculture, the term “commodity” is “basically synonymous with one of the ‘agricultural products’ defined in Article 2 and Annex 1.”¹⁰⁰ Thus, using the ordinary meanings of the terms in their context, the phrase “*support to a specific commodity*” may be re-written as “*support for a definite agricultural product*.” The near identity with the Article 1(h) phrase “*support for basic agricultural products*” and close similarity to the Article 1(a) phrase “*support . . . provided for an agricultural product in favour of the producers of the basic agricultural product*” provide a strong textual basis for concluding that these phrases in Article 1 provide important context for interpreting the phrase “support to a specific commodity.”

89. Articles 1(a) (“support . . . provided for an agricultural product in favour of the producers of the basic agricultural product”) and Article 1(h) (“support for basic agricultural products”) define and refer to, respectively, the category of domestic support considered “product-specific.” Neither Article 1(a) nor Article 1(h) use the term “product-specific.” However, comparing the text and structure of Article 1 and Annex 3 of the Agreement on Agriculture establishes that Articles 1(a) and 1(h) are referring to that concept.

90. Annex 3 is entitled “Calculation of Aggregate Measurement of Support.” Paragraph 1 of Annex 3 specifies that two different types of AMS shall be calculated:

⁹⁹See, e.g., Agreement on Agriculture, Articles 1(a), 1(d), 1(f), 6.4, and Annex 3 (paragraphs 1 and 7).

¹⁰⁰Panel Report, para. 7.480.

- First, “an Aggregate Measurement of Support (AMS) shall be calculated *on a product-specific basis* for each basic agricultural product.” Second, “[s]upport *which is non-product specific* shall be totalled into one non-product-specific AMS in total monetary terms.”

Thus, Annex 3 distinguishes and calls for the separate calculation of product-specific support and non-product-specific support, which together comprise the AMS.

91. Article 1(a) provides the agreed definition for “Aggregate Measurement of Support” or “AMS,” and contains the identical distinction as found in Annex 3, paragraph 1. While only “non-product-specific support” is identified by name in Article 1(a), the structure of its definition of AMS – which parallels the structure of Annex 3, paragraph 1, setting out the calculation of AMS – demonstrates that product-specific and non-product-specific support together comprise the AMS:

- “‘Aggregate Measurement of Support’ and ‘AMS’ mean the annual level of *support*, expressed in monetary terms, [1] *provided for an agricultural product* in favour of the producers of the basic agricultural product ***or*** [2] non-product-specific support provided in favour of agricultural producers in general . . . [bold and italics added].”¹⁰¹

That is, just as the calculation of AMS (which uses the term “product-specific”) distinguishes product-specific from non-product-specific support, logically, so too does the definition of AMS (which does not use that term).¹⁰²

92. Article 1(h) provides the agreed definition for the “Total Aggregate Measurement of Support” or “Total AMS.” This is the sum of “[1] all aggregate measurements of *support for*

¹⁰¹Agreement on Agriculture, Article 1(a).

¹⁰²See also Agreement on Agriculture, Article 6.4(a) (for purposes of *de minimis* support, distinguishing “product-specific domestic support” from “non-product-specific domestic support”).

basic agricultural products, [2] all non-product-specific aggregate measurements of support and [3] all equivalent measurements of support for agricultural products” [italics added]. The first two categories are those set out in Annex 3, paragraph 1, which were product-specific support and non-product-specific support.¹⁰³ Thus, again without using the phrase “product-specific support,” the structure of this “Total AMS” definition establishes that “support for basic agricultural products” (the first category) *is* product-specific support.

93. Accordingly, the context of the phrase “support to a specific commodity” establishes several points:

- First, the close textual similarities suggest that the phrase “support to a specific commodity” in Article 13(b)(ii) can be read as both “*support for basic agricultural products*” (Article 1(h)) and “*support . . . provided for an agricultural product in favour of the producers of the basic agricultural product*” (Article 1(a)).
- Second, as these Article 1 phrases are referring to the concept of product-specific support, without using that term, the phrase “support to a specific commodity” in Article 13(b)(ii) can also be read as meaning product-specific support.
- Finally, as Articles 1(a) and 1(h) expressly distinguish product-specific from non-product-specific support, “support to a specific commodity” is *not* non-product-specific support – that is, support not for a “precise, exact, definite” “agricultural crop.”

94. The Panel apparently agreed that the Article 1(a) phrase “support . . . provided for an agricultural product in favour of the producers of the basic agricultural product” referred to product-specific domestic support, but the Panel believed that the “choice of a different phrase in

¹⁰³The third category, the equivalent measurement of support, is subject to separate calculation under Annex 4.

Article 13(b)(ii) and (iii) indicates that [Article 1(a) is] not pertinent to the additional condition in the proviso.”¹⁰⁴ In light of the close textual similarities between Article 13(b)(ii) and Articles 1(a) and 1(h), we do not believe an interpreter could simply conclude that these phrases are “not pertinent.”

95. As we have seen, moreover, the Agreement elsewhere defines (Article 1(a)) and refers to (Article 1(h)) the concept of product-specific support without using that exact phrase. Indeed, as the Panel recognizes, the Agreement on Agriculture *nowhere* uses the exact phrase “product-specific support.”¹⁰⁵ Despite the absence in the text of that exact phrase, the Panel has no difficulty recognizing that such a concept exists in the Agreement on Agriculture.¹⁰⁶ Thus, that the exact phrase “product-specific support” was not used in the Peace Clause is no bar to finding that the correct interpretation of “support to a specific commodity,” read in its context, is “support . . . provided for an agricultural product in favour of the producers of the basic agricultural product,” which defines the concept of product-specific support without ever using that term.

96. The Panel argues that the concept of product-specific support in Article 1(a) and Article 6.4(a)(i) is “not pertinent to the additional condition of the proviso” because “the class of measures which is covered by paragraph (b) is broader than either of them.”¹⁰⁷ The Panel also argues that the proviso in Article 13(b) must cover more than product-specific support because

¹⁰⁴Panel Report, para. 7.491 (“The Panel notes that its interpretation of “support to a specific commodity” bears some similarity to product-specific domestic support. However, the phrase “support to a specific commodity” is unique to Article 13(b). The phrase “product-specific domestic support” (not “product-specific support”) appears in the *de minimis* provision in Article 6.4(a)(i) and the phrase “support . . . provided for an agricultural product in favour of the producers of the basic agricultural product” appears in the definition of AMS in Article 1(a). Both those concepts are relevant to Article 13(b) but the class of measures which is covered by paragraph (b) is broader than either of them. The choice of a different phrase in Article 13(b)(ii) and (iii) indicates that the other two are not pertinent to the additional condition in the proviso.”) (footnote omitted).

¹⁰⁵Panel Report, fn. 631 (“That term [“product-specific support”] does not, in fact, appear anywhere in the *Agreement on Agriculture*, although the term “product-specific domestic support” is used in Article 6.4(a)(i), and the term “product-specific” is used in paragraph 2(b) of Annex 2, paragraph 1 of Annex 3 and paragraphs 2 and 3 of Annex 4.”).

¹⁰⁶*See, e.g.*, Panel Report, paras. 7.504, 7.505, 7.506, 7.579 (referring to “product-specific support”).

¹⁰⁷Panel Report, para. 7.491.

the proviso begins with the phrase “such measures,” which refers back to all of the Article 6 (non-green box) measures identified in the chapeau of Article 13(b).¹⁰⁸ However, the fact that all Article 6 measures are identified in the chapeau to Article 13(b) does not mean that all such measures “grant support to a specific commodity.” In fact, the Panel itself recognizes that certain Article 6 measures could be excluded from the comparison under the proviso in Article 13(b): that is, the Panel’s approach “exclud[es] all other support, which either grants support to other specific commodities or does not grant support to any specific commodity.”¹⁰⁹ The Panel also notes that “Brazil acknowledges this implicitly in that it does not challenge very widely available support, such as infrastructure or irrigation subsidies, some of which, presumably, deliver support to upland cotton either directly or indirectly.”¹¹⁰ Thus, the mere fact that all Article 6 measures are identified in the chapeau to Article 13(b) does not resolve the issue of whether a particular measure grants “support to specific commodity.” Only an analysis of the measure under the proper interpretation of that phrase can answer whether the measure is relevant to the comparison in the Peace Clause proviso.

97. **Context in Articles 3 and 6:** Interpreting the text in its context, the phrase “support to a specific commodity” is “assistance” or “backing” for a “precise, exact, definite” “agricultural crop” or “support . . . provided for an agricultural product in favour of the producers of the basic agricultural product” (that is, product-specific support). Articles 3 and 6 of the Agreement on Agriculture also provide context in which to understand this phrase.

98. Under the Agreement, a Member must comply with its domestic support reduction commitments as set out in its Schedule.¹¹¹ However, these commitments are set out as an aggregate amount of domestic support in favor of agricultural producers.¹¹² That is, there are no product-specific caps on domestic support. Since the domestic support reduction commitments

¹⁰⁸Panel Report, paras. 7.472, 7.502.

¹⁰⁹Panel Report, para. 7.502.

¹¹⁰Panel Report, para. 7.502 (footnote omitted).

¹¹¹Agreement on Agriculture, Article 3.2.

¹¹²Agreement on Agriculture, Article 6.3, Article 1(h).

are set out on an aggregate basis, a Member could conform to its overall reduction commitments while increasing support to a specific agricultural commodity. The Peace Clause – in particular the proviso in Article 13(b) – ensures that, if a Member otherwise in conformity with its reduction commitments shifts support between commodities such that support to any one commodity exceeds the level decided during the 1992 marketing year, that support would not be exempt from subsidies actions.

99. The Panel wonders “why the drafters would have distinguished between product-specific and non-product-specific domestic support when they determined the additional condition under which measures which could be exempt from certain types of actions.”¹¹³ Several reasons suggest themselves. The Agreement itself draws a distinction between these two types of domestic support, establishes that they are to be calculated separately, and imposes separate *de minimis* calculations for them.¹¹⁴ Product-specific support, precisely because it is support directed for a specific commodity, potentially distorts producer decisions more than support not directed for a specific commodity (non-product-specific support), for example, support that is decoupled from production.

100. It is also important to remember that the chapeau to Article 13(b) establishes that a Member’s complying with its domestic support reduction commitments is the *prerequisite* for Peace Clause protection for non-green box measures. If a Member has exceeded its AMS commitments, *none* of its domestic support measures (whether they provide product-specific or non-product-specific support) would be “exempt from actions.” However, if a Member *is* in compliance with its reduction commitments, it has disciplined itself to meet the sole obligation with respect to domestic support in the Agreement on Agriculture. In that light, it was understandable that Members would agree that *only* such measures that are in compliance with reduction commitments but that grant support to a specific commodity in excess of agreed levels

¹¹³Panel Report, para. 7.505.

¹¹⁴See Agreement on Agriculture, Articles 1(a), 1(h), 6.4, Annex 2, para. 1.

– and therefore potentially present an enhanced risk of production and trade effects – would be exposed to Subsidies Agreement actions. *Other* measures that comply with reduction commitments but do *not* grant support to a specific commodity or have *not* breached the additional criterion, would continue to enjoy Peace Clause protection.

2. The Panel’s interpretation also leads it to erroneously include as “support to upland cotton” payments to recipients that do not produce upland cotton at all

101. The Panel’s interpretation of the phrase “support to a specific commodity” ignores the ordinary meaning of the terms and rejects all relevant context in the Agreement on Agriculture. These interpretive missteps lead the Panel to a patently erroneous application of the criterion in Article 13(b)(ii) to the challenged U.S. measures.

102. ***The Panel’s interpretation:*** With respect to the “support to a specific commodity” that measures grant, the Panel correctly reasoned that the measures themselves must define the products to which support is granted.¹¹⁵ The Panel then asserts that:

In the Panel’s view, where these [non-green box] measures identify and allocate support based on an express linkage to specific commodities, they provide support to those commodities within the meaning of subparagraph (b)(ii), read in its context and in the light of its object and purpose. Where, for example, these measures specify commodities in the eligibility criteria and payment rates, they constitute support to the commodities specified in that way.¹¹⁶

¹¹⁵We discuss this interpretation further in the preceding section on comparing the support current measures “grant” to that “decided” during the 1992 marketing year.

¹¹⁶Panel Report, para. 7.484.

However, the Panel is not referring to “eligibility criteria and payment rates” relating to current production of upland cotton. For the Panel, “eligibility criteria and payment rates” that relate to *historical* production of upland cotton during a base period would mean that “they constitute support to the commodities specified in that way.”

103. ***The Panel erred in finding that payments based on past production during a base period currently grant support:*** For example, the Panel writes: “PFC payments were made in respect of cropland covered by a contract. Eligible cropland had to satisfy *very specific eligibility criteria*, in that it had to be land that, *for at least one of the 1991 through 1995 crops*, was enrolled in the acreage reduction programme authorized for a crop of seven contract commodities or was considered planted or subject to a conservation reserve contract. Upland cotton was specified as one of those contract commodities.”¹¹⁷ The Panel concludes, for PFC payments as for other U.S. measures that are based on historical acreage: “In view of the above, the Panel finds that Brazil has made a *prima facie* case that each of these measures clearly and explicitly specifies upland cotton . . . as a commodity to which they grant support within the meaning of Article 13(b)(ii).”¹¹⁸

104. U.S. decoupled measures (direct payments, counter-cyclical payments, production flexibility contract payments, and market loss assistance payments) do *not* “specif[y] upland cotton . . . as a commodity to which they grant support.” These measures do not require upland cotton production in order to receive payment; in fact, a recipient is free to produce nothing at all.¹¹⁹

¹¹⁷Panel Report, para. 7.513 (italics added).

¹¹⁸Panel Report, para. 7.518.

¹¹⁹Panel Report, para. 7.215 (production flexibility contract payments: “Producers were permitted to plant any commodity or crop on base acres, subject to certain limitations and exceptions concerning the planting of fruits and vegetables. . . . Otherwise, PFC payments were not affected by what was planted on base acreage nor by whether anything was produced on it at all.”) (footnote omitted); *id.*, para. 7.217 (market loss assistance payments: “MLA payments were only made to recipients enrolled in the PFC programmes.”); *id.*, para. 7.222 (direct payments: “Producers are permitted to plant any commodity or crop on base acres, subject to certain limitations concerning the planting of fruits and vegetables. . . . Otherwise, DP payments are not affected by what is produced on base acreage nor by whether anything is produced on it at all.”) (footnote omitted); *id.*, para. 7.223-7.224 (counter-cyclical

105. The Panel’s error stems largely from its assertion that merely identifying *historical* criteria relating to a commodity according to which payments will be made would render such payments “support to a specific commodity.” However, such a reading ignores the ordinary meaning of the phrase, that is, “assistance” or “backing” for a “precise, exact, definite” agricultural crop.

- Payments relating to *historical production* of a crop are not “assistance” or “backing” for that crop.
- Such payments are support for owners of the asset (land) on which the decoupled payments are made and non-product-specific support for whatever (if anything) they choose to produce.

The Panel itself recognizes that such decoupled payments are not support for production of a “definite” crop when it describes these measures as “*tied to production* of those specific commodities *in a base period*.”¹²⁰ That such payments are “tied to production . . . in a base period” does not mean that such payments grant “assistance” or “backing” for a definite agricultural crop today.

106. ***The Panel erred in finding that payments to recipients with no cotton production were support to upland cotton:*** The Panel’s error is also evident in the uncontested facts on the record: approximately 47 percent of the farms receiving the challenged decoupled payments,¹²¹

payments: “The eligibility requirements and planting flexibility requirements are the same as for the DP programme.”).

¹²⁰Panel Report, para. 7.504.

¹²¹Comments of the United States of America on the February 18, 2004, Comments of Brazil, para. 26 (March 3, 2004); *id.*, n. 55 (citing Brazil Further Rebuttal Submission, para. 23, which presented data showing that 46, 45, and 45 percent of farms receiving decoupled payments for upland cotton base acres received no upland cotton marketing loan payments (Brazil’s proxy for upland cotton production) in 2000, 2001, and 2002, respectively).

representing approximately 25 percent of the payments made for upland cotton base acres,¹²² *did not plant even a single acre of upland cotton.*

- Under the Panel’s interpretation, that is, it deemed certain payments to recipients that *did not produce upland cotton at all* as “support to a specific commodity,” upland cotton.
- Under the Panel’s interpretation, moreover, even if *not a single* recipient of payments on upland cotton base acres produced upland cotton, nonetheless, the *entire amount* of such payments would be “support to” upland cotton.

The United States does not believe that there can be any question that payments cannot be deemed to grant support to a crop the recipient does not produce. Thus, payments to recipients that do not produce upland cotton cannot be “assistance” or “backing” for upland cotton. The Panel’s erroneous interpretation of “support to a specific commodity” resulted in its incorrect finding that decoupled payments for upland cotton base acres were support to upland cotton.

107. Finally, we note that Brazil has also rejected the Panel’s interpretation of “support to a specific commodity.” This is telling as it was Brazil that originally asserted that all decoupled payments made with respect to upland cotton base acres were “support to upland cotton.”¹²³ However, in response to rebuttal arguments from the United States, Brazil quickly and thoroughly reversed its position. In explaining the second of six different methodologies it put forward to measure the “support to upland cotton” that the challenged decoupled measures grant,¹²⁴ Brazil explained that (in the Panel’s words) an “adjustment was necessary because only the portion of upland cotton payments under the programmes that actually benefits acres planted to upland

¹²²Panel Report, para. 7.636 (Table A-1, last row).

¹²³Panel Report, para. 7.573 (“Brazil initially submitted that implementation period support included all payments under these four programmes as indicated in a USDA fact sheet summary of the 2002 Commodity Loan and Payment Program. The payments listed in that fact sheet represent all payments on upland cotton base acreage.”) (footnote omitted).

¹²⁴*See, e.g.*, U.S. Comments on Brazil’s March 10, 2004, Comments, paras. 2-12 (March 15, 2004) (detailing six different Brazilian methodologies under eight legal theories in the course of the dispute).

cotton can be considered support to upland cotton.”¹²⁵ That is, Brazil recognized that payments for upland cotton base acres received by recipients that do not have *any* “acres planted to upland cotton” could not in any sense “be considered support to upland cotton.”

3. Application to U.S. measures: Payments that are decoupled from production do not grant “support to a specific commodity” but rather support whatever a recipient chooses to produce – be it no, one, or multiple commodities

108. *Decoupled payments that support whatever a recipient chooses to produce (if anything) do not grant “support to a specific commodity”*: As we have seen, the phrase “support to a specific commodity,” read according to the ordinary meaning of its terms, in their context, in light of the object and purpose of the Agreements, means “assistance” or “backing” for a “precise, exact, definite” “agricultural crop” or (as explained in Article 1(a)) “support . . . provided for an agricultural product in favour of the producers of the basic agricultural product” – that is, product-specific support. Both of these definitions make clear that the “assistance” or “backing” must be for a “precise” or “definite” product.

109. Payments that are decoupled from production do not grant “support to a specific commodity.” That is, if the recipient does not need to produce upland cotton to receive payments for upland cotton base acres, but rather can choose to produce no product, one product (be it upland cotton or something else), or several products, the payment is not granting “assistance” or “backing” for a “precise” or “definite” product. Rather, the assistance or backing is provided to whichever products the recipient chooses to produce (if any).

110. We also recall that Article 1(a) distinguishes “support . . . provided for an agricultural product in favour of the producers of the basic agricultural product” from “non-product-specific

¹²⁵Panel Report, para. 7.574.

support to agricultural producers in general.” Article 1(h), Article 6.4, and paragraph 1 of Annex 3 make the same distinction. Payments that provide support to whichever products a recipient chooses to produce are “non-product-specific support to agricultural producers in general” – that is, “assistance” or “backing” *not* for a “precise, exact, definite” “agricultural crop” and *not* “specially . . . pertaining to a particular” “agricultural crop”.

111. Thus, a proper reading of the Peace Clause proviso compares *only* the support that actually is “support to a specific commodity” and not that is support to whatever a recipient chooses to produce – be it no, one, or multiple commodities. The latter support – such as decoupled payments that do not require production of any specific crop – is *not* for a “precise, exact, definite” “agricultural crop.”

112. The Panel’s own reading of the Peace Clause criterion brought it close to the proper interpretation, but the Panel resisted its own logic. The Panel argued that its interpretation that a measure must define the commodity to which it grants support “exclud[es] all other support, which either grants support to other specific commodities or does not grant support to any specific commodity. Brazil acknowledges this implicitly in that it does not challenge very widely available support, such as infrastructure and irrigation subsidies, some of which, presumably, deliver support to upland cotton either directly or indirectly.”¹²⁶

113. We agree that widely available support, such as irrigation subsidies, are not support to a specific commodity. Such support is not for a “precise, exact, definite” agricultural crop, even if it may benefit upland cotton as a result of producer choices of what to grow. However, decoupled payments that do not require upland cotton production are also not for a “precise, exact, definite” agricultural crop. Rather, they grant support to whatever (if anything) a producer decides to grow, which may or may not include cotton. Thus, payments that are decoupled from

¹²⁶Panel Report, para. 7.502.

upland cotton production do not grant support to a specific commodity and are not part of the Peace Clause comparison under the proviso of Article 13(b)(ii).

114. ***The Panel correctly rejects Brazil’s allocation methodology as not reflecting support “decided”:*** As noted earlier, Brazil in this dispute presented six different methodologies for allocating decoupled payments as “support to upland cotton.”¹²⁷ Pointedly, the Panel does not utilize *any* of these other than using the entire amount of payments on upland cotton base acres, on the incorrect theory that the measures themselves indicated that they were granting support to upland cotton. However, in the “Attachment to Section VII:D” of the report, the Panel did repeat one allocation methodology of Brazil that involved allocating payments for base acres for upland cotton and other crops to currently planted cotton acres. The Panel wrote: “Therefore, as a factual matter, the Panel finds the above allocation of support delivered under these programmes to one covered commodity appropriate, because it combines elements of the way in which the payments are calculated with the volume of upland cotton which recipients plant.”¹²⁸

115. There are a number of errors in the Panel’s statement. First, the Panel purports to find “as a factual matter” that Brazil’s allocation is “appropriate,” but that conclusion can only be made with reference to the legal standard of “support to a specific commodity.” Therefore, whether Brazil’s allocation of support is “appropriate” is not a “factual matter” but a legal characterization. In fact, it is impossible to reconcile the Panel’s assertion that Brazil’s approach was “appropriate” with its conclusion that the Panel’s approach was legally required. If (in the Panel’s view) its approach was required, how could a different approach be “appropriate”? What the Panel apparently meant was, ‘if our approach isn’t correct, then this other approach is’. But that is a patently legal conclusion, not a factual one – and using the words “factual matter” can neither change that reality nor can it insulate the Panel’s analysis from appellate review.

¹²⁷See, e.g., U.S. Comments on Brazil’s March 10, 2004, Comments, paras. 2-12 (March 15, 2004) (detailing six different Brazilian methodologies under eight legal theories in the course of the dispute).

¹²⁸Panel Report, para. 7.646.

116. Second, we recall that the United States presented an extensive critique of this Brazilian methodology, both in terms of its inconsistency with the phrase “support to a specific commodity” as well as its glaring logical inconsistencies, which the Panel largely did not address.¹²⁹ However, in setting out its interpretation of the Peace Clause proviso 158 paragraphs earlier, the Panel itself accurately explained why Brazil’s allocation cannot be “appropriate” under the Peace Clause:

The Panel’s interpretation enables WTO Members to ensure that their domestic support measures satisfy this additional condition, since the Members are responsible for what their measures clearly and explicitly define, and how much they grant. *Were this not so, and the proviso focused on where support was spent due to reasons beyond the control of the government, such as producer decisions on what to produce within a programme, it would introduce a major element of unpredictability into Article 13, and render it extremely difficult to ensure compliance. It is not clear how Members providing support would ever be able to ensure that their domestic support measures satisfied this additional condition. The additional condition would become an impenetrable barrier for other Members who wished to challenge support provided by a Member who, unlike the United States, did not maintain detailed records about payment recipients. This would undermine the security and predictability of the multilateral trading system, which would be at odds with the function of the WTO dispute settlement system as set out in Article 3.2 of the DSU.*¹³⁰

We agree entirely with the logic, and the concerns, the Panel expresses in this passage. Quite simply, an approach like Brazil’s that allocates decoupled support based on producer choices does not reflect the “support to a specific commodity” that a Member has “decided.”

¹²⁹See, e.g., U.S. Comments on Brazil’s February 18, 2004, Comments, paras. 17-24, 37-44 (March 3, 2004).

¹³⁰Panel Report, para. 7.487.

117. In the foregoing passage, the Panel expressed a view diametrically opposed to that expressed when it labeled Brazil’s allocation of support “appropriate.” That is, the Panel opined that Brazil’s allocation methodology was “appropriate, *because it combines elements of the way in which the payments are calculated with the volume of upland cotton which recipients plant.*”

- However, in the discussion of its own interpretation of the Peace Clause proviso, the Panel stated: “Were . . . the proviso focused on where support was spent due to reasons beyond the control of the government, *such as producer decisions on what to produce within a programme*, it would introduce a major element of unpredictability into Article 13, and render it extremely difficult to ensure compliance.”
- That is, the Panel’s own interpretation of the Peace Clause proviso recognizes that measuring “support to a specific commodity” based on “producer decisions,” such as “the volume of upland cotton which recipients plant,” would undermine the multilateral trading system and the interests of both Members providing support and those seeking to challenge support.

Thus, the Panel itself explains why Brazil’s allocation of support is not “appropriate,” as a factual or a legal matter.

118. Brazil’s allocation inherently involves focusing on “where support was spent due to reasons beyond the control of the government, such as producer decisions on what to produce within a programme.”

- Thus, under Brazil’s approach, in one year a measure could be entirely “support to upland cotton” because all recipients chose to produce cotton.
- In another year, the same measure could be entirely “support to soybeans” because all recipients chose to produce soybeans.

- In a third year, the same measure could be “support to upland cotton” *and* “support to soybeans” *and* support to any other products the recipients produce.

Such a measure is not “assistance” or “backing” for a “precise, exact, definite” “agricultural crop” or “support . . . provided for an agricultural product in favour of the producers of the basic agricultural product.” Rather, it is support for whatever (if anything) recipients choose to produce in a given year. The Panel correctly reasons that such support is *not* “support to a specific commodity.” Thus, Brazil’s allocation of support does not reflect “support to a specific commodity” and does not provide a basis to include payments that are decoupled from upland cotton production in the comparison under the proviso of Article 13(b)(ii).

D. The Challenged U.S. Measures Grant Less Support to Upland Cotton Than That Decided During the 1992 Marketing Year, and the United States Is Entitled to Peace Clause Protection

1. U.S. measures did not breach the Peace Clause in any marketing year between 1999 and 2002

119. The United States has demonstrated that the Panel erred in two important respects in comparing support under the Peace Clause proviso.

- First, the Panel erred in interpreting “grant” and “decided” as allowing support under price-based measures to be calculated using either a price gap calculation or budgetary outlays. Only a price gap calculation reflects the support decided by the United States rather than reflecting factors beyond U.S. control, such as market prices.
- Second, the Panel erred in finding that U.S. decoupled payments are “support to a specific commodity.” Decoupled payments that do not require production of any specific crop are support to whatever a recipient chooses to produce – be it no, one, or multiple

commodities – and therefore are *not* for a “precise, exact, definite” “agricultural crop” and *not* “support . . . provided for an agricultural product in favour of the producers of the basic agricultural product” (that is, product-specific support).

Under a proper interpretation of the Peace Clause proviso, using the methodologies set out in Annex 3 on calculating the AMS, challenged U.S. measures conform to the Peace Clause because they do not grant support to upland cotton in excess of that decided during the 1992 marketing year.

120. Simply put, if the Panel’s legal errors set out above are corrected – that is, decoupled payments are excluded from the Peace Clause analysis and price-based marketing loan payments and deficiency payments are calculated using a price-gap methodology – *U.S. measures did not breach the Peace Clause in any marketing year between 1999 and 2002*. Below we present a revised Table 2 from the Panel’s report,¹³¹ setting out the correct “Comparison of support in accordance with Article 13(b)(ii)”:

¹³¹Panel Report, para. 7.596.

REVISED Table 2: Comparison of support in accordance with Article 13(b)(ii)					
\$ million	MY1992	MY1999	MY2000	MY2001	MY2002
Marketing loan programme ¹³²	866 -84	1761 -133	636 -136	2609 -162	897.8 -130
User marketing (Step 2)	102.7	165.8	260	144.8	72.4
Deficiency payments ¹³³	1017.4 867	0	0	0	0
PFC payments**	0	616 n/a	574.9 n/a	473.5 n/a	436 n/a
MLA payments*	0	613 n/a	612 n/a	654 n/a	0
DP payments**	0	0	0	0	181 n/a
CCP payments*	0	0	0	0	1309 n/a
Crop insurance payments ¹³⁴	26.6	169.6	161.7	262.9	194.1
Cottonseed payments	0	79	184.7	0	0
TOTAL	912.3	281.4	470.4	245.7	136.5

* Payments decoupled from production and therefore not support to a specific commodity.

** Green box payments exempt under Article 13(a) (also decoupled and not support to a specific commodity).

121. That is, *in no marketing year from 1999 through 2002 did the support to upland cotton exceed that decided in marketing year 1992.*¹³⁵ Again, these lower levels of support “decided” in

¹³²Panel Report, para. 7.565 n. 727. The United States had proposed entering a zero in place of negative numbers in each year when the applied administered price was less than the fixed reference price, but the Panel calculated the actual negative values that would result from the Annex 3, paragraphs 10-11, price-gap calculation. Entering a zero in place of the negative numbers does not alter the outcome of the calculation.

¹³³Panel Report, para. 7.564.

¹³⁴The United States notes that the Panel includes in its Peace Clause calculation as “support to a specific commodity” the portion of crop insurance premium subsidies made by the United States with respect to policies covering upland cotton. See Panel Report, paras. 7.517-7.518. The United States disagrees that such premium subsidies are “support to a specific commodity” since the share paid by the United States does not vary by crop or policy but rather is widely available to more than one hundred agricultural products. However, as we are focusing on many other issues on appeal and this issue is not necessary to determine that U.S. measures have not breached the Peace Clause, we are not appealing this aspect of the Panel’s erroneous finding.

¹³⁵Because the price gap calculation reflects changes in the level of support decided by a Member, it provides an appropriate methodology (within the context of an AMS calculation) to compare the support “decided” during the 1992 marketing year with the “support to a specific commodity” that challenged measures “grant.” Not

recent years reflects the U.S. decision after the Uruguay Round to move away from the product-specific deficiency payments with high target prices and instead to supplement producer income with a mix of decoupled income supports that are green box (direct and production flexibility contract payments) or non-product-specific (counter-cyclical and market loss assistance payments).

2. Conclusion: The United States disciplined itself to conform to the Agreement on Agriculture, including the Peace Clause, and is entitled to Peace Clause protection

122. The Panel erred in finding that U.S. non-green box measures are not exempt from actions under Article 13(b) of the Agreement on Agriculture. Under a proper interpretation of the Peace Clause proviso, the challenged U.S. measures did not breach the proviso in Article 13(b)(ii) in any marketing year from 1999-2002. That is, the challenged measures do not grant support to upland cotton “in excess of” the support “decided during the 1992 marketing year.”

123. The completion of the Uruguay Round provided Members the incentive to shift from support that is fully coupled to production to support that is non-product-specific (decoupled from production of a specific commodity) or fully decoupled (decoupled from production and prices). In response, the United States eliminated traditional deficiency payments with a high target price tied to upland cotton production and replaced them with payments that are decoupled from upland cotton production. The result is that U.S. support to upland cotton during marketing years 1999-2002 was well below the support decided during the 1992 marketing year.

124. Brazil has not alleged that the United States has failed to meet its domestic support reduction commitments. Brazil and other Members benefitted, moreover, from U.S. reforms to

surprisingly, the results are identical to a comparison made using the U.S. approach of looking at the rate of support as decided by U.S. measures: the Peace Clause has not been breached because the support that challenged measures grant is not in excess of that decided during the 1992 marketing year.

its agricultural support measures designed to ensure conformity with the Peace Clause proviso – that is, from the elimination of deficiency payments and introduction of decoupled payments that reduced incentives to U.S. upland cotton producers to plant upland cotton. Nonetheless, Brazil prematurely launched this action prior to expiry of the Peace Clause when U.S. measures were still “exempt from actions.” The United States has disciplined itself through two major legislative efforts to comply with its domestic support reduction commitments and the conditions set out in the Peace Clause proviso. The United States is entitled to the protection of the Peace Clause and respectfully requests the Appellate Body to so find.

IV. The Panel Erred in Finding that Certain U.S. Measures Caused Serious Prejudice in the Sense of Significant Price Suppression in the “World Market” During Marketing Years 1999-2002 within the Meaning of Articles 5(c) and 6.3(c) of the Subsidies Agreement

A. Introduction: The Panel’s Legal Errors Invalidate, in Whole or in Part, Its Finding of Serious Prejudice on at least Nine Different Grounds

125. “Serious prejudice” is one of the three types of adverse effects for which Part III of the Subsidies Agreement provides a remedy if the effect is caused by actionable subsidies. Part III, in turn, is the multilateral counterpart to the unilateral remedy against subsidies provided for in Part V of the Subsidies Agreement. At the outset, it is worth taking a moment and comparing the two parts of the Agreement.

126. In terms of the remedy available, Part III is potentially much more powerful than Part V. Under Part V, the remedy is limited to the importing Member’s market and may take the form of either countervailing duties or an undertaking. Under Part III, however, the remedy potentially is applicable to multiple markets and may entail the withdrawal of the subsidy by the subsidizing Member or the removal of the adverse effects. If the subsidy is not withdrawn or the adverse

effects are not removed, the complaining Member may seek authorization from the DSB to take countermeasures “commensurate with the degree and nature of the adverse effect determined to exist.”¹³⁶

127. Both parts also contain a causation requirement. In the case of Part V, there are various provisions that relate to causation, but Article 15.5 of the Subsidies Agreement probably offers the best summary of the requirement when it states: “It must be demonstrated that the subsidized imports are, through the effects of subsidies, causing injury” and “injuries caused by ... other [known] factors must not be attributed to the subsidized imports [footnote omitted].” In the case of Part III, one of the “adverse effects” is injury to the domestic industry of a Member. Footnote 11 of the SCM Agreement makes it clear that “injury to the domestic industry” is used in part III in the same sense as it is used in part V, creating a direct link between parts III and V. Article 5 of the Subsidies Agreement provides that: “No Member should cause, through the use of any subsidy . . . adverse effects.” With respect to “serious prejudice” in particular, each subparagraph in Article 6.3 requires that the particular result described therein be due to “the effect of the subsidy.”

128. Although the Appellate Body has not yet addressed the causation provisions of Part V, its findings with respect to corresponding provisions of the *Agreement on Safeguards* and the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* (“AD Agreement”) have called for a fairly rigorous analysis on the part of investigating authorities. In discussing the causation standard under the *Agreement on Safeguards*, the Appellate Body has stated that an authority must determine “whether ‘the causal link’ exists between increased imports and serious injury, and whether this causal link involves a genuine and substantial relationship of cause and effect between these two elements.”¹³⁷ The Appellate Body has not hesitated to find determinations of investigating authorities to be WTO-inconsistent

¹³⁶Subsidies Agreement, Article 7.9.

¹³⁷Appellate Body Report, *US – Wheat Gluten*, para. 69.

where the authorities’ causation analysis has been wanting.¹³⁸ With respect to the AD Agreement, the causation provisions of which are virtually identical to those of the Subsidies Agreement,¹³⁹ the Appellate Body has stated that: “We recognize . . . that it may not be easy, as a practical matter, to separate and distinguish the injurious effects of different causal factors. However, although this process may not be easy, this is precisely what is envisaged by the non-attribution language.”¹⁴⁰ Given the similarity between the causation provisions of the AD Agreement and Subsidies Agreement, the Appellate Body’s findings provide guidance with respect to the causation provisions of Part V of the Subsidies Agreement.

129. The focus of the causation inquiry under Part III and Part V of the Subsidies Agreement is essentially the same – whether the provision of subsidies has resulted in some form of trade harm. (Indeed, in the case of the adverse effect of “injury” the focus is identical.) Given that, and given the more powerful remedy that is available under Part III, one would think that the causation analysis of a panel considering an adverse effects claim under Part III would be at least as rigorous as the analysis that has been required of investigating authorities in disputes involving trade remedies. Otherwise the multilateral WTO dispute settlement system, with its broader powers and reach, would be being held to a lesser standard than that for domestic investigating authorities.

130. Unfortunately, however, that was not the case with this Panel. While the Panel did devote a section of its report to the topic, there is virtually no causation *analysis* to be found in the Panel’s report. And what little analysis there is in the report is not supported by the facts.

¹³⁸Appellate Body Report, *US – Wheat Gluten*, para. 91 (Appellate Body found that investigating authority had not “adequately evaluated the complexities of [the causation] issue”); Appellate Body Report, *US – Lamb Meat*, para. 188 (Appellate Body found that investigating authority “did not adequately explain how it ensured that injury caused to the domestic industry by factors other than increased imports was not attributed to increased imports.”).

¹³⁹*Compare* Subsidies Agreement, Article 15.5, with AD Agreement, Article 3.5.

¹⁴⁰Appellate Body Report, *US – Japan Hot-Rolled*, para. 228. The Appellate Body also found that its reports involving the non-attribution language in the *Agreement on Safeguards* can provide guidance in interpreting the non-attribution language of the AD Agreement. *Id.*, para. 230.

131. For example, a critical component of the Panel's causation analysis is circular. We will discuss this in greater detail below. However, we emphasize at the outset that the Panel *assumed* causation (that the subsidies “have discernible suppressive price effects) in order to find price suppression, and then pointed to the “price suppression we have found to exist” to support a finding of causation (what “the effect of the subsidy is”). It is difficult to imagine such circularity being acceptable to a panel or the Appellate Body reviewing an investigating authority's work under Part V of the SCM Agreement.

132. On a related topic, the Panel repeatedly asserted that in assessing “the effect of the subsidy,” it was unnecessary for Brazil to establish – and the Panel to find – the amount of the subsidy. Based on this assertion, the Panel declared itself free to ignore a variety of analytical issues that might otherwise have complicated its life. The Panel's basic reasoning appeared to be that Part III calls for a less rigorous analysis than Part V.¹⁴¹

133. The United States strongly disagrees with this basic premise of the Panel. There is no basis in the text of the Subsidies Agreement or the other WTO agreements for the proposition that the causation standard in Part III is lower than the comparable standard in Part V.

134. Therefore, in reviewing the Panel's findings, the United States urges the Appellate Body to ask itself: Would the Panel's analysis pass muster if it were done in the context of a countervailing duty proceeding subject to Part V of the Subsidies Agreement? If the Appellate Body's answer to this question is in the negative, then it should reverse the finding in question.

135. The Panel erred as a matter of law in finding that “the effect of the mandatory, price contingent United States subsidies at issue - that is, marketing loan programme payments, user marketing (Step 2) payments and MLA payments and CCP payments - is significant price suppression in the same world market for upland cotton in the period MY 1999-2002 within the

¹⁴¹See Panel Report, para. 7.1166-7.1179.

meaning of Articles 6.3(c) and 5(c) of the *SCM Agreement*.”¹⁴² In reaching this erroneous conclusion, the Panel committed several legal errors, each of which independently invalidate the Panel’s finding, in whole or in part. The United States asks the Appellate Body to reverse the following legal errors by the Panel as well as its erroneous finding that the effect of certain U.S. measures was serious prejudice in the sense of significant price suppression.

1. The Panel’s finding that “the effect of” certain U.S. payments is significant price suppression fails as a matter of law because the Panel did not analyze the relevant production decision – that is, planting– and ignored all primary U.S. rebuttal arguments

136. The Panel’s finding that the challenged price-contingent subsidies caused significant price suppression is legally erroneous. The Panel’s analysis ignored the primary U.S. rebuttal arguments by not examining what the parties agreed was the relevant production decision faced by farmers – that is, the decision on what to plant. The Panel never examined the impact, if any, of U.S. payments on that decision, instead generalizing about effects on “production.” This fundamental error in analysis by the Panel invalidates the Panel’s conclusion that U.S. payments have insulated U.S. cotton farmers from market forces.

137. In fact, the uncontroverted evidence before the Panel – that the Panel did not analyze – showed that U.S. cotton plantings respond to expected prices *at the time planting decisions are taken*. The data show that U.S. cotton acreage rises and falls commensurately with cotton acreage in the rest of the world and that the U.S. share of world production has remained stable over the period examined. Thus, contrary to the facts on the record, the Panel’s fundamentally flawed economic analysis led it to conclude that U.S. payments have insulated U.S. cotton farmers from market forces, fatally undermining its finding that the effect of the challenged subsidies was significant price suppression.

¹⁴²Panel Report, para. 7.1416.

138. The Panel not only ignored the relevant economic decision and the evidence demonstrating that U.S. farmers respond to market signals just as their competitors do in the rest of the world, it also misconstrued the U.S. arguments related to the planting decision as alleging that this was an “other causal factor” “attenuating this causal link” between the payments and significant price suppression. In fact, the U.S. argument was that U.S. payments did not have more than minimal effects on production and did not cause significant price suppression; the Panel’s mischaracterization of that argument reveals its failure to conduct a proper analysis.

139. The Panel also employed circular logic in basing its conclusion on “the effect of the subsidy” in part on its previous *assumption* that the nature of the subsidies was to have “price suppressive effects.”

2. The Panel’s finding of “price suppression” of the “world market” price for cotton was legally erroneous as it assumed, before finding, the effect of the challenged subsidies, ignored U.S. arguments, failed to examine other countries’ supply response, and was not a finding with respect to the Brazilian “world market” price

140. The Panel’s finding of price suppression was legally erroneous as it concluded that challenged price-contingent subsidies had “price suppressive effects” by prejudging its subsequent analysis of “the effect of the subsidy.” The Panel provided a legally insufficient analysis of the nature of the challenged subsidies, ignoring U.S. rebuttal arguments relating to the relevant economic decision, the farmer’s decision to plant upland cotton.

141. The Panel also erred in finding that certain U.S. payments suppressed the “world market” price for cotton by failing to examine supply response in other countries – that is, to what extent other countries would simply increase production in response to any alleged decrease in U.S. cotton production resulting from the absence of U.S. payments, therefore maintaining prices at

the same equilibrium level. Thus, the Panel offered no analysis of whether cotton prices would actually be higher in the absence of the challenged U.S. payments. The Panel also failed to look at actual market conditions in any market. Finally, the Panel erred in finding price suppression because it never found that the price of Brazilian upland cotton was suppressed, as opposed to the “world market” price generally.

3. The Panel erred in concluding that it need not find the amount of the challenged subsidy in order to determine serious prejudice

142. The Panel erred in concluding that, for purposes of its serious prejudice claim, Brazil need not demonstrate, and the Panel need not find, the amount of the challenged subsidy that benefits upland cotton. Under the Panel’s logic, presumably it would make no difference in a serious prejudice dispute whether the amount of the challenged payment was \$1 or \$1 billion. It seems implausible to suggest that, for a given subsidy program, these two amounts of payment would not have different effects on prices and sales.

143. The Panel’s interpretation ignores the text and context of Article 6.3(c) of the Subsidies Agreement, including the terms “benefit” and “subsidized product” and the explicit direction in Annex V to examine the amount of the subsidy in order to identify whether its effect is serious prejudice. In fact, the Panel included in its analysis *decoupled payments that were made to recipients who did not produce upland cotton at all*, and that therefore were outside the Panel’s terms of reference and could not have benefitted upland cotton.

4. The Panel erred in concluding that it need not allocate subsidies not tied to current production of upland cotton (decoupled payments) over recipients’ total sales

144. A related legal error was the Panel’s conclusion that subsidies not tied to current production of upland cotton (decoupled payments) need not be allocated over recipients’ total

sales. The Panel’s approach ignores the economic reality that decoupled payments benefit all of the recipient’s economic activities. The Panel therefore must have attributed payments that benefit *other* subsidized products to upland cotton. Because the Panel failed to identify the amount of decoupled payments benefitting upland cotton, its serious prejudice finding with respect to counter-cyclical and market loss assistance payments is invalid.

5. The Panel erred in making serious prejudice findings with respect to past recurring subsidy payments that no longer existed

145. With respect to the subsidy payments at issue, which Brazil conceded were recurring, the Panel made two related legal errors.

146. First, the Panel erroneously concluded that the challenged payments not be allocated to the marketing year to which they relate (that is, need not be “expensed”), despite the fact that the Panel fully (and appropriately) expensed those payments to their respective marketing years for Peace Clause purposes. The Panel cannot have it both ways. Because these annually recurring payments are made year after year with respect to a particular marketing year, they are appropriately expensed to, and therefore deemed to be used up in, that marketing year. In other words, a previous marketing year’s subsidy no longer exists in a later year when new payments are made and a new crop is harvested (as opposed to non-recurring subsidies that are allocated over time and may exist in a subsequent year). *Thus, the Panel could not have found that the effect of those past subsidy payments is significant price suppression and present serious prejudice because those subsidies for marketing years 1999-2001 no longer existed at the time of Panel establishment.*

147. Second, the Panel never found that the past recurring subsidy payments at issue (that is, those from marketing years 1999-2001) had continuing effects at the time of Panel establishment, such that “the effect of” those expired payments “is” significant price suppression. That is, while Brazil alleged continuing effects from these subsidies – despite its concession that these

subsidies were recurring (and therefore would no longer exist in a subsequent marketing year) – the Panel never found such continuing effects. The Panel did *not* find that past payments were causing significant price suppression at the time of panel establishment (in fact, the Panel’s finding of significant price suppression “in the period MY 1999-2002” suggests that it found that the payments it expensed to past marketing years had effects *in those marketing years*). *Thus, in the absence of a finding that past recurring subsidy payments somehow had continuing effects, the Panel erred in making a finding of present serious prejudice related to past recurring subsidy payments.*

6. The Panel erred in failing to determine the extent to which processed cotton benefitted from subsidies provided with respect to raw cotton

148. Another error committed by the Panel was that it failed to determine – and excused Brazil from having to demonstrate – the extent to which processed cotton benefits from subsidies provided with respect to raw cotton.¹⁴³ Unless the subsidy is passed through to the processor, the processed cotton is not subsidized. Accordingly, the Panel could not find that sales of processed cotton had any adverse effects within the meaning of Articles 5(c) and 6.3(c).

7. The Panel erred in interpreting the phrase “same market” in Article 6.3(c) as including a “world market”

149. The Panel erroneously interpreted the phrase “same market” in Article 6.3(c) as including a “world market”, contrary to the text and context of the provision. However, the Panel itself implicitly recognized that there can be no “world market” for upland cotton because it found that different conditions of competition exist in different national or regional markets. Thus, the Panel’s interpretation contradicts its own reading of “world market” in Article 6.3(d) as inclusive

¹⁴³See Panel Report, paras. 7.1180-7.1181.

of all national markets. The Panel never found, moreover, that U.S. and Brazilian upland cotton compete in any “world market.”

8. The Panel failed to meet the requirements of DSU Article 12.7

150. The Panel failed to meet the requirements of DSU Article 12.7 in several respects by failing to set out the findings of fact, the applicability of the relevant provisions, and the basic rationale behind its findings and recommendations. The Panel’s failure to set these out include the findings or lack of findings concerning the following areas: the amount of the challenged subsidies, including the amount of payments not directly tied to current production of upland cotton (decoupled payments); that significant price suppression existed; the degree of price suppression it deemed “significant”; that “the effect of” the U.S. subsidies “is” significant price suppression; and the basis for its ability to make findings with respect to subsidies that no longer existed at the time of panel establishment.

B. The Panel’s finding that “the effect of” certain U.S. payments is significant price suppression fails as a matter of law because the Panel did not analyze the relevant production decision – that is, planting – and ignored all primary U.S. rebuttal arguments

1. Introduction

151. Imagine a world where agricultural crops are made in the same way as manufactured products. In this world, when prices are high, a farmer requisitions from her Parts Department sun, water, fertilizer, seeds and soil in the amounts needed to make enough cotton to fill current demand. Or, if the farmer uses just-in-time inventory practices, she requisitions these inputs from outside suppliers as needed. Whatever the source, in our imaginary world, the farmer combines the inputs in her agricultural factory, and at the end of the process, out comes the necessary amount of cotton.

152. In our imaginary world, the farmer also is able to stop producing cotton if current prices become too low. Our farmer can turn off the assembly line, and store “incomplete” cotton until prices go up to warrant a resumption of production.

153. Maybe someday, this is how crops will be grown. Distressingly, however, this appears to be how the Panel in this dispute thinks crops are grown today. And this is not some minor misperception on the part of the Panel that affected some fringe issue in the dispute. Instead, it lies at the core of the Panel’s conclusion that U.S. subsidies suppressed prices for upland cotton and thereby caused serious prejudice to the interests of Brazil. As the United States will explain below, the Panel’s key conclusion that U.S. subsidies “numb[] the response of United States producers to production adjustment decisions when prices are low,”¹⁴⁴ is valid only if one posits the type of imaginary world we have described. The Panel’s conclusion simply is not valid in the real world of today. In the real world, as both the United States and Brazil agreed, a farmer’s primary economic decision is the decision on what to plant, and the relevant prices at that point are the prices that the farmer *expects* to receive when the crop is harvested, not the currently prevailing price.

154. The Panel’s analysis ignored the primary U.S. rebuttal arguments by not examining the relevant production decision faced by farmers – that is, the decision on what to plant – and the estimated impact, if any, of U.S. payments on that decision. Thus, the Panel’s finding that “the effect of” the challenged price-contingent subsidies is significant price suppression is legally erroneous.

155. In fact, the evidence before the Panel did not support a conclusion that those payments materially impacted U.S. farmers’ planting decisions in the period under review.

¹⁴⁴Panel Report, para. 7.1308.

- Acreage and futures price data reveal that U.S. cotton planted acreage did respond to expected market prices of cotton and other competing crops. The Panel ignored this data.
- Acreage data show that U.S. farmers change cotton acreage commensurately with changes made by cotton farmers in the rest of the world. The Panel ignored this data as well.
- In fact, the Panel itself found that the U.S. share of world cotton production has been stable, again demonstrating that U.S. farmers respond to the same market signals as cotton farmers in the rest of the world do. The Panel ignored the import of its own findings on the U.S. share of world production.

Thus, the evidence did not support the conclusion that U.S. payments have insulated U.S. cotton farmers from market forces.

156. The Panel not only ignored all of this evidence, it also misconstrued the U.S. arguments related to this evidence as alleging that these were an “other causal factor” “attenuating this causal link” between the payments and significant price suppression. In fact, the United States was arguing that this evidence demonstrated that the payments *were not a cause* of suppressed prices. The Panel’s failure to confront these U.S. arguments was itself legal error.

157. Aside from the Panel’s failure to analyze the planting decision and the evidence noted above, the four main, cumulative grounds given by the Panel as supporting a causal link do not withstand scrutiny. The Panel also employed circular logic in basing its conclusion on “the effect of the subsidy” in part on its previous *assumption* that the nature of the subsidies was to have “price suppressive effects.” This circular logic invalidates its finding as to the effect of the subsidy.

2. The Panel failed to address the relevant production decision faced by farmers on what to plant and therefore could not have found causation

158. The Panel’s analysis of “the effect of” the challenged subsidies – in particular, those subsidies the Panel labeled “price-contingent” (marketing loan payments, Step 2 payments, counter-cyclical payments, and market loss assistance payments) – was legally insufficient. We note that one of the “four main, cumulative grounds” the Panel advanced for finding causation was “the nature of the United States subsidies at issue.” This analysis was not presented in the causation portion of the report; rather, the Panel referred back to its examination of the “nature” of the subsidies in the “price suppression” part of its report.¹⁴⁵ In the U.S. appeal of the Panel’s finding of price suppression, we note that the Panel has prejudged the result of its analysis of “the effect of the subsidy” when it concludes, in the context of its *price suppression* analysis, that the “structure, design, and operation” of the payments is to have “production and trade-distorting effects.”¹⁴⁶ However, because the Panel reached conclusions as to the “effects” of the subsidies in its price suppression analysis (on which its causation analysis relies), the United States will discuss the flaws in the Panel’s analysis of the nature (structure, design, and operation) of the subsidies and their alleged effects in this portion of its submission on causation.

159. The United States focuses on the Panel’s conclusion that these payments “stimulate production and exports and result in lower world market prices than would prevail in their absence.”¹⁴⁷ In so concluding, the Panel ignored the principal U.S. arguments relating to the proper analysis of the nature of these payments. If these payments “stimulate production,” as the Panel believed, they must affect the relevant production decision faced by farmers – that is, the decision to plant upland cotton. Although the United States repeatedly argued to the Panel that

¹⁴⁵See Panel Report, para. 7.1349 n. 1458.

¹⁴⁶Panel Report, para. 7.1295 (marketing loan payments); *see id.*, para. 7.1303 (discussing the “effects of these three price-contingent subsidies”).

¹⁴⁷*See, e.g.*, Panel Report, para. 7.1295.

these payments, by their nature and given the facts in the time period at issue, did not cause farmers to plant more upland cotton,¹⁴⁸ the Panel simply ignored the planting decision in its analysis.

160. The Panel’s statement that these payments “stimulate production” without examining the nature of a farmer’s decision to produce upland cotton reveals the fundamentally erroneous economic approach taken by the Panel. While the amount a farmer ultimately produces relates in part to various decisions taken at different points during the production cycle, the first and perhaps most significant decision a producer must make is whether and how much to plant of a given crop (and any other input decisions that must be made at planting time). These decisions will be made given *expected* returns for that crop and other competing crops, consistent with good agricultural practices (such as crop rotation).¹⁴⁹ Actual “production” will be impacted by a farmer’s subsequent decisions on what inputs to apply to the planted acreage (for example, fertilizer, irrigation, pesticides, etc.), but production is also heavily affected by exogenous factors such as sunshine, temperature, rainfall, insect pressure, etc. Thus, the farmer does not directly decide how much to produce but does directly decide how much acreage to plant to a given crop.

161. We note that Brazil and the United States agree on the fundamental point that planting is the relevant economic decision taken by a farmer. In fact, Brazil’s economic model was based on what the effect of removal of certain U.S. farm programs would be on farmers’ planting decisions. As Brazil’s economic expert explained:

- “One of the key aspects of the policy analysis presented here is *assessing the effect of U.S. subsidies on U.S. acreage planted to cotton. Effects on U.S. cotton acreage depend*

¹⁴⁸See, e.g., U.S. Further Rebuttal Submission, paras. 152-77 (November 18, 2003).

¹⁴⁹See Brazil’s Further Submission, Annex I, para. 17 (“Effects [of subsidies] on U.S. cotton acreage depend on how different subsidy programs (either collectively or individually) change the *projected net returns per acre for cotton relative to competing crops*. This change in projected profitability depends crucially on expectations that U.S. upland cotton farmers have about market prices and government program benefits associated with planting cotton.”) [italics added].

on how different subsidy programs (either collectively or individually) change the projected net returns per acre for cotton relative to competing crops. This change in projected profitability depends crucially on expectations that U.S. upland cotton farmers have about market prices and government program benefits associated with planting cotton. Acreage planted to cotton in a given year (normally between February and May) does not depend upon actual realizations of prices, climate or other facts, which occur later. Instead, cotton plantings depend on costs and the expectations about production incentives that growers hold at the time they make their planting decisions. Thus, for marketing year 2000, which began on 1 August 2000, the expectations of cotton farmers about production incentives are those held during the previous winter, prior to planting the crop and several months before the beginning of the 2000 marketing year.”¹⁵⁰

Later, Brazil again explains:

- “[W]hile the market price for marketing year 2001 *eventually* dropped to historic lows, *at the time of planting for that marketing year* (during February-May 200[1]), prices were much higher. *[O]ur model and analysis [are] premised on the expectations of farmers at the time of planting.*”¹⁵¹

The United States agrees with these explanations that planting is the relevant economic decision; thus, the relevant analysis of the nature of challenged subsidies would be whether they “stimulate” *planting* of upland cotton, not whether they “stimulate production.”

162. The Panel’s analysis of the “nature” of the price-contingent subsidies ignored the planting decision, contrary to the approach of both the United States and Brazil. Instead, the Panel concluded:

¹⁵⁰Brazil’s Further Submission, Annex I, para. 17 [italics added].

¹⁵¹Brazil’s Further Submission, Annex I, para. 71 (italics added; “expectations” italicized in original).

- “As we have just indicated, several of the United States subsidies are directly linked to world prices for upland cotton, *thereby numbing the response* of United States producers *to production adjustment decisions when prices are low.*”¹⁵²

This notion – that farmers can make significant “production adjustment decisions when prices are low” – is fundamentally flawed. The Panel appears to envision farming a crop as an activity similar to production on a factory line: when prices are low, the factory can reduce production accordingly by operating fewer hours, consuming fewer inputs, and/or employing fewer workers. In farming, however, production decisions are very different. As explained earlier, the primary decision is the decision on what to plant. The relevant prices at that point are the prices the farmer *expects* to receive when the crop is harvested, not the currently prevailing price.

163. To follow the Panel’s logic further, consider the farmer’s available “production adjustment decisions” mid-way through the growing season if “prices are low.” When a farmer decides to plant a crop, a whole series of costs are incurred: for example, financing related to that crop, purchase of seed and fertilizer, land preparation, and obtaining machinery and labor to plant the crop. Once these costs are incurred and the crop is planted, however, those costs are sunk because the farmer has incurred them, whether or not he continues growing the crop. The farmer’s “production adjustment decision,” then, will depend on whether the marginal cost of bringing the crop to harvest is greater than the price she expects to receive for the harvested crop.

164. The farmer is likely to harvest that planted crop, barring weather-related disasters or abandonment, because the marginal cost of harvesting the crop is very low. In fact, the United States provided evidence to the Panel estimating that the variable costs related to harvesting a pound of cotton in the United States are only 13 to 15 cents per pound. That is, even in those years when upland cotton prices were very low at harvest time, those prices remained well above

¹⁵²Panel Report, para. 7.1308 [italics added].

(two to three times higher than) the cost of harvesting the crop, meaning that the only economically rational choice for farmers was to “produce” (harvest) the crop.

Marketing Year Average Farm Price and “Costs Related to Harvesting” (cents per pound) ¹⁵³					
	MY1999	MY2000	MY2001	MY2002	MY2003
Average Farm Price	45.00	49.80	29.80	44.50	54.47 ¹⁵⁴
“Costs Related to Harvesting”	13.4	15.2	14.3	14.5	14.5

Because U.S. harvesting costs are low, during this period it was always economically rational for farmers to harvest their planted upland cotton, even in the face of low harvest season prices. This differs, of course, from a factory line in which at any point during the year, in response to prevailing market prices, the decision can be made *not* to undertake to produce an additional unit of a product.

165. The Panel’s fundamental economic error can also be vividly seen in “Chart 2” following paragraph 7.1293, which shows the per pound marketing loan payment rate¹⁵⁵ during the period marketing years 1999 to 2002. The Panel explains that the graph shows that marketing loan payments were made throughout almost the entire period in question and that “[t]he further the adjusted world price drops, the greater the extent to which United States upland cotton producers’ revenue is insulated from decline, numbing United States production decisions from world market signals.”¹⁵⁶ That is, in the Panel’s view, without marketing loan payments being made, U.S. production decisions would *not* be “numb[ed] . . . from world market signals.”

¹⁵³U.S. Further Rebuttal Submission, paras. 169-70 (November 18, 2003).

¹⁵⁴Marketing year 2003 data was simple average of monthly farm prices for marketing year 2003 through mid-October. U.S. Further Rebuttal Submission, para. 170 (November 18, 2003).

¹⁵⁵That is, for each week, the difference between the marketing loan rate and the adjusted world price calculated by the U.S. Department of Agriculture.

¹⁵⁶Panel Report, para. 7.1294.

166. However, as Brazil and the United States agree, that market prices have dropped *during* a particular growing season is irrelevant to a farmer’s planting decision.¹⁵⁷ The Panel never examined whether U.S. farmers’ planting decisions were rational given (in Brazil’s words) “*expectations of farmers at the time of planting.*”¹⁵⁸ That market prices have dropped during the growing season, moreover, does not mean that the U.S. cotton farmers’ “production decisions” post-planting should *change* unless the marginal cost of harvesting the crop is greater than the marginal revenue expected for the harvested crop (in which case the farmer would be choosing to lose *more* money by harvesting, an economically irrational decision). Brazil never provided evidence that that was the case; in fact, the uncontroverted data presented above demonstrated that farm prices were in excess of harvesting costs throughout the period marketing year 1999-2002.

167. The Panel failed to examine the nature of upland cotton production decisions, distinguishing between the decision to plant, the decision to harvest, and associated costs. Because the Panel ignored the primary economic decision, whether to plant, the Panel’s analysis provides no basis to conclude that U.S. payments “numb[ed] United States production decisions from world market signals.” Thus, the Panel erred in concluding that “the structure, design and operation of these three [price-contingent] measures constitutes evidence supporting a causal link with the significant price suppression we have found to exist.”¹⁵⁹ The Panel’s finding on “the effect of the subsidy” fails as a matter of law because it ignores the key economic decision, which was the focus of U.S. rebuttal arguments.

¹⁵⁷Brazil’s Further Submission, Annex I, para. 17 (“Acreage planted to cotton in a given year (normally between February and May) does not depend upon actual realizations of prices, climate or other facts, which occur later. Instead, cotton plantings depend on costs and the expectations about production incentives that growers hold at the time they make their planting decisions. Thus, for marketing year 2000, which began on 1 August 2000, the expectations of cotton farmers about production incentives are those held during the previous winter, prior to planting the crop and several months before the beginning of the 2000 marketing year.”).

¹⁵⁸Brazil’s Further Submission, Annex I, para. 71 (italics in original); *see also* Statement of Andrew MacDonald at the First Panel Meeting, Second Session, para. 7 (October 7, 2003) (“The supply of cotton can also be affected by the levels of government support provided to producers. These government support measures affect producers’ expectation about their net returns and, thus, *their planting decisions*. Therefore market participants also keep a close watch on cotton support programs and *their potential influence on plantings.*”).

¹⁵⁹Panel Report, para. 7.1349.

3. The Panel ignored or misconstrued U.S. rebuttal evidence and arguments that U.S. cotton farmers are not insulated from market signals

a. The Panel ignored U.S. evidence and arguments that U.S. planted acreage responded to expected prices

168. The Panel’s decision to ignore the key economic decision, whether to plant cotton, invalidates its finding of causation and serious prejudice. We also note that the Panel failed to examine U.S. evidence and arguments that U.S. planted acreage did, in fact, respond to expected market prices rather than U.S. payments.

169. The United States and Brazil agreed that the decision to plant cotton depends on farmers’ *expectations* of prices for the crop, *not* the *actual* prices that farmers receive for the crop once harvested, which farmers could not know would result at the time they take their planting decision. As Brazil explained:

- “Effects [of subsidies] on U.S. cotton acreage depend on how different subsidy programs (either collectively or individually) change the *projected* net returns per acre for cotton relative to competing crops. This change in *projected* profitability depends crucially on *expectations that U.S. upland cotton farmers have about market prices* and government program benefits associated with planting cotton.”¹⁶⁰

¹⁶⁰Brazil’s Further Submission, Annex I, para. 17 [italics added].

The United States agrees. The decision to plant cotton is made based on “expectations that U.S. upland cotton farmers have about market prices.”¹⁶¹ Farmers use expected prices to compare “projected net returns per acre for cotton relative to competing crops.” The decision to plant is based on maximizing these “projected net returns per acre,” consistent with good agricultural practices (such as crop rotation). Following from its decision to ignore planting as the relevant economic decision, the Panel simply ignored the issue of “expectations that U.S. upland cotton farmers have about market prices” for cotton and competing crops.

170. We recall that the Panel concluded that price-contingent U.S. payments “are directly linked to world prices for upland cotton, thereby numbing the response of United States producers to production adjustment decisions *when prices are low*.”¹⁶² But both the United States and Brazil agree that the *actual* prices received by farmers are irrelevant for a farmer’s decision to plant. For example, as Brazil explained with respect to the record low cotton prices in marketing year 2001:

- “[W]hile the market price for marketing year 2001 *eventually* dropped to historic lows, *at the time of planting for that marketing year* (during February-May 200[1]), prices were much higher. [O]ur model and analysis [are] premised on *the expectations of farmers at the time of planting*.”¹⁶³

Thus, the Panel erred as a matter of law in focusing its causation analysis on the reactions of farmers to *actual* prices of harvested cotton rather than the *expected* prices for cotton held by farmers at the time they made their planting decisions.

¹⁶¹See also Brazil’s Further Submission, Annex I, para. 71 (“[W]hile the market price for marketing year 2001 eventually dropped to historic lows, at the time of planting for that marketing year (during February-May 200[1]), prices were much higher. [O]ur model and analysis [are] premised on the *expectations* of farmers at the time of planting.”) (italics in original); Statement of Andrew MacDonald at First Panel Meeting, Second Session, para. 4 (“Farmers’ perceptions of whether prices will go up or down will affect their planting decisions and, thus, the future supply of cotton.”) (October 7, 2003).

¹⁶²Panel Report, para. 7.1308 [italics added].

¹⁶³Brazil’s Further Submission, Annex I, para. 71 (italics added; “expectations italicized in original).

171. The United States notes that the evidence on the record demonstrates that U.S. cotton farmers *are* responsive to expectations about market prices for cotton and competing crops. That is, the level of U.S. cotton planted acreage corresponds to the relative attractiveness of cotton compared to competing crops. The following graph reflects the evidence before the Panel.¹⁶⁴ The first line in the graph shows U.S. cotton planted acreage. The second line shows the ratio of harvest season cotton futures prices at the time of planting to harvest season soybeans futures at the time of planting.¹⁶⁵ As Brazil’s expert on cotton markets explained, futures prices reflect how market participants, including growers, believe market prices will develop in the future.¹⁶⁶ Thus, because soybeans are a main competing crop to cotton in many U.S. states, the ratio of cotton futures to soybeans futures is a simple way of estimating the relative attractiveness of planting cotton.

¹⁶⁴U.S. Answer to Question 175 from the Panel, para. 110 (October 27, 2003).

¹⁶⁵The futures prices used are the January-March average for December cotton and November soybeans futures contracts. (These are the most comparable contracts: there are no November cotton or December soybeans contracts.) Planting decisions are generally taken in the January-March period. December futures prices for cotton and November futures prices for soybeans show what the market expects prices to be when the crop is harvested and brought to market.

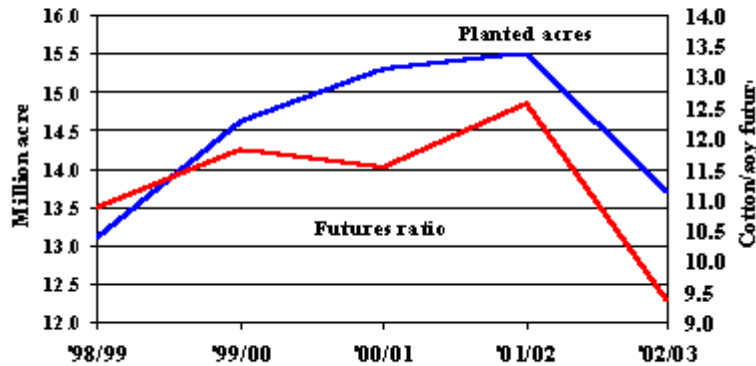
We note that Brazil would not disagree that planting decisions are generally taken in the January-March period as Brazil explained that “[a]creage planted to cotton in a given year” is “normally [planted] between February and May,” and “planting decisions” for a given marketing year are taken “the previous winter, *prior to planting the crop* and several months before the beginning of the . . . marketing year”. Brazil’s Further Submission, Annex I, para. 17 [italics added].

¹⁶⁶Mr. MacDonald, Brazil’s “expert in the operation of [] world cotton markets,” Brazil’s Opening Statement at the Second Session of the First Panel Meeting, para. 61, explained at the first Panel meeting:

“The cotton futures market functions basically like a stock market, with floor traders exercising the orders from market participants around the world. *The price levels at the New York futures market reflect the daily-changing perception of market participants worldwide on how prices of cotton will develop in the future*, as well as in the near and medium-term. The New York futures market is the principal price and trend indicator for the whole worldwide cotton market. *The “New York futures price” is a key mechanism used by cotton growers, traders and consumers in determining the current market values as well as the contract prices for forward deliveries*, in both the international as well as the domestic U.S. and non-U.S. markets.”

Exhibit Bra-281, para. 13 (statement by Andrew MacDonald) [italics added].

U.S. Cotton Planting Reflects Expected Prices



172. This graph demonstrates that:

- In years when U.S. cotton planted acreage was higher (marketing years 1999-2001), cotton was relatively more attractive to plant than soybeans.
- Conversely, in years when cotton was relatively less attractive to plant than soybeans (that is, the cotton to soybeans futures ratio was lower), like marketing years 1998 and 2002, U.S. cotton acreage fell below marketing year 1999-2001 levels.

Thus, the futures data show that when U.S. farmers planted cotton in the spring of 1999, 2000, and 2001, they expected relatively higher prices for cotton compared to competing crops. By the time of harvest in the fall of those years, they actually got low cotton prices. But, as Brazil agrees, the *actual* prices received after harvesting a crop are irrelevant to a farmer's decision to

plant.¹⁶⁷ At the time of planting, futures prices indicated that, for many farmers, planting cotton was the right business decision because it maximized “the *projected* net returns per acre.”

173. The Panel simply ignored this evidence that U.S. cotton planted acreage *did respond* to “projected net returns per acre for cotton relative to competing crops” based on “expectations that U.S. upland cotton farmers have about market prices.”¹⁶⁸ The Panel ignored this evidence contrary to the shared understanding of the United States and Brazil of how farmers make their planting decisions. Thus, the Panel’s analysis of “the effect of the subsidy” was legally deficient as it ignored evidence and arguments that went to the core of any causation analysis.

b. The Panel ignored U.S. evidence and arguments that U.S. cotton farmers change acreage just like producers in the rest of the world

174. The Panel’s analysis was that U.S. price-contingent “payments stimulate production and exports, resulting in lower world market prices than would prevail in their absence.”¹⁶⁹ Thus, the Panel must have believed that the payments result in higher U.S. production than would result in their absence. The United States presented evidence, however, that demonstrates that U.S. cotton

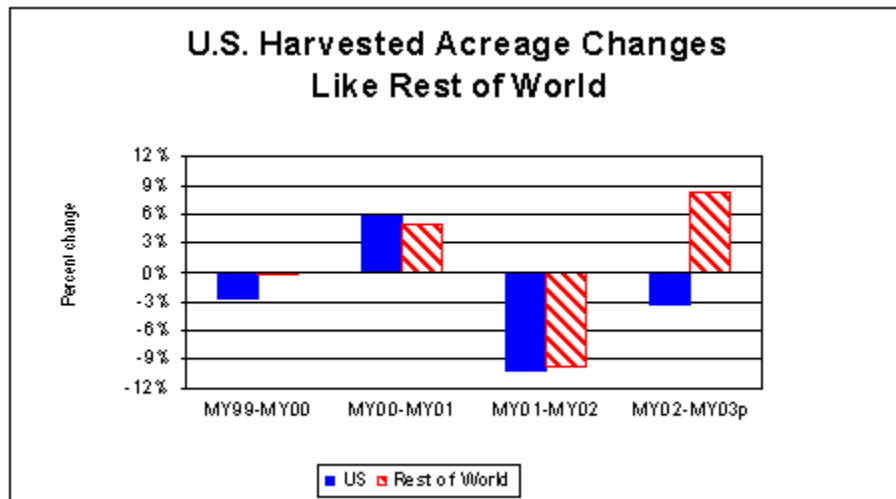
¹⁶⁷See, e.g., Brazil’s Further Submission, Annex I, para. 17 (“Acreage planted to cotton in a given year (normally between February and May) *does not depend upon actual realizations of prices, climate or other facts, which occur later. Instead, cotton plantings depend on costs and the expectations about production incentives that growers hold at the time they make their planting decisions.* Thus, for marketing year 2000, which began on 1 August 2000, the expectations of cotton farmers about production incentives are those held during the previous winter, prior to planting the crop and several months before the beginning of the 2000 marketing year.”) [italics added]; *id.*, Annex I, para. 71 (“[W]hile the market price for marketing year 2001 *eventually* dropped to historic lows, at the time of planting for that marketing year (during February-May 200[1]), prices were much higher. [O]ur model and analysis [are] premised on the expectations of farmers at the time of planting.”) (italics added; “expectations italicized in original).

¹⁶⁸In fact, the United States noted that “the correlation between [U.S. cotton] planted acreage and the ratio of cotton futures to soybean futures is 0.69 over the 1996 to 2002 period. This compares to a correlation of 0.40 for lagged prices [the approach Brazil defended] to planted acreage, and a *negative correlation* using Dr. Sumner’s [Brazil’s expert] expected net return calculation and planted acreage. Thus, in contrast to statements by Brazil that futures prices are poor predictors of planted acreage, the correlation data suggest that the futures price ratios are better predictors of planted acreage than the arbitrary net return calculations as constructed by Dr. Sumner.” U.S. Comments to Brazil’s Answers to Panel Questions Following the Second Panel Meeting, para. 27 (January 28, 2004).

¹⁶⁹Panel Report, para. 7.1295, 7.1299.

acreage rises and falls commensurately with acreage in the rest of the world. Thus, unless cotton production in the rest of the world is also stimulated by payments or other means, the evidence supports the notion that U.S. producers are *not* insulated from market signals by U.S. payments.

175. The evidence before the Panel demonstrates that U.S. producers have increased and decreased cotton acreage commensurately with producers in the rest of the world. The graph below shows the annual percent change in harvested acreage from marketing year 1999 to marketing year 2003.¹⁷⁰



Simply put, the graph demonstrates that U.S. cotton farmers have increased and decreased harvested acreage commensurately with producers in the rest of the world. In fact, the one year in which U.S. and foreign farmers changed acreage differently (marketing year 2002 to 2003), it was U.S. farmers who *decreased* their acreage while foreign producers *expanded* theirs – a fact

¹⁷⁰See U.S. Comments to Brazil’s Answers to Panel Questions Following the Second Panel Meeting, para. 49 (January 28, 2004). In this graph, the United States presents the changes from marketing years 1999 through 2003. The United States noted to the Panel “the anomalous years of 1998 and 1999 for the U.S., where harvested area was sharply below planted area in 1998 because of severe adverse weather but then planted (and harvested) area increased sharply in 1999 in reaction both to the previous year’s high abandonment and to favorable prices relative to competing crops.” *Id.*, para. 48.

not consistent with the notion that U.S. payments result in higher U.S. production than would prevail in their absence.¹⁷¹

176. The Panel simply ignored this evidence relating to annual changes in cotton acreage in the United States and the rest of world. However, if U.S. farmers were changing acreage just like farmers in the rest of the world, then this acreage data does not support the proposition that U.S. payments “numb[] United States production decisions from world market signals.”¹⁷² Therefore, the Panel’s analysis of “the effect of the subsidy” fails as a matter of law because it ignored evidence and arguments that demonstrated that U.S. farmers respond to market signals no differently than farmers in the rest of the world.

c. The Panel ignored the import of its own findings that the U.S. share of world production has been stable

177. Finally, the United States notes that the Panel ignored the import of its own finding that the U.S. share of world cotton production has been stable over the period in question, ranging between 19.2 and 20.6 percent.¹⁷³ The fact that the U.S. share did not vary significantly reinforces the point made by the data shown above on changes in harvested acreage: if the U.S. share of production has been stable, then U.S. and foreign producers must have been increasing and decreasing production commensurately over the period in question.

¹⁷¹See U.S. Comments to Brazil’s Answers to Panel Questions Following the Second Panel Meeting, para. 50 (January 28, 2004) (“In marketing year 2003, U.S. cotton area declined 3 percent while the rest of the world rose 10 percent. These divergent results again suggest that cotton area around the world is affected by different factors and these need to be accounted for carefully. But a *decline* in U.S. harvested acreage in marketing year 2003, following a decline in marketing year 2002, is certainly not consistent with Brazil’s theory that the United States increased support in the 2002 Act and that these ‘higher’ payments will result in U.S. overproduction of cotton, threatening to cause serious prejudice.”).

¹⁷²Panel Report, para. 7.1294.

¹⁷³Panel Report, para. 7.1282.

- That is, rather than “numbing the response of United States producers to production adjustment decisions when prices are low,”¹⁷⁴ the production data reveal that U.S. producers make the same production decisions as producers in the rest of the world.

Once again, the Panel’s analysis of “the effect of the subsidy” fails as a matter of law because it ignored the import of its own findings that U.S. farmers respond to market signals no differently than farmers in the rest of the world.

d. The Panel misconstrued the U.S. arguments related to this evidence as alleging that these were an “other causal factor”

178. The Panel not only ignored the foregoing evidence, it also misconstrued – and therefore failed to address – the U.S. arguments related to this evidence. After finding that the challenged price-contingent U.S. subsidies caused significant price suppression, the Panel stated: “We proceed to an examination of other causal factors in order to see whether any of these would have the effect of attenuating this causal link, or of rendering not ‘significant’ the effect of the subsidy.”¹⁷⁵ Among these “other causal factors” were the U.S. argument that “upland cotton planting decisions . . . are not limited only to benefits derived from United States subsidies, but rather are driven by other factors such as . . . [] the relative movement of upland cotton prices vis-à-vis prices of competing crops, which affect upland cotton producers’ planting decisions and []the expected prices for the upcoming crop year.”¹⁷⁶

¹⁷⁴Panel Report, para. 7.1308.

¹⁷⁵Panel Report, para. 7.1356.

¹⁷⁶Panel Report, para. 7.1362 (footnote omitted).

179. The Panel, in fact, never addressed these arguments.¹⁷⁷ However, the United States was *not* arguing that the evidence relating to farmers’ planting decisions, such as price expectations for cotton and competing crops and changes in U.S. farmers’ cotton acreage compared to the rest of the world, was an “*other causal factor*.” Rather, we argued that this evidence demonstrated that the payments *were not a cause* of suppressed prices.

- That is, this evidence relating to farmers’ planting decisions goes to the heart of the Panel’s causation analysis – in the Panel’s words, whether the “payments stimulate production and exports and result in lower world market prices than would prevail in their absence.”¹⁷⁸

In fact, the evidence demonstrated that “the effect of the subsidy” was not to “stimulate production” nor price suppression. Thus, the Panel erred in considering these U.S. arguments as an “other causal factor” rather than arguments going to the very heart of the causation analysis.

4. The four main, cumulative grounds the Panel identified supporting a finding of causation do not withstand scrutiny

180. The Panel’s failure to analyze the relevant production decision – whether and how much to plant cotton – must result in reversal of the Panel’s finding that “the effect of the subsidy is” significant price suppression. In addition, the four main, cumulative grounds the Panel identified supporting a finding of causation do not withstand scrutiny, which would also warrant reversal of the Panel’s finding.

¹⁷⁷The Panel’s consideration relating to these arguments was limited to: “Furthermore, during MY 1999-2002, we have found a strongly positive relationship between upland cotton base acres and continued production of upland cotton. Thus, *it is reasonable to conclude* that United States producers continued to grow upland cotton due to United States subsidies rather than market prices or expected market revenue.” Panel Report, para. 7.1362 (footnote omitted). It is reasonable to conclude, from this statement, that the Panel did not analyze the U.S. arguments in any substantive way.

¹⁷⁸*See, e.g.*, Panel Report, para. 7.1291.

a. Substantial proportionate influence

181. The Panel asserts that the United States exerts “a substantial proportionate influence in the world cotton market.”¹⁷⁹ To support this conclusion, the Panel points to the U.S. share of world cotton production and exports and argues that “the United States does not disagree with the proposition that a Member’s proportionate magnitude in world production and consumption of upland cotton might be a relevant consideration here.” However, the U.S. submission the Panel cites contains no support for that claim.¹⁸⁰ As the United States pointed out above, moreover, the Panel ignores its own finding that the U.S. share of production has been stable, which suggests that U.S. producers make the same production decisions as producers in the rest of the world.

182. Second, the Panel claims that the United States does not disagree “with the proposition that increased production and supply of upland cotton which reaches the world markets will have an effect on prices.” In support, the Panel cites the U.S. argument that Chinese sales of upland cotton from government stocks drove prices down during the period in question.¹⁸¹ The sale of upland cotton from government stocks in China, the size of which are not well understood by markets, would be an intervention that increases supply in the short run over what the market has set. However, whether U.S. price-contingent payments “increase[] production and supply of upland cotton” over what U.S. farmers would have produced in the absence of those payments is *the very question the Panel must analyze*.

¹⁷⁹Panel Report, para. 7.1348.

¹⁸⁰*Compare* Panel Report, para. 7.1348 fn. 1456 (citing U.S. Further Rebuttal Submission, para. 37) *with* U.S. Further Rebuttal Submission, para. 37 (“Article 6.3(c) establishes that significant price suppression or depression must be caused by the effect of the subsidy on a subsidized product “in the same market” as the “like product of another Member.” Thus, this provision requires the identification of “the same market,” the presence of both the subsidized product and the like product of another Member, and evidence of causation in that market. Brazil has not satisfied these elements of Article 6.3(c).”).

¹⁸¹Panel Report, para. 7.1348 fn. 1457.

183. The Panel’s simple assertion that U.S. cotton exports exerted a “substantial proportionate influence on prices in the world market” is followed by a recitation of relative shares of world exports. The Panel fails to recognize that, absent some analysis of how U.S. cotton competes with cotton from other sources, relative sizes are meaningless. This second claim, then, cannot support the Panel’s analysis of what “the effect of the subsidy is.”

b. Nature of the challenged U.S. price-contingent subsidies

184. The Panel also concluded that the nature of the price-contingent subsidies supported its view that the effect of these payments was significant price suppression. This second ground is also based on simple assertion – that the Panel “believes that the structure, design and operation of these three measures constitutes evidence supporting a causal link with the significant price suppression we have found to exist.”¹⁸² Again, the Panel provides no analysis of *why* this is the case or *how* the subsidy caused price suppression. It does observe that world market prices are a factor in determining payments under the relevant programs, but that fact demonstrates only that world prices may have an effect on U.S. prices, not the reverse.

185. The Panel errs because (1) it fails to analyze the relevant production decision – whether to plant cotton; (2) it employs circular logic in using its price suppression finding to support a causation finding; and (3) its analysis of each of the price-contingent payments at issue is deficient.

186. ***The Panel failed to analyze the relevant production decision:*** As explained above, the relevant economic decision is whether and how much to plant cotton or some competing crop. The Panel failed to examine this issue at all. Therefore, for the reasons given above, the Panel’s conclusion that price-contingent U.S. payments “are directly linked to world prices for upland

¹⁸²Panel Report, para. 7.1349.

cotton, thereby insulating United States producers from low prices”¹⁸³ was erroneous as a matter of law. Such a finding, therefore, could not support its finding of causation.

187. ***The Panel employed circular logic:*** The Panel also employed circular logic in reaching its conclusion on “the effect of the subsidy.” The Panel stated that “the structure, design, and operation of these three measures constitutes evidence supporting a causal link with the significant price suppression we have found to exist.”¹⁸⁴ However, the Panel’s logic is circular: the Panel earlier based its price suppression finding on its affirmative answer to the question “whether or not the nature of these subsidies is such as to have discernible price suppressive effects.”¹⁸⁵

- That is, the Panel assumed causation (that the subsidies “have discernible price suppressive effects”) to find price suppression and then points to the “price suppression we have found to exist” to support a finding of causation (what “the effect of the subsidy is”).

Thus, the Panel erred as a matter of law in basing its conclusion on “the *effect* of the subsidy” on its previous assumption that the nature of the subsidies was to have “price suppressive *effects*.”

188. ***The Panel’s analysis of each type of payment was deficient:*** The Panel’s analysis of each type of payment was also flawed because the Panel failed to characterize and analyze properly the nature of each payment.

189. ***(1) Marketing loan payments:*** The Panel acknowledges that principal price-contingent measure that could provide an incentive to produce cotton is the marketing loan program. A marketing loan is a contingent promise to provide cover a shortfall in income below 52 cents per

¹⁸³Panel Report, para. 7.1349 (footnote omitted).

¹⁸⁴Panel Report, para. 7.1349.

¹⁸⁵Panel Report, paras. 7.1280, 7.1308.

pound. Thus, whether marketing loans provide an incentive to plant depends upon expectations at planting of the level of prices at time of harvest, not the actual price that prevails at time of harvest. Actual harvest season prices may be higher or lower depending on market conditions unforeseen at the time of planting. Payments or gains to upland cotton producers result only when the calculated “adjusted world price” falls below the loan rate, and the producer has harvested upland cotton on hand.

190. Impacts of the program on planting decisions are thus greater when expected prices are low relative to the loan rate. The United States and Brazil agree on this point:

- “One of the key aspects of the policy analysis presented here is *assessing the effect of U.S. subsidies on U.S. acreage planted to cotton*. Effects on U.S. cotton acreage depend on how different subsidy programs (either collectively or individually) change the projected net returns per acre for cotton relative to competing crops. This change in projected profitability depends crucially on *expectations that U.S. upland cotton farmers have about market prices* and government program benefits associated with planting cotton.”¹⁸⁶

191. Futures prices provide producers with current market expectations for future price levels and as a result are good proxies for price expectations.¹⁸⁷ The United States sets out below the level of the December (harvest season) futures contract during the period when farmers are making planting decisions (January through March) compared with the loan rate for 1999-2002.

Harvest Futures Prices at Planting Decision Time Compared to Marketing Loan Rate (cents per pound) ¹⁸⁸					
	MY 1999	MY 2000	MY 2001	MY 2002	MY 2003
Futures Price	60.27	61.31	58.63	42.18	59.60

¹⁸⁶Brazil’s Further Submission, Annex I, para. 17 [italics added].

¹⁸⁷U.S. Opening Statement at the Second Session of the First Panel Meeting, paras. 33-35.

¹⁸⁸U.S. Further Rebuttal Submission, para. 162 (November 18, 2003).

Loan Rate	51.92	51.92	51.92	52.00	52.00
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At the time of planting decisions (January through March), the December futures contract price for upland cotton was above the loan rate in each year from 1999 through 2001. Producers expected that market prices at harvest would be above the marketing loan rate, suggesting minimal impact from the marketing loan program.

192. The Panel ignored this analysis, fundamentally mistaking the proper means of analyzing the impact of marketing loans. The Panel failed to consider what market prices farmers expected to receive when they made their planting decisions. Instead of the futures price at planting, the Panel focused its analysis instead on the level of the adjusted world price throughout the marketing year, but the level of the adjusted world price is influenced by a number of factors exogenous determined in world markets after planting decisions are made.¹⁸⁹

193. In marketing year 2002, harvest season futures prices at the time of planting had fallen below the loan rate. In this marketing year, then, there is at least the possibility that producers were planting for the loan rate and not for the harvest season expected price. However, as Dr. Glauber noted in the U.S. opening statement at the second session of the first Panel meeting, the decline in U.S. planted cotton acreage was within the range of expected values given the decline in the harvest season futures price from the previous year.¹⁹⁰ The average harvest season futures price at planting was 28 percent lower for marketing year 2002 than for marketing year 2001.¹⁹¹ Based on an own-price elasticity of 0.466,¹⁹² a 28 percent price decline would suggest a drop in acreage of 13 percent from the preceding year. In fact, actual U.S. cotton planted acreage dropped 12 percent from marketing year 2001 (15.5 million acres) to marketing year 2002 (13.7

¹⁸⁹U.S. Further Submission, paras. 16-45 (September 30, 2003).

¹⁹⁰U.S. Opening Statement at the Second Session of the First Panel Meeting, para. 35.

¹⁹¹For marketing year 2001, the average December futures price in February 2001 was 58.62 cents per pound; for marketing year 2002, the average December futures price in February 2002 was 42.18 cents per pound.

¹⁹²See U.S. Answer to Question 125(2)(d) from the Panel, para. 11 (reporting cotton own-price elasticity of 0.466 from Lin *et al.* (Exhibit US-64).

million acres).¹⁹³ Thus, the availability of the marketing loan rate could theoretically have impacted planting decisions, but we note that, had U.S. producers in fact been planting for the 52 cents per pound marketing loan rate, one would have expected to see only a 1.4 percent decline in planted acreage from marketing year 2001 to 2002.¹⁹⁴

194. Moreover, the percent change from marketing year 2001 to 2002 in U.S. harvested acreage was very similar to (but larger than) the change in harvested acreage in the rest of the world.¹⁹⁵ Thus, despite the theoretical possibility that the marketing loan rate could have had some impact on planting decisions in marketing year 2002, the actual decline in U.S. planted and harvested acreage suggests that U.S. acreage levels were entirely consistent with price expectations and market conditions.

195. Thus, even in marketing year 2002, there is no evidence on this record that the marketing loan rate serves to insulate U.S. producers' planting decisions from market price movements. To the contrary, the evidence suggests that U.S. producers do respond to changes in expected prices (for cotton and for other competing crops) and are as responsive, if not more so, than producers in other countries.

196. **(2) Step 2 payments:** The Panel erred in its analysis of the effect of the Step 2 program. As the United States has argued in its submissions to the Panel, the proper starting point for analysis of the effect of the program is the planting decision. The Panel completely ignores the

¹⁹³U.S. Department of Agriculture, National Agricultural Statistics Service, Acreage, at 18 (June 2003) (Exhibit US-86). The United States notes that the planted acreage figure of 13.7 million acres for marketing year 2002 is a revision of the preliminary estimate of 14.2 million acres reported in the January 2003 U.S. Upland Cotton Fact Sheet.

¹⁹⁴The expected harvest season price at planting in marketing year 2001 was 53.63 cents per pound (58.63 - 5 cents basis). A decline in expected revenue to 52 cents per pound (the loan rate) for marketing year 2002 would be an 3.0 percent drop $((53.63 - 52) / 53.63)$. Given an own-price elasticity of 0.466, an 3.0 percent decline in price implies a 1.4 percent decline in acreage $(0.03 * 0.466)$.

¹⁹⁵See Exhibit US-63. We note that the U.S. Department of Agriculture does not consider that there is a reliable data series for planted acreage for cotton supplying countries. Therefore, the United States has used harvested acreage to compare marketing year 2001 and 2002 levels.

planting decision and solely concentrates on the size of the U.S. government outlays for the program. It determined that Step 2 payments are “very large” (without ever explaining or analyzing what “very large” means), that they induce increased demand for U.S. cotton, and increase the price the U.S. cotton farmer receives and U.S. production, thus reducing the world price of cotton.¹⁹⁶

197. The Panel’s analysis appears to assume that the Step 2 is a guaranteed payment that will always be made. This, however, is not the case. Step 2 payments are only made when certain price conditions prevail in the market.¹⁹⁷ Therefore, to look at the effect of the subsidy would require looking at expectations of farmers at the time of planting, the period when the farmer decides amount of acres to plant to upland cotton, which forms the basis for the amount of production in that marketing year. The subsidy only has an effect on U.S. production to the extent that U.S. farmers believe Step 2 payments will be available and adjust their level of production as such. The Panel never linked expectations at planting to the actual payments under Step 2. Instead, it argues since the actual payments were very large, they had a production enhancing effect.

198. We agree with the Panel that Step 2 payments are price-contingent, in the sense that they are paid out when specific price triggers are met.¹⁹⁸ However, the payments are not contingent on the relationship between the A-Index and the United States adjusted world price, as was characterized by the Panel, but instead are contingent on the difference between the A-Index and the lowest Northern European quote of U.S. cotton.¹⁹⁹ The Panel also makes an incorrect statement that the adjusted world price is the determinative price for the availability and magnitude of the user marketing (Step 2) payments.²⁰⁰

¹⁹⁶ Panel Report, para. 7.1299.

¹⁹⁷ See Panel Report, para. 7.210-7.211.

¹⁹⁸ Panel Report, para. 7.1300.

¹⁹⁹ Although the Panel mischaracterized the structure of the Step 2 program in its price suppression and causation analysis, it did correctly describe the structure of the program earlier in the report at paragraphs 7.209-7.211.

²⁰⁰ Panel Report, para. 7.1296.

199. Step 2 payments are provided to merchandisers or manufacturers who use upland cotton, and they represent the first step in the marketing chain where those payments could be made and have the greatest impact on producer prices. Step 2 payments reflect world market conditions and payments are not always in effect. The timing of payments affects the potential benefits and thus the impacts of the program on users of upland cotton.²⁰¹

200. Not only did the Panel cite no credible economic analysis that shows a significant effect of Step 2 payments on U.S. upland cotton production, it ignored economic analysis provided by the United States that showed the Step 2 payments had small, indirect effects on U.S. producers and negligible effects on world cotton prices. Unlike marketing loan payments which are paid directly to the producer, the effects of Step 2 payments on U.S. cotton producers are indirect. Because demand for cotton is more price responsive than supply, the incidence of processor subsidies like Step 2 accrue to supply rather than to demand. That is, producers gain through higher prices paid to producers while world prices are relatively unaffected.²⁰² To the degree that such payments increase the demand for cotton and hence raise prices, the producers may receive smaller deficiency payments, counter-cyclical payments, as well as potentially lower marketing loan gains and loan deficiency payments.²⁰³

201. **(3) Counter-cyclical payments:** Counter-cyclical payments are expressly linked to current prices of commodities. They are provided to producers with base acres and yields for a covered commodity for each of the 2002 through 2007 crop years whenever the effective price falls below the target price, which is fixed by the 2002 Act at 72.4 cents per pound for upland cotton.²⁰⁴

²⁰¹U.S. Opening Statement, July 22, 2003.

²⁰²U.S. Comments, January 28, 2004, para. 169.

²⁰³Exhibit US-24 (Dr. Joseph Glauber, Calculating the Per-Unit Rate of Support); U.S. Answers to Panel's Questions Following the Second Panel Meeting, para. 171 (December 22, 2003).

²⁰⁴Panel Report, paras. 7.223 - 7.226.

202. However, counter-cyclical payments are decoupled from current production so that producers cannot affect the size of the payment by what they produce. Payments are made on 85 per cent of the base acreage for each commodity multiplied by the corresponding payment rate multiplied by the applicable payment yield. Producers are then free to plant one crop, several crops, or indeed nothing at all, on acreage equivalent to their base acres and still receive a payment, if the price conditions are met.²⁰⁵

203. In addition to mischaracterizing counter-cyclical payments as price-contingent in a manner similar to, for example, marketing loan payments, the Panel offers no empirical evidence as to their economic effect. To support its opinion of the price suppressive nature of counter-cyclical payments, the Panel states that it agrees with the view of USDA economists. The Panel cites only a USDA study, which itself did not empirically estimate any economic effects of counter-cyclical payments.²⁰⁶ The Panel relied on only one part of the analysis contained in the study, and it should be noted it was a hypothetical outcome, which was that CCP payments “*may influence production decisions indirectly by reducing total and per unit revenue risk associated with price variability in some situations* [italics added].” While these USDA economists did posit this hypothetical outcome, they had concluded that counter-cyclical payments had no direct effect on production:

Counter-cyclical payments under the 2002 Farm Act are essentially decoupled from an individual farmer’s planting decisions since they are paid on a constant, pre-determined quantity for the farm (equal to 85 percent of a fixed acreage base times a fixed CCP payment yield) and they are not affected by a farmer’s current production. The expected marginal revenue of a farmer’s additional output is the expected market price (augmented by marketing loan benefits when prices are relatively low), so counter-cyclical payments do not affect production directly through expected net returns. Thus, production

²⁰⁵The Production Effects of Decoupled Payments, Dr. Glauber, August 22, 2003.

²⁰⁶Panel Report, para. 7.1302.

*decisions at the margin are based on market price signals and are not directly influenced by the counter-cyclical payments.*²⁰⁷

204. The Panel, however, ignored this conclusion of the very USDA economists with whom it stated it agreed. Thus, the study offers no support to the Panel's conclusion that counter-cyclical payments have a significant effect on upland cotton production.

205. **(4) Market loss assistance payments:** Market loss assistance payments were made under four separate pieces of legislation, one each for the years 1998 through 2001. They were *ad hoc* emergency and supplementary assistance provided to producers in order to make up for losses sustained as a result of recent low commodity prices. The 1998 market loss assistance payments were intended essentially as a 50 per cent additional PFC payment. The 1998, 1999 and 2001 Acts each appropriated a dollar amount to assistance which was divided among PFC payment recipients proportionately to their respective previous PFC payment. The 2000 Act provided for payments at the same contract payment rates as the 1999 Act. Market loss assistance payments were only made to recipients enrolled in the PFC program.²⁰⁸

206. Market loss assistance payments were paid on the identical payment base as PFC payments. Market loss assistance payments were authorized by the U.S. Congress on a *post hoc* basis as emergency supplemental payments. The legislation authorizing these payments was passed several months after planting for the crop year in question had occurred. If producers had expectations of payment, then they also knew that they would be eligible to receive a payment regardless of what crop they planted. Indeed, they could choose not to plant and still be eligible for the payment.²⁰⁹ Thus, market loss assistance payments were not expressly or directly linked to prices, as claimed by the Panel; that is, a certain price level did not trigger a certain level of

²⁰⁷Exhibit Bra-42 ("The 2002 Farm Act, Provisions and Implications for Commodity Markets, page 14) [italics added].

²⁰⁸Panel report, 7.216 -7.217.

²⁰⁹U.S. Opening Statement, October 7, 2003, para. 42.

payment. Rather, during a period of historically low yet variable prices, market loss assistance payments were made available but did not vary in any systematic or deterministic way with the level of prices. Payments were certainly not contingent on any particular price, as were marketing loan or Step 2 payments.

207. In addition to mis-characterizing market loss assistance payments as price-contingent, the Panel offers no evidence as to their economic effect.²¹⁰ In fact, the proper economic analysis of the effect of market loss assistance payments would dovetail exactly with the analysis done for PFC and direct payments.²¹¹ Market loss assistance payments were supplementary income support, not contingent on production of upland cotton or of any crop, not directly related to any specific price, and received on a *post hoc* basis. No credible economic analysis has found any significant production effect from a decoupled payment, which is how market loss assistance payments were designed to operate.²¹²

c. Discernible temporal coincidence between suppressed world market prices and U.S. subsidies

208. The Panel’s recitation of unconnected facts to support a claim of “discernible temporal coincidence” of suppressed market prices and the price-contingent U.S. subsidies is an exercise in spurious correlation and ignores the substantial analysis the U.S. presented with respect to world cotton markets and the U.S. textile industry.²¹³ The mere presence of subsidies cannot answer the question of causation.

209. The Panel misleadingly uses 1998 as the base year from which to measure increases in U.S. cotton production and cotton exports, and the decrease in U.S. and world cotton prices. As

²¹⁰Panel Report, para. 7.1301.

²¹¹Panel Report, para. 7.1307.

²¹²For example, see Exhibit US-54.

²¹³Panel Report, paras. 7.1351-7.1352.

the U.S. made clear in numerous submissions, 1998 was a highly unusual year because, among other reasons, drought severely reduced U.S. production.²¹⁴ For example, U.S. cotton production fell to 16 percent of world production in that year but remained at a steady share of approximately 20 percent between marketing years 1999-2002,²¹⁵ as the Panel itself found.²¹⁶ For the Panel to conclude U.S. production and share of the world market *increased* between marketing years 1998-2002 is inaccurate and misleading. In addition, the Asian financial crisis was affecting global economic growth and world cotton demand. The combination of reduced U.S. production and weak world demand made the 1998 marketing year an atypical year. For the Panel to use that year as a base year results in highly misleading comparisons.

210. The Panel continues its misleading analysis by comparing U.S. prices between 1998, a low production year, with 2001, a high production year in which yields were record highs around the world.²¹⁷ The Panel acknowledges weather played a key role in these two years but seems to dismiss its own facts in maintaining its “discernible temporal coincidence” argument.²¹⁸ The Panel fails to realize, moreover, that is exactly the kind of end-point-to-end-point analysis of changes in shipment quantities that the Appellate Body has condemned repeatedly in the context of the Safeguards Agreement. As the Appellate Body has observed, “[W]e do not dispute the Panel’s view and ultimate conclusion that the competent authorities are required to consider the trends in imports over the period of investigation (rather than just comparing the end points) under Article 4.2(a).”²¹⁹ The *Argentina – Footwear* panel had noted in this regard that “intervening trends in the injury indicators would be highly relevant in determining whether an industry was experiencing serious injury.”

²¹⁴U.S. cotton production fell by nearly 5 million bales, accounting for 70 percent of the decline in world cotton production. Exhibit US-40.

²¹⁵Panel Report, para. 7.1282; Exhibit US-47.

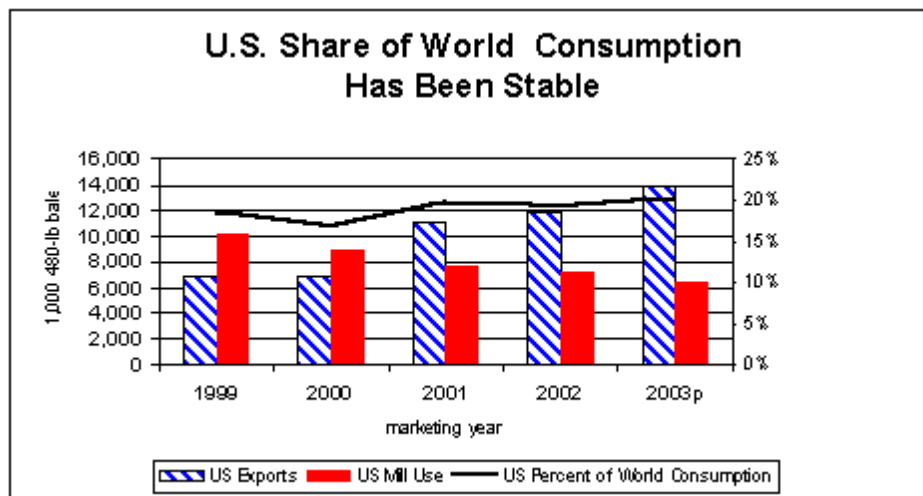
²¹⁶Panel Report, para. 7.1351 n. 1461.

²¹⁷Exhibit US-40.

²¹⁸Panel Report, para. 7.1352.

²¹⁹Appellate Body Report, *Argentina – Footwear*, para. 129.

211. The Panel notes an increase in U.S. cotton exports over the 1998 - 2002 period (we note again the inappropriate use of 1998 as the starting point), but dismisses the central reason accounting for the increase. U.S. imports of cotton textile imports have been increasing steadily for decades but shot up even more rapidly than previous years beginning around 1997 (with the lone exception of the recession year 2001).²²⁰ As cotton textile imports shot up, U.S. domestic mill use collapsed and cotton textile exports fell sharply. Even though U.S. cotton production showed no discernible trend over the marketing year 1999-2002 period and remained constant as a share of world production, U.S. cotton exports logically increased as there was limited domestic demand and increasing foreign demand. As the graph below demonstrates, the combination of declining U.S. mill use and increasing exports to fill demand from foreign textile producers resulted in U.S. cotton satisfying a stable share of world cotton consumption (as implied in the stable U.S. share of world production).²²¹



Thus, one does not need to rely on “discernible temporal coincidence” between market prices and subsidies to explain the increase in U.S. cotton exports. An analysis of factors affecting U.S. and

²²⁰U.S. Further Submission, paras. 32 - 34 (September 30, 2003).

²²¹See, e.g., U.S. Opening Oral Statement at the Second Panel Meeting, para. 13 (December 4, 2003) (as delivered); Exhibit US-47.

world cotton markets provides a logical, economic explanation for trends in U.S. consumption and exports of cotton.²²²

212. The Panel also notes that U.S. cotton imports remained at comparatively low levels during this period.²²³ This finding is irrelevant. As a large, efficient producer of cotton for hundreds of years, the U.S. has never been a significant importer of cotton. This finding leads one to conclude that the Panel did not fully weigh the U.S. analysis about burgeoning U.S. imports of cotton textiles as domestic mill use dropped off. The U.S. did not make claims about cotton imports. The relevant argument concerns U.S. cotton textile imports, which the Panel did not even mention in its list of facts about “discernible temporal coincidence.”

d. Divergence between U.S. total costs of production and market revenue

213. The final ground relied upon by the Panel to find causation was that subsidies may have kept some farms from ceasing production during times when prices received by farmers were below the average total cost of production in the United States.²²⁴ As set out below, the United States does not believe this comparison between average total costs and market returns is valid or can establish that the effect of subsidies was to stimulate production. However, even if it were valid, absent some evidence of the causal relationship between any additional subsidy-enhanced production and prices in the “world market,” there is no evidence that the presence or absence of these subsidies had any effect on world market prices, let alone that they caused the price suppression that the Panel thought occurred.

214. The Panel accepted uncritically Brazil’s argument that the divergence between U.S. producers’ total costs of production and revenue from sales of upland cotton (and sometimes

²²²The U.S. provided substantial analysis of all the factors driving world cotton markets during this period. We have highlighted only one here. U.S. Further Submission, paras. 16-44 (September 30, 2003); Exhibit US-40.

²²³Panel Report, para. 7.1351.

²²⁴Panel Report, para. 7.1354.

cottonseed) provides evidence that U.S. producers of upland cotton could not have remained in business except for U.S. subsidies. This finding is wrong on both an economic and legal basis:

(1) it perpetuates the economic fallacy of using average total costs of production as the relevant measure farmers use when making production (that is, planting) decisions; and

(2) it disregards the research literature of the economics profession with respect to the theory, method of measurement, and proper use of costs of production.²²⁵

215. ***The Panel’s analysis ignores the farmer’s planting decision:*** As was presented at great length in U.S. submissions, the relevant measure producers use when making annual planting decisions is *variable* costs of production, not *total* costs of production.²²⁶ Producers make planting decisions based on projected net revenues from planting cotton relative to the projected net revenue from planting alternative crops or allowing the land to remain idle. Producers will choose not to plant cotton if the expected revenues from planting cotton are less than the expected variable costs. In each year from 1999-01, U.S. expected cotton revenue exceed average variable costs. In 2002, average variable costs narrowly exceeded the expected price of cotton, and in that year cotton planted acreage declined substantially.²²⁷

²²⁵We also note that the Panel failed to address any U.S. argument concerning Brazil’s faulty measure of revenue from sales of upland cotton and cottonseed. The flaws in Brazil’s revenue measure alone are sufficient to invalidate its revenue - cost gap argument. (U.S. Further Rebuttal Submission, November 18, 2003, paras. 109 - 115) We noted that Brazil constructed the revenue portion of its revenue gap method in three different ways. In its second version, Brazil did not include revenue from cottonseed, yet included ginning costs. The Panel indicated in Panel Report footnote 1468 that any of Brazil’s three approaches are valid, but this clearly cannot be so. Including the costs for an activity but not including the revenue from that activity improperly inflates any alleged gap.

²²⁶U.S. Further Rebuttal Submission, November 18, 2003, paras. 116 - 151.

²²⁷This conclusion that farmers plant to maximize projected net returns is reinforced by Brazil’s economic expert, Dr. Sumner: “Effects on U.S. cotton acreage depend on how different subsidy programs (either collectively or individually) change the projected net returns per acre for cotton relative to competing crops. This change in projected profitability depends crucially on expectations that U.S. upland cotton farmers have about market prices and government program benefits associated with planting cotton.” Brazil’s Further Submission, Annex I, para. 17 (September 9, 2003).

216. ***The Panel incorrectly analyzes U.S. costs over the long term:*** The Panel correctly notes that: “Fixed and variable costs are the total amount which the producer incurs in order to produce the product and the total amount it must recoup, *in the long-term*, to avoid making losses. To the extent that the producer charges prices that do not recoup the total cost of production, over time, it sustains a loss which must be financed from some other source, or else the producer simply has to close down his business.”²²⁸ However, the Panel then ignored its own statement in two ways.

217. First, Brazil made no attempt to define the “medium to long term” for the U.S. cotton industry. Consequently, the Panel made no factual finding that any particular period was the “medium to long term” over which total costs must be covered. Second, the Panel accepted Brazil’s use of total costs of production to analyze annual production decisions. This approach is completely at odds with every theoretical and analytical approach used by the agricultural economic’s profession, including that employed by Brazil’s economic expert, Dr. Sumner.²²⁹

218. The Panel erred in relying on total costs of production when the economic literature makes clear that “The decision of whether or not to produce in the short run is not based on covering fixed costs. Economic theory is very clear that only variable cash expenses must be covered in the short run.”²³⁰ Although the United States reviewed in some detail why the economics profession distinguishes between operating and economic costs, it is important to point out the Panel ignored all of the U.S. arguments with respect to the nature and estimation of the economic, or allocated overhead costs.²³¹ The method for estimating these costs makes clear they cannot be treated as annual cash expenses in the same manner as variable cash expenses. In

²²⁸Panel Report, footnote 1465 [italics added]. The Panel makes 3 references to the time dimension of costs of production.

²²⁹U.S. Answers to Panel’s Questions, December 22, 2004, para. 46. In his submission, “Analysis of Counterfactual Retrospective Scenarios and Prospective Scenarios of Elimination of Upland Cotton Subsidies in the United States using an elaboration of the FAPRI/CARD Modeling Framework (page 2),” Dr. Sumner uses variable costs of production in his equation for upland cotton planting, consistent with theory and practice.

²³⁰U.S. Further Rebuttal Submission, November 18, 2003, para. 117.

²³¹U.S. Further Rebuttal Submission, November 18, 2003, paras. 117-122. Brazil cited no literature or research from the economics profession that claimed otherwise.

fact, most countries neither have data nor make any attempt to estimate these complex measures and only include variable cash expenses as a cost of production.²³²

219. The Panel not only ignored the correct economic analysis as set out in all the economic literature before it, it also ignored the U.S. data that showed that over a 6-year period U.S. upland cotton producers more than covered their variable costs in every year but 2001, thus allowing them to earn a sufficient margin to pay off some or all of their fixed costs.²³³ As noted by Brazilian cotton farmer Christopher Ward, conventional business practice is to cover *variable or operating costs* every year, but even if a farmer is unable to do so in one year, that does not mean he will go out of business. As Mr. Ward pointed out, if a producer is able to earn a margin above variable costs, those funds are then available to pay off fixed costs, as well as being available for those low-priced years when producers may not be able to cover even their variable costs.²³⁴ This description exactly fits the situation of U.S. cotton producers over the 6-year period of 1997 - 2002.

220. The Panel dismissed U.S. arguments by noting, “We do not believe the utility of the record data is fundamentally undermined by any of the criticisms levied by the United States for the purposes of this dispute, particularly as the data are calculated in accordance with a methodology which the USDA itself has deemed to be sufficiently reliable reflection of United States upland cotton producers’ costs and revenues.”²³⁵ But the Panel then ignores what the USDA itself says about the proper use and interpretation of its own data.

²³²U.S. Further Rebuttal Submission, November 18, 2003, paras. 142 - 143. The Panel fell into the same trap in Panel Report footnote 1469, when it used the faulty data on costs of production from different countries to draw an unsupported conclusion about higher U.S. costs.

²³³U.S. Answers to Panel’s Questions, December 22, 2004, para. 47. Between 1997-2002, the cumulative net return of U.S. upland cotton producers (market revenue minus variable costs) was \$592.65 per acre. Brazil presented this same data in Answers To Panel Questions, October 27, 2003, table following para. 136.

²³⁴Exhibit Bra-283.

²³⁵Panel Report, para. 7.1354.

*“Short-term production decisions are mostly based on the relationship between operating costs and expected product prices. Producers have already incurred the cost of owning farm assets, and so give asset cost little consideration. However, as the planning period stretches to 5-10, or even to 20 years and capital assets have to be replaced, producers consider both operating and asset ownership costs in relation to expected prices.”*²³⁶

221. The Panel accepted Brazil’s argument that by 2002 there was a huge cumulative gap between average market returns and average total costs. But as the economics literature makes clear, a producer looks at variable costs, not asset ownership costs, in relation to *expected* prices to make a *prospective* judgment as to whether to continue planting cotton. Brazil’s retrospective “gap analysis” does not reflect either economic theory or agricultural business practice. In fact, the over- and under-planted acreage data shows tremendous shifts in where cotton was being planted, suggesting that farmers were continuously evaluating their planting decisions.²³⁷ The U.S. demonstrated that over six years producers on average more than covered their variable or operating costs, meaning those producers were also covering some or all of their fixed and economic costs. The Panel ignored its own reasoning about the appropriate use of USDA methodology to reach an erroneous finding.

222. As noted, the Panel ignored all of the agricultural economics literature that indicates that the relevant costs for production decisions are variable costs, not total costs. The Panel’s sole support for relying on average total costs of production was the Appellate Body report from *Canada – Dairy (Article 21.5)*.²³⁸ But this report is not relevant to the issue here. The only question in that dispute was whether a practice involved an export subsidy within the meaning of Article 9.1(c) of the Agriculture Agreement. Solely because the question was to determine whether certain milk provided to processors constituted a payment for purposes of Article 9.1(c)

²³⁶McBride, W. “Production Costs Critical to Farming Decisions.” *Amber Waves* Vol 1, Issue 4, September 2003. pp. 38-45 [italics added] (Exhibit US-84).

²³⁷U.S. Opening Statement at the Second Panel Meeting, December 2, 2003, paras. 55 - 57

²³⁸Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US) (AB)*, paras. 87, 88.

did the Appellate Body opt to use the average cost of production. Here, the issue for which Brazil seeks to use total costs is not to determine whether a payment exists but to evaluate the effect of the subsidy, an altogether different analysis. Thus, *Canada - Dairy (Article 21.5)* provides no support for the Panel accepting Brazil’s average total cost argument to establish causation.²³⁹ In fact, in that report, the Appellate Body did not opine on which costs a producer examines to decide whether to produce but expressly noted that “a producer may very well decide to sell goods or services if the sales price covers its marginal costs.”²⁴⁰

223. The Panel also erred in concluding that Brazil’s flawed revenue gap analysis based on covering total costs on an annual basis demonstrated that the effect of the subsidies is to maintain U.S. production. The Panel reasoned that “but for” U.S. payments, U.S. production would have been lower because U.S. upland cotton producers could not have covered their average total costs of production. However, Brazil presented no evidence to that effect. Brazil simply asserted that *only* government subsidies could have filled the gap.²⁴¹ Brazil and the Panel’s analysis ignores other sources of income available to upland cotton producers.

224. As the Appellate Body noted in *Canada – Dairy (Article 21.5)*, “[t]o the extent that the producer charges prices that do not recoup the total cost of production, over time, it sustains a loss which must be financed from some other source, possibly ‘by virtue of governmental action.’”²⁴² That is, the “loss” may be financed “from some other source,” but the Panel expressly rejected any analysis of whether there was any “other source” to finance the loss but government payments.²⁴³ In fact, the evidence before the Panel showed that U.S. upland cotton producers

²³⁹U.S. Answers to Panel’s Questions, December 22, 2004, para. 42, footnote 46.

²⁴⁰Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US) (AB)*, para. 94.

²⁴¹Brazil’s Further Submission, September 9, 2003, paras. 117 - 122; Brazil’s Further Rebuttal Submission, November 18, 2003, paras. 59 - 61.

²⁴²*Canada – Dairy (Recourse to Article 21.5)*, para. 87; *see also id.*, para. 94 (“Although a producer may very well decide to sell goods or services if the sales price covers its marginal costs, the producer will make losses on such sales unless all of the remaining costs associated with making these sales, essentially the fixed costs, *are financed through some other source*, such through highly profitable sales of the product in another market.”) [italics added].

²⁴³Panel Report, para. 7.1354 n. 1470.

earn 30 percent of their revenue from off-farm sources of income, and the same cost data on which Brazil and the Panel relied showed that upland cotton production accounted for only 44 percent of farm revenue for such producers.²⁴⁴ Because upland cotton producers have significant “other source[s]” of income to finance any alleged long-term losses, there was no basis for the Panel to conclude that, *but for* the challenged price-contingent payments, U.S. upland cotton production would have been lower because farmers could not have covered their average total costs.²⁴⁵

225. The Panel erred by uncritically accepting Brazil’s definition and use of total costs of production as the relevant measure producers use for making production decisions; by not defining medium to long term, and by concluding that only subsidies could be used to cover the alleged revenue gap. For these reasons the Panel erred in concluding that Brazil’s revenue gap method can be used to conclude that U.S. upland cotton production is higher than it would have been in the absence of the subsidies.²⁴⁶

e. Conclusion

226. In conclusion, the four main, cumulative grounds cited by the Panel for finding that the challenged price-contingent payments caused significant price suppression do not withstand

²⁴⁴See U.S. March 3 Comments, paras. 50-51.

²⁴⁵We also recall that Brazil’s argument was that *all* of the challenged payments, both price-contingent and non-price-contingent, were necessary to cover U.S. upland cotton producers’ average total costs and that without *all* of those payments U.S. upland cotton production would have been lower. Brazil’s Further Submission, paras. 117-122 (September 9, 2003); Brazil’s Further Rebuttal Submission, paras. 59-61 (November 18, 2003). However, the Panel *only* analyzed the *price-contingent payments* for purposes of this cost-revenue argument. These payments would not have sufficed to make up the alleged gap between average total costs of production and market revenue over the six-year period put forward by Brazil. Thus, under Brazil’s own theory and analysis, U.S. upland producers *must* have been financing the “loss” between market revenues and average total costs of production “from other sources” besides the price-contingent payments. The disconnect between Brazil’s argument and the Panel’s analysis further demonstrates that the Panel erred as a matter of law in ignoring other sources of revenue in finding causation on the basis of an alleged total cost - revenue gap.

²⁴⁶Panel Report, para. 7.1354.

scrutiny. The Panel erred as a matter of law in finding that “the effect of the subsidy” is significant price suppression.

C. The Panel’s finding of “price suppression” of the “world market” price for cotton was legally erroneous as it assumed without basis the effect of the challenged subsidies, ignored the relevant economic decision (planting), failed to examine other countries’ supply response, and was not a finding with respect to the Brazilian “world market” price

227. The Panel found that there was suppression of the “world market” price for upland cotton. However, the Panel’s finding of price suppression was legally erroneous as it assumed, without basis, the effect of the challenged subsidies. In the course of making that erroneous finding, the Panel provided a legally insufficient analysis of the nature of the challenged subsidies, ignoring U.S. rebuttal arguments relating to the relevant economic decision, the farmer’s decision to plant upland cotton. The Panel also erred in finding that certain U.S. payments suppressed the “world market” price for cotton by failing to examine supply response in other countries – that is, to what extent other countries would increase supply in response to any alleged decrease in cotton production resulting from the absence of U.S. payments, maintaining prices at an equilibrium level. Finally, the Panel erred in finding price suppression because it never found that the price of Brazilian upland cotton was suppressed, as opposed to the “world market” price generally.

1. The Panel prejudices the outcome of its analysis of “the effect of the subsidy”

228. Fundamentally, the Panel erred in finding price suppression of the “world market” price by prejudging the outcome of its causation analysis. In this portion of its report, the Panel was

“assess[ing] whether or not ‘price suppression’ has occurred in the same ‘world market.’”²⁴⁷ The Panel looked to “the relative magnitude” of U.S. production and exports, general price trends, and “the nature of the subsidies at issue, and in particular, whether or not *the nature* of these subsidies *is such as to have discernible price suppressive effects.*”²⁴⁸ However, this portion of the Panel’s report is purportedly analyzing whether *price suppression* has occurred, *not* what is “the effect of the subsidy.” The Panel does not take up that analysis until paragraph 7.1334 of its report, 12 pages and 54 paragraphs later.²⁴⁹ Therefore, in analyzing “whether or not . . . these subsidies . . . have price suppressive effects,” the Panel prejudices the outcome of its analysis of “the effect of the subsidy.”

229. In finding that “the nature” of the U.S. subsidies at issue is such that they have price suppressive effects, the Panel repeatedly uses language that reveals that the Panel, in fact, is assuming what is “the effect of the subsidy”:

- “We have *no doubt* that the payments *stimulate production and exports and result in lower world market prices* than would prevail in their absence.”²⁵⁰
- “The [marketing loan] payments *stimulate production and exports and result in lower world market prices* than would prevail in their absence.”²⁵¹
- “The [Step 2] payments therefore *stimulate production and exports and result in lower world market prices* than would prevail in their absence.”²⁵²

²⁴⁷Panel Report, para. 7.1280.

²⁴⁸Panel Report, para. 7.1280 [italics added].

²⁴⁹Panel Report, para. 7.1334.

²⁵⁰Panel Report, para. 7.1291 [italics added].

²⁵¹Panel Report, para. 7.1295 [italics added].

²⁵²Panel Report, para. 7.1299 [italics added].

- “*The effects of these three price-contingent subsidies are, in our view, manifest in the movements in upland cotton prices in the same world market during the reference period.*”²⁵³
- “*These subsidies are of a different nature, and thus effect, than the other (price-contingent) subsidies we have examined above.*”²⁵⁴
- “As we have indicated, several of the United States subsidies are directly linked to world prices for upland cotton, *thereby numbing the response* of United States producers *to production adjustment decisions* when prices are low.”²⁵⁵

That is, in all of these statements, the Panel assumes “the effect of the subsidy” that it sets out to analyze in a later section of the report.

230. Logically, the Panel could not have made a finding of significant price suppression *prior* to any finding on “the effect of the subsidy” that is being challenged. A finding of price suppression *without* any prior finding of “the effect of the subsidy” would be meaningless; how could one know that prices were lower than they otherwise would have been without knowing what allegedly caused the prices to be lower? In fact, the Panel concluded the “nature of the subsidy” was to have “price suppressive *effects*” – that is, the Panel *assumed* what was “the effect of the subsidy” even though its *analysis* of what was “the effect of the subsidy” had yet to be made. As a result, the Panel’s finding of price suppression was legally erroneous as it assumed, without basis, the effect of the challenged subsidies.

²⁵³Panel Report, para. 7.1303 [italics added].

²⁵⁴Panel Report, para. 7.1308 (italics added; footnote omitted).

²⁵⁵Panel Report, para. 7.1308 [italics added].

2. The Panel’s analysis of the “nature” of the subsidies was legally insufficient, ignoring U.S. rebuttal arguments related to planting, the relevant economic decision

231. The Panel’s analysis of the “nature” of the challenged subsidies – in particular, those subsidies the Panel labeled “price-contingent” (marketing loan payments, Step 2 payments, counter-cyclical payments, and market loss assistance payments) – was legally insufficient. As set out above with respect to causation, the Panel erred in concluding that these payments “stimulate production and exports and result in lower world market prices than would prevail in their absence.”²⁵⁶ Simply put, without a proper analysis of the relevant production decision – that is, the decision to plant upland cotton – the Panel could not have concluded that these payments “stimulate production and exports and result in lower world market prices” nor that these payments “numb[] the response of United States producers to production adjustment decisions when prices are low.”²⁵⁷ Thus, the Panel erred as a matter of law in concluding that “the structure, design and operation, particularly of the price-contingent subsidies, constitutes strong evidence supporting a finding of price suppression.”²⁵⁸

3. The Panel did not examine supply response in other countries, invalidating its finding that the “world market” cotton price was suppressed

232. The Panel’s analysis of “price suppression” hinged on its finding that the nature of the price-contingent U.S. subsidies was to “stimulate production and exports” resulting “in lower world market prices than would prevail in their absence.”²⁵⁹ The Panel explained that “suppressed world prices may follow from an increased supply being infused on the world

²⁵⁶See, e.g., Panel Report, para. 7.1295.

²⁵⁷Panel Report, para. 7.1308.

²⁵⁸Panel Report, para. 7.1308.

²⁵⁹Panel Report, paras. 7.1295, 7.1299.

market, over and above existing available world supply of fungible upland cotton.”²⁶⁰ The United States disagrees with the Panel’s analysis of the nature of the challenged price-contingent subsidies as stimulating production and exports, resulting in lower world cotton prices. The United States also disagrees with the Panel’s later analysis of “the effect of the subsidy.” However, we note that, on its own terms, the Panel’s rationale does not support a finding of price suppression because the Panel has failed to take into account supply and demand response of other market participants.

233. The Panel’s theory on how U.S. payments caused price suppression was that U.S. payments “stimulate[d]” production, which was “infused on the world market, *over and above existing available world supply*.” This allegedly “result[ed] in lower world market prices than would prevail in their absence.” The Panel’s analysis, however, is incomplete. The Panel apparently only took into consideration the effect of the removal of U.S. payments on U.S. payment recipients and not the effect of that removal on all market participants. This is evidenced by the lack of any discussion on how suppliers and users of cotton react to the change in policy.

234. As economics tells us, reducing supply without any reduction in demand would result in higher prices. Economics, however, also tells us that higher prices induce producers to increase their levels of production and purchasers to reduce consumption. As producers increase supply, prices begin to drop until supply and demand reach a new equilibrium. This resulting new level of supply, demand, and price would represent the market outcome in the absence of the programs, and this is what should be compared to the situation in which the programs were still in place. Thus, to complete its analysis, the Panel should have incorporated adjustment by all market participants.

²⁶⁰Panel Report, para. 7.1309.

235. The inclusion of the adjustment of other suppliers and users into the analysis is not uncommon or an unique approach adopted by the United States for these proceedings. In fact, Brazil recognized that this represents the appropriate analysis:

- *“It is also important to include multiple countries and regions in the model to reflect alternative sources of supply and demand when a policy condition changes. For example, a policy-induced increase in incentives to produce cotton in the United States . . . would engender indirect market responses in many other countries that produce or consume cotton. An increase [decrease] in U.S. subsidies for upland cotton induces producers in other countries to reduce [increase] area planted to upland cotton in anticipation of higher [lower] U.S. exports and a decline [increase] in the world market price. The world market impacts on prices and quantities are an amalgam of the direct and indirect responses from suppliers and demanders in many locations.”²⁶¹*

We agree with Brazil’s explanation that it is “important” to include multiple countries to “reflect alternative sources of supply” when a policy condition changes.²⁶²

236. Additionally, independent studies submitted in this dispute also included in their analysis the adjustment of all suppliers to the policy change. For example, ICAC stated the following about the impact of removing U.S. programs:

²⁶¹Brazil’s Further Submission, Annex I, paras. 9-10 [italics added].

²⁶²We recall that the Panel expressly stated that it did not rely on this model or its results in reaching its findings: “We have not relied upon the quantitative results of the modelling exercise - in terms of estimating any numerical value for the effects of the United States subsidies, nor, indirectly, in our examination of the causal link required under Articles 5 and 6.3(c) of the SCM Agreement.” Panel Report, para. 7.1205. *See also id.*, para. 7.1206 (“Without prejudice to the relevance or utility of such simulations generally to a serious prejudice analysis under Part III of the *SCM Agreement*, we would point out our particular concern here, in ensuring procedural fairness between the parties and the reliability of evidence, that the underlying model itself was not equally accessible to the parties and, as relevant, to the Panel in these proceedings. Brazil did not itself have access to the model. While Brazil instructed the organization which owned and operated the model (FAPRI) as to the modifications and adaptations that Brazil believed needed to be made in order to produce the econometric results presented to the Panel, Brazil could not itself autonomously check the use of those modifications and adaptations. When the United States asked to be able to analyse the model and its workings, FAPRI stipulated that neither Brazil nor the Panel could have similar access.”).

- It is difficult to measure the impact of direct subsidies upon cotton prices. A removal of subsidies would result in lower production and, thus, higher prices in the short term. However, such an impact would likely be offset, partially or totally, by shifting world production to non-subsidizing countries in the medium and long terms. Similarly higher prices would reduce cotton use.²⁶³

237. Thus, consistent with basic economics, Brazil and the United States would agree that, in order to determine the effect of U.S. payments on cotton prices, the Panel should have considered to what extent other market participants would increase supply or reduce demand in response to any alleged increase in cotton prices resulting from the absence of U.S. payments. The Panel failed to do so. Therefore, the Panel erred as a matter of law in finding that certain U.S. payments suppressed the “world market” price for cotton.

4. The Panel did not find that Brazilian prices in the “world market” were significantly suppressed

238. The Panel erred in not examining Brazilian upland cotton prices in the “world market” the Panel had found to be a “same market.” That is, the Panel concluded that the A-index was “a ‘price’ for the purposes of analysing whether or not ‘price suppression’ has occurred in the same ‘world market’ for purposes of Article 6.3(c)” and found that that price had been suppressed.²⁶⁴ However, the Panel never found that the effect of the challenged U.S. subsidies was significant price suppression of the *Brazilian* price in the “world market.”²⁶⁵

²⁶³ Exhibit BRA-284.

²⁶⁴ Panel Report, para. 7.1265.

²⁶⁵ See Panel Report, para. 1274 (A-index is a world price); *id.*, para. 7.1303 (single effects-related variable examined is “world price”).

239. If there is no “significant price suppression” of *Brazilian* prices “in the same market” in which both U.S. and Brazilian upland cotton is found, there can be no “serious prejudice to the interests of another Member” (Brazil) within the meaning of Article 5(c) nor any “adverse effects to the interests of other Members” within the meaning of the chapeau of Article 5.²⁶⁶ We recall that the panel in *Indonesia – Automobiles* reviewed a U.S. claim of serious prejudice on behalf of a U.S. company manufacturing products at a European factory. The panel concluded that a serious prejudice claim must be made with respect to products produced within a Member’s territory.²⁶⁷ Here, however, the Panel never found suppression of the price of Brazilian upland cotton in the “world market.” Therefore, the Panel could not have found significant price suppression in the same market causing serious prejudice to the interests of Brazil.²⁶⁸

D. The Panel Erred in Concluding That It Need not Find the Amount of the Challenged Subsidy

240. The Panel erred in accepting Brazil’s argument that, for purposes of a serious prejudice claim, Brazil need not allege and demonstrate, and the Panel need not find, the amount of the challenged subsidy that benefits upland cotton.²⁶⁹ Under the Panel’s logic, presumably it would make no difference in a serious prejudice dispute whether the amount of the challenged payment

²⁶⁶Similarly, Subsidies Agreement Article 7.2 requires a complaining Member’s statement of available evidence to include evidence of “serious prejudice caused to the interests of the Member requesting consultations” [italics added].

²⁶⁷Panel Report, *Indonesia – Automobiles*, para. 14.202. The panel analyzed the question whether the United States could bring a claim of serious prejudice on behalf of a U.S. company manufacturing products at a European factory in some detail and concluded that a serious prejudice claim must be made with respect to products produced within a Member’s territory and that one Member could not bring a claim that another Member has suffered serious prejudice.

²⁶⁸Indeed, the United States provided evidence of Brazilian undercutting of the U.S. price for cotton. *See, e.g.*, U.S. Further Rebuttal Submission, para. 40; Exhibit US-75.

²⁶⁹*See, e.g.*, Brazil’s Further Rebuttal Submission, para. 99 (“In this phase of the proceeding, Brazil need only show that there is a ‘financial contribution’ and a ‘benefit,’ within the meaning of Article 1. It does not need to quantify benefit.”) (18 November 2003); Brazil’s Comments on U.S. 11 February Comments, para. 78 (“Brazil has argued that Part III of the SCM Agreement does not require detailing the precise amount of the subsidies or a subsidization rate.”) (18 February 2004).

was \$1 or \$1 billion. It seems implausible to suggest that, for a given subsidy program, these two amounts of payment would not have different effects on prices and sales.

241. The Panel's interpretation ignores the text and context of Article 6.3(c) of the Subsidies Agreement, including the terms "benefit" and "subsidized product" and the explicit direction in Article 6.8 and Annex V to examine "the amount of the subsidy in question" in order to determine "the existence of serious prejudice" – that is, identify its effect. Thus, the Panel erred as a matter of law in concluding that identifying the amount of the subsidy in question was not a prerequisite for Brazil's serious prejudice claims.

242. To the extent that the Panel could have included in its analysis counter-cyclical and market loss assistance payments to recipients who did not produce upland cotton at all, moreover, these payments were outside the Panel's terms of reference and could not have benefitted upland cotton.

1. To make a serious prejudice claim, Brazil had to establish the amount of the challenged subsidy that benefits the subsidized product, upland cotton

243. The Panel erred in finding that a complaining party need not establish the amount of the challenged subsidy in order to for the Panel to evaluate its "effect." The Panel's error invalidates its finding of present serious prejudice with respect to two decoupled payments, counter-cyclical payments and market loss assistance payments.²⁷⁰ For these payments, the amount of the subsidy that benefits the subsidized product, upland cotton, was in dispute because the payment is not tied to upland cotton production, and a payment recipient need not produce upland cotton at all.

²⁷⁰In the case of challenged marketing loan payments and Step 2 payments, the parties agreed on the amount of the subsidy.

Thus, the Panel may have attributed to upland cotton payments that benefitted, in whole or in part, other products or that benefitted no products at all.

244. **Articles 5(c) and 6.3(c) rely on the term “subsidy”:** The requirement that a complaining party identify the amount of the challenged subsidy stems from the text and context of Articles 5(c) and 6.3(c), which form the basis for Brazil’s serious prejudice claim. Article 5(c) states that no Member should cause adverse effects to the interest of another Member, including serious prejudice, through the use of “any subsidy referred to in paragraphs 1 and 2 of Article 1.” Article 6.3(c) states that serious prejudice may arise where “the effect of the subsidy is . . . significant price suppression . . . in the same market.” Thus, both of these provisions rely on the term “subsidy” as defined in Article 1 (entitled “Definition of a Subsidy”).

245. **Context in Article 1:** Article 1.1 establishes that “a subsidy shall be deemed to exist” if there is a financial contribution by a government or any form of income or price support plus “a benefit is thereby conferred.” Thus, Brazil’s claims against “subsidies provided to US producers, users, and/or exporters of upland cotton”²⁷¹ would require that challenged payments confer a benefit on those recipients.²⁷²

246. **Articles 5(c) and 6.3(c) also use the term “subsidized product”:** Further support for the notion that the amount of subsidy benefit must be identified can be found in the reference in Article 6.3(c) to a “subsidized product.” The Panel correctly notes that “Article 6.3(c) calls for an examination of price suppression, and that price suppression necessarily involves the prices of certain products. Thus, our examination of ‘prices’ in the world market necessarily relates to ‘prices’ of certain ‘products’.”²⁷³ Thus, Article 6.3(c) suggests that the challenged subsidy must, in fact, subsidize the product at issue. In the case of a decoupled payment that is not tied to the

²⁷¹WT/DS267/7 (panel request).

²⁷²Further context for the meaning of the term “subsidy” is found in Article 14 of Part V of the Subsidies Agreement on countervailing measures, which is entitled “calculation of the amount of a subsidy in terms of the benefit to the recipient.”

²⁷³Panel Report, para. 7.1216 n. 1333.

production or sale of a particular product, this would require a complainant to identify that part of the subsidy that benefits the product at issue so that the panel may analyze its effect. Similarly, to the extent that a subsidy benefits *other* “subsidized products” besides the product at issue, those subsidy amounts could not be taken into account when determining “the effect of the subsidy.”²⁷⁴

247. **Article 6.8 and Annex V, paragraph 2, direct the Panel to examine the amount of the subsidy:** The Panel ignores crucial contextual support for the foregoing interpretation of the text of Articles 6.3(c) and Article 5(c) when it ignores Article 6.8 and Annex V of the Subsidies Agreement. These provisions explicitly direct the Panel to consider certain evidence in determining whether serious prejudice exists. Incredibly, the Panel instead points to the text of Article 7.2, which spells out the content of an actionable subsidies *consultation request*, as “call[ing] for a qualitative and, to some extent, quantitative analysis of the existence and nature of the subsidy and the serious prejudice caused.”²⁷⁵ However, Article 7.2 does not purport to establish the evidence required to support a serious prejudice claim, nor the evidence to be examined by a panel. Rather, Article 6.8 does just that.

248. Article 6.8 states that, “[i]n the absence of circumstances referred to in paragraph 7, *the existence of serious prejudice should be determined on the basis of the information submitted to or obtained by the Panel, including information submitted in accordance with the provisions of Annex V*” [italics added]. That is, while Article 7.2 does not directly guide the Panel’s examination of serious prejudice claims, Article 6.8 expressly directs the Panel to determine “the existence of serious prejudice” on the basis of, *inter alia*, information submitted under Annex V. Annex V, in turn, sets out “Procedures for Developing *Information Concerning Serious Prejudice*” [italics added]. What is that information? Paragraph 2 states:

²⁷⁴As we shall see later, Articles 6.3(c), 6.3(d), 6.4, and 6.5’s references to a “subsidized product” call for an “allocation methodology” to determine the products that benefit from a subsidy that is not tied to production or sale of a given product. Such a methodology for determining the “subsidization” of a “product” is set out in Annex IV; in fact, this is the only allocation methodology that Members have agreed in the Subsidies Agreement.

²⁷⁵Panel Report, para. 7.1173 (footnote omitted).

[T]he DSB shall, upon request, initiate the procedure *to obtain such information* from the government of the subsidizing Member *as necessary to establish the existence and amount of subsidization*, the value of total sales of the subsidized firms, as well as information necessary to analyze the adverse effects caused by the subsidized product.⁶⁶

⁶⁶In cases where the existence of serious prejudice has to be demonstrated.

That is, Article 6.8, in conjunction with Annex V, paragraph 2, establishes that “information concerning serious prejudice” includes “such information . . . as necessary to establish the . . . amount of subsidization.”

249. ***The Panel misreads paragraph 2 of Annex V:*** We recall the Panel’s somewhat hidden explanation of this provision in footnote 1294 of the panel report. Here, the Panel explains its view that “[w]e see this as an indication that information relating to the general order of magnitude of the subsidy could be relevant in a given case. We recall, however, that the Annex V procedures also related to the establishment of the presumption of serious prejudice in Article 6.1 and Annex IV (based upon an ad valorem rate of subsidization) during the period of application of that provision.” The Panel’s reading of Annex V, paragraph 2, fails in two ways.

250. First, the Panel fails to interpret the text of paragraph 2, in particular that the information subject to these “procedures for developing information concerning serious prejudice” are concerned with “obtain[ing] such information from the government of the subsidizing Member *as necessary to establish the existence and amount of subsidization.*” If information relating to the “amount of subsidization” merely “*could be* relevant in a given case,” it would not be “necessary to establish” that amount, nor to obtain “such information from the government of the subsidizing Member,” contrary to the plain text of paragraph 2.

251. Second, the Panel fails to examine footnote 66, which follows the phrase “as well as information necessary to analyze the adverse effects caused by the subsidized product.” Footnote 66 reads: “In cases where the existence of serious prejudice has to be demonstrated.” Under Article 6.1(a), where certain elements are established, serious prejudice is deemed to exist (unless the subsidizing Member overcomes the presumption), and the complaining Member need not demonstrate the existence of serious prejudice. Thus, footnote 66 suggests that *only* in Article 6.1 cases will the information “to analyze the adverse effects caused by the subsidized product” *not* be “necessary.”

- However, footnote 66 does *not* suggest any circumstances in which any *other* information identified in paragraph 2, including “such information . . . as necessary to establish the . . . amount of subsidization,” will not need to be demonstrated.

Thus, the Panel’s suggestion that paragraph 2 and the Annex V procedures are limited to Article 6.1 is flatly contradicted by the text of Annex V. In fact, the text suggests that the “amount of subsidization” is a necessary piece of information for establishing serious prejudice.

252. ***Annex V, paragraph 5, also establishes that the information to be considered by the Panel includes “the amount of the subsidy in question”:*** The Panel also ignores paragraph 5 of Annex V, which details the information to be submitted to the Panel pursuant to the Annex V information-gathering process. Paragraph 5 states:

The information obtained during this process shall be submitted to the panel established by the DSB This information should include, *inter alia*, data concerning *the amount of the subsidy in question* (and, where appropriate, the value of total sales of the subsidized firms), prices of the subsidized product, prices of the non-subsidized product, prices of other suppliers to the market, changes in the supply of the subsidized product to the market in question and changes in market shares [italics added].

Thus, in conjunction with Article 6.8, the existence of serious prejudice should have been determined by the Panel on the basis of information submitted to it, including “data concerning the amount the subsidy in question.” As with the text of paragraph 2, there is no indication that this information is relevant only to claims under Article 6.1.

253. **Conclusion:** Establishing a serious prejudice claim under Articles 5(c) and 6.3(c) requires identifying the amount of the challenged subsidy that benefits the subsidized product, upland cotton. Both Articles 5(c) and 6.3(c) rely on the term “subsidy,” which Articles 1 and 14 suggest requires identifying the benefit to the recipient. The use of the term “subsidized product” in Article 6.3(c) also requires a complainant to identify that part of the challenged subsidy that benefits the product at issue. Article 6.8 and Annex V, paragraphs 2 and 5, direct the Panel to examine the amount of the subsidization or subsidy in question in order to determine “the existence of serious prejudice.” Thus, Brazil *was* required to identify the amount of the challenged subsidy that benefitted upland cotton in order to establish its claims under Articles 5(c) and 6.3(c).

254. The Panel has no compelling answers for the foregoing interpretation. In fact, as we shall see, the Panel simply ignored the terms “subsidy” and “subsidized product” in Articles 5(c) and 6.3(c), ignored the context provided by Articles 1 and 14 and ignored the express direction to consider the amount of the subsidy in Article 6.8 and Annex V. In rejecting the U.S. argument that Brazil must identify the amount of the subsidy that benefits upland cotton, the Panel primarily interpreted the provisions of Part V of the Subsidies Agreement relating to countervailing duties rather than interpreting Article 6.3(c) in its context.²⁷⁶ It is no surprise, then, that it erred in concluding that Brazil need not identify the amount of the challenged subsidies that benefit upland cotton.

²⁷⁶See Panel Report, paras. 7.1166-7.1177 (interpreting or discussing provisions of Part V in paragraphs 7.1166- 7.1168, 7.1170, 7.1176)

2. Brazil failed to identify the amount of challenged payments decoupled from upland cotton production that benefit upland cotton, and the Panel was precluded from making serious prejudice findings

255. Brazil argued, and the Panel agreed, that it need not identify the amount of the subsidy in question to establish its serious prejudice claims. On this view, a complaining party need not identify whether the amount of the challenged subsidy is \$1 or \$1 billion so long as “the effect” of the subsidy is established. Common sense suggests that examining the nature of the challenged subsidy is not enough; size does matter. In this case, at least, common sense is reflected in the text of the Subsidies Agreement. Articles 5(c) and 6.3(c), read in their context, establish that Brazil must identify the amount of the “subsidy” that “benefits” upland cotton, the “subsidized product.” Article 6.8 and Annex V further establish that to determine the existence of serious prejudice, the Panel should have considered the amount of the subsidization or the subsidy in question.

256. Consistent with its legal interpretation, Brazil failed to identify the amount of the payments decoupled from upland cotton production – that is, counter-cyclical and market loss assistance payments – that benefit upland cotton.²⁷⁷ The Panel, in turn, did not make any finding on the amount of the challenged subsidies.

- For payments not tied to (decoupled from) upland cotton production, the Panel did not make any finding on the amount of the subsidy that benefitted upland cotton. The Panel

²⁷⁷We do note that Brazil offered an in-the-alternative argument that, to the extent the Panel determined it needed to identify the amount of the subsidy in question, it would rely on its Peace Clause calculation with respect to these payments. The Panel did not find that Brazil’s allocation methodology identified the amount of the decoupled payments that benefit upland cotton. The Panel could not have done so because Brazil’s methodology is not based on any text in the Subsidies Agreement, contrary to basic economic principles, internally inconsistent, and is contradicted by available information on the record.

made no suggestion that this amount was small, medium, large, very large, or something else.²⁷⁸

Thus, the Panel *could not have* found that the decoupled subsidies in question caused serious prejudice because Brazil failed to identify the amount of these subsidies benefitting upland cotton. In fact, the Panel made no finding regarding the amount of decoupled subsidies in question to support a finding of serious prejudice.

257. To the extent the Panel considered the support to upland cotton it determined for purposes of the Peace Clause comparison,²⁷⁹ moreover, the Panel committed another legal error by attributing subsidy benefits to upland cotton from payments that were outside its terms of reference. Decoupled payments for upland cotton base acres are, in fact, made to recipients who did not produce upland cotton at all. The uncontradicted facts indicate that approximately 47 percent of farms receiving payments for upland cotton base acres – holding 25 percent of upland cotton base acres)²⁸⁰ – do not plant any upland cotton.²⁸¹

- Therefore, these payments were not made to “producers, users, and/or exports of upland cotton”²⁸² and were outside the Panel’s terms of reference.

²⁷⁸Compare Panel Report, para. 7.1301-7.1302 (no finding relating to the amount of the counter-cyclical or market loss assistance payments) with Panel Report, para. 7.1349 (asserting that “while we do not believe that it is strictly necessarily to calculate precisely the amount of the subsidies in question, we observe that we have readily available information on the record showing us that the price-contingent subsidies in question involve very large amounts of United States government money benefiting United States upland cotton production”).

²⁷⁹See Panel Report, para. 7.582 (calculating total amount of payments in respect of upland cotton base acreage).

²⁸⁰See Panel Report, paras. 7.636, tbl A-1 (indicating that approximately 25 percent of upland cotton base acres are found on farms that do not plant any upland cotton at all).

²⁸¹See Panel Report, paras. 7.623; Comments of the United States of America on the February 18, 2004, Comments of Brazil, para. 26 (March 3, 2004); *id.*, n. 55 (citing Brazil Further Rebuttal Submission, para. 23, which presented data showing that 46, 45, and 45 percent of farms receiving decoupled payments for upland cotton base acres received no upland cotton marketing loan payments (Brazil’s proxy for upland cotton production) in 2000, 2001, and 2002, respectively).

²⁸²WT/DS267/7 (panel request).

- There is no evidence that the Panel took note of this fact or excluded such payments from its analysis.

To the extent these payments to recipients who did not produce upland cotton were included in the Panel’s analysis of the effect of challenged subsidies, the Panel’s finding of serious prejudice for decoupled payments would fail. The Panel would have incorrectly analyzed payments *not* benefitting upland cotton as having effects on upland cotton production.

3. The Panel’s arguments for why it need not find the amount of the challenged subsidies do not withstand scrutiny

258. *The Panel misunderstood the U.S. argument as based on transposing Part V methodologies to Part III:* The Panel rejected what it labelled “the United States argu[ment] that we are under an obligation to precisely quantify the subsidies at issue in our serious prejudice analysis.”²⁸³ It is worth noting at the outset that the Panel overstates the U.S. argument. We did not focus on the *degree of precision* with which the amount of the challenged subsidies must be identified. We did, however, argue that Brazil must “quantify” or identify the “amount of the subsidy” to ensure that a subsidy that benefits products other than upland cotton is not attributed to cotton as well as to allow a panel to determine the existence of serious prejudice. In rejecting that argument, the Panel simply ignored the terms “subsidy” and “subsidized product” in Articles 5(c) and 6.3(c), ignored the context provided by Articles 1 and 14, and ignored the express direction to consider the amount of the subsidy in Article 6.8 and Annex V.²⁸⁴

259. The Panel’s misunderstanding of the U.S. argument – which transformed in the Panel’s mind into an argument that it must “allocat[e] *absolutely precise proportions* of the subsidies to the product concerned”²⁸⁵ – may have stemmed from its view that the U.S. argument that Brazil

²⁸³Panel Report, para. 7.1179.

²⁸⁴See Panel Report, paras. 7.1166-7.1179.

²⁸⁵Panel Report, para. 7.1173 [italics added].

must identify the amount of the subsidy that benefits upland cotton “raise[s] the question of the appropriateness of applying certain relatively precise quantitative and/or ‘countervailing duty’ methodologies and concepts, found in Part V of (or elsewhere in) the *SCM Agreement*, when conducting a ‘serious prejudice’ analysis under Part III.”²⁸⁶ The Panel then spent considerable time determining that “the more precise quantitative concepts and methodologies found in Part V of the *SCM Agreement* are not directly applicable in our examination of Brazil’s actionable subsidy claims under Part III.”²⁸⁷ (Ironically, what the Panel termed the “methodologies found in Part V” are *not* actually found in Part V, particularly the treatment of recurring and non-recurring subsidies, which the Panel accepted.)

260. However, as reflected above, the argument of the United States was *not* that the “methodologies found in Part V” should be applied to Part III; rather, it was that the *text* of Articles 5(c) and 6.3(c), interpreted in the context (as it must be) of Parts I, III, and V and Annex V of the Subsidies Agreement, *required* identifying the amount of the subsidies in question benefitting upland cotton in order to determine the existence of serious prejudice. Therefore, the Panel’s lengthy exposition on the provisions of Part V relating to countervailing duties, simply to conclude that identical provisions do not exist in Part III, was misguided.²⁸⁸ While the Panel claimed that its conclusion was made “[o]n the basis of the text of Part III, and for the reasons that follow,”²⁸⁹ there is no interpretation in this portion of the panel report of the text of Articles 5(c) and 6.3(c) in their context. The Panel’s failure to actually interpret *that* text, and instead to interpret Part V and look for the same words in Part III, was legal error.

261. ***The Panel’s reliance on the consultation provision in Part III is misplaced:*** The Panel spent considerable time dwelling on Article 7.2, which sets out the content of an actionable

²⁸⁶Panel Report, para. 7.1166. *See also* Panel Report, para. 7.1177 (“[W]e decline to transpose directly the quantitative focus and more detailed methodological obligations of Part V into the provisions of Part III of the *SCM Agreement*.”) (footnote omitted).

²⁸⁷Panel Report, para. 7.1167 (footnote omitted).

²⁸⁸*See* Panel Report, paras. 7.1166-7.1177 (interpreting or discussing provisions of Part V in paragraphs 7.1166- 7.1168, 7.1170, 7.1176)

²⁸⁹Panel Report, para. 7.1167.

subsidies consultation request. The Panel derived from this provision the lesson that a serious prejudice analysis “call[s] for a qualitative and, to some extent, quantitative analysis of the existence and nature of the subsidy and the serious prejudice caused.”²⁹⁰ However, as noted above, Article 6.8, in conjunction with Annex V, states that “*the existence of serious prejudice should be determined on the basis of*” certain “information concerning serious prejudice,” which includes “such *information . . . as necessary to establish the . . . amount of subsidization.*” Thus, the Panel’s reliance on Article 7.2 to conclude that it need not consider the amount of the subsidy is misplaced.

262. The Panel also reasoned that under Article 7.3, which expresses that the purpose of consultations is to “clarify the facts of the situation,” the pertinent “facts” logically pertain to the “existence and nature of the subsidy in question,” which is the subject of the first part of a consultation request under Article 7.2.²⁹¹ However, Article 7.3 does not limit “the facts of the situation” to those elements set out in Article 7.2. In fact, Articles 6.8 and Annex V establish that “the facts of the situation” in the case of a serious prejudice claim *include* “the amount of the subsidy in question.” GATT 1994 Article XVI:1, which relates to serious prejudice, requires Members to notify “the *extent* and nature of [any] *subsidization*” [italics added] affecting trade. Annex V also provides procedures in serious prejudice disputes through which a complaining party may obtain information “to establish the . . . amount of subsidization.”

4. Conclusion

263. In sum, the Panel erred as a matter of law in concluding that Brazil need not identify, and the Panel need not find, the amount of the challenged subsidy that benefits the subsidized product, upland cotton, to establish a serious prejudice claim under Articles 5(c) and 6.3(c). Brazil argued that it need not identify the amount of the subsidy in question and therefore failed

²⁹⁰Panel Report, para. 7.1173 (footnote omitted).

²⁹¹Panel Report, para. 7.1174-7.1175.

to identify the amount of the payments decoupled from upland cotton production – that is, counter-cyclical and market loss assistance payments – that benefit upland cotton. In fact, the Panel made no finding regarding the amount of decoupled subsidies in question. Therefore, Brazil did not establish a *prima facie* case of serious prejudice with respect to these payments, and the Panel *could not have* found that the decoupled subsidies in question caused serious prejudice.

E. The Panel Erred in Concluding That It Need not Allocate Subsidies not Tied to Current Production of Upland Cotton (Decoupled Payments) over Recipients' Total Sales

1. Introduction

264. A related legal error was the Panel's conclusion that subsidies not tied to current production of upland cotton (decoupled payments) need not be allocated over the total sales of the recipients.²⁹² In reaching this conclusion, the Panel failed to interpret the text of Articles 5(c) and 6.3(c) in their context. Further, in the absence of a finding of the amount of the decoupled payments that benefit upland cotton using an appropriate methodology, such as that suggested by paragraph 3 of Annex IV, the Panel must have attributed payments that benefit other subsidized products to upland cotton. By failing to identify the amount of decoupled payments benefitting upland cotton, the Panel's serious prejudice finding with respect to counter-cyclical and market loss assistance payments is invalid and must be reversed.

2. The text and context of Articles 5(c) and 6.3(c) require identifying the amount of the subsidy that benefits the subsidized product

265. As explained in the previous section, establishing a serious prejudice claim under Articles 5(c) and 6.3(c) requires identifying the amount of the challenged subsidy that benefits

²⁹²Panel Report, para. 7.1186.

the subsidized product, upland cotton. Both Articles 5(c) and 6.3(c) rely on the term “subsidy,” which Articles 1 and 14 indicate requires identifying the “benefit” conferred. The use of the term “subsidized product” in Article 6.3(c) also requires a complainant to identify the extent of the subsidization of the product at issue by the challenged payments. Finally, Article 6.8 and Annex V, paragraphs 2 and 5, direct the Panel to examine the amount of the subsidization or subsidy in question in order to determine “the existence of serious prejudice.” Thus, Brazil was required to identify the amount of the challenged subsidy *that benefitted upland cotton* in order to establish its serious prejudice claims.

266. The reference in Article 6.3(c) to a “subsidized product” – and similar references in Articles 6.3(d), 6.4, and 6.5 and Annex V, paragraphs 2 and 5 – establish that the challenged subsidy must, in fact, subsidize the product at issue. That is, where a payment is “decoupled” – not tied to the production or sale of a particular product – there must be some allocation of the subsidy to the products a recipient produces or sells. This follows from basic economics: the same dollar payment cannot be deemed to provide one dollar of subsidy to two different products since this would amount to double-counting of the “benefit” provided by that one dollar of subsidy. Brazil does not disagree since its elaborate and illogical “allocation methodology” for purposes of the Peace Clause was precisely an effort to allocate *each* dollar of decoupled payments as “support to” upland cotton *or* some other crop.

3. An allocation methodology to allocate a non-tied subsidy across the products a recipient produces is set out in Annex IV

267. The Panel is right in asserting that Part III of the Subsidies Agreement does not explicitly set out a methodology for determining the amount of a subsidy that is not tied to production or sale of a given product that benefits a particular product. It would be surprising if these provisions *had* gone into such detail. However, that does not mean that the Agreement is silent on this topic. Important context for the term “subsidized product” as used in Article 6.3(c), 6.3(d), 6.4, and 6.5 is found in Annex IV, which sets out methodologies for determining the rate

of “subsidization” of a “product” for purposes of the now-defunct Article 6.1(a). In fact, this is the only allocation methodology that Members have agreed in the Subsidies Agreement. Thus, where an allocation of the subsidy in question is necessary between the “subsidized product” and other products the recipients produce, Annex IV provides essential context.

268. In fact, Annex IV expressly sets out an agreed methodology for determining the amount of a subsidy that is not tied to production or sale of a given product. In such a case, paragraph 2 establishes that “the value of the product” that is subsidized is equal to “the total value of the recipient firm’s sales.”²⁹³ (By way of contrast, where a “subsidy is tied to the production or sale of a given product, the value of the [subsidized] product shall be calculated as the total value of the recipient firm’s sales *of that product*.”²⁹⁴) Thus, Annex IV suggests a methodology for determining the amount of a non-tied subsidy that benefits a given product: the subsidy would be allocated to the product according to the ratio of the value of sales of that product to the total value of the recipient firm’s sales.

269. The United States did not argue that Annex IV was directly applicable to a serious prejudice claim under Article 6.3(c).²⁹⁵ We did argue that an allocation methodology was necessary to determine the amount of the decoupled subsidies in question that benefitted upland cotton, according to the text and context of Articles 5(c) and 6.3(c). We further argued that this allocation methodology must make economic sense by recognizing that a payment that is not tied to the production or sale of a given product benefits all of the products the recipient produces. Allocating such a non-tied payment exclusively to one product over another would be economically arbitrary. Annex IV indicates an economically neutral methodology to allocate the benefits of non-tied subsidies to which Members have agreed.

²⁹³Subsidies Agreement, Annex IV, para. 2 (footnote omitted).

²⁹⁴Subsidies Agreement, Annex IV, para. 3 [italics added].

²⁹⁵Panel Report, para. 7.1185.

270. Annex V provides further contextual support for the notion that allocating a subsidy across the total value of the recipient firm’s sales may be necessary in a given case. Paragraph 2 establishes that “information concerning serious prejudice” includes “such information . . . as necessary to establish the . . . amount of subsidization, *the value of total sales of the subsidized firms*, as well as information necessary to analyze the adverse effects caused by the subsidized product” [italics added]. We recall that the footnote following the phrase “information necessary to analyze the adverse effects caused by the subsidized product” expressly states “[i]n cases where the existence of serious prejudice has to be demonstrated,” which would exclude claims under the expired Article 6.1(a) where only the *ad valorem* rate of subsidization had to be shown. However, the phrase “such information . . . as necessary to establish . . . the value of total sales of the subsidized firms” is *not* limited to any particular case, for example, disputes under Article 6.1(a) where the provisions of Annex IV were directly applicable.

271. Indeed, paragraph 5 of Annex V contains a further reference to information that “shall be submitted to the Panel,” which includes “the amount of the subsidy in question (and, where appropriate, the value of total sales of the subsidized firms).” Two points can be drawn from this text.

- First, it is significant that the phrase “value of total sales of the subsidized firms” is expressed as a parenthetical to “the amount of the subsidy in question,” suggesting that the amount in question may depend on the allocation of the payment across the recipients’ total sales.
- Second, the phrase “where appropriate” is not limited to claims under the expired Article 6.1(a), where the provisions of Annex IV were directly applicable. Rather than referencing Article 6.1(a) or the provisions of Annex IV (as in footnote 14 in the Subsidies Agreement), the use of the phrase “where appropriate” suggests that the “value of total sales of the subsidized firms” may be “appropriate” in other circumstances in order to identify “the amount of the subsidy in question.”

Thus, paragraphs 2 and 5 of Annex V provide further contextual support for the notion that allocating a subsidy across the total value of the recipient firm’s sales could be necessary to determine the amount of the subsidy in question, a fundamental step in establishing a serious prejudice claim. Indeed, such an allocation methodology is “appropriate” where a challenged subsidy is not tied to the production or sale of a given product.

4. The Panel erred as a matter of law in finding that Brazil need not allocate non-tied subsidies to all of the products the recipients produce, and the Panel therefore could not find that such decoupled payments caused serious prejudice

272. In light of the text of Articles 5(c) and 6.3(c), read in all of its context, the Panel erred as a matter of law in concluding that Brazil need not allocate non-tied subsidies to all of the products the recipients produce in order to identify the amount of the subsidy in question that benefits upland cotton. Further, we recall that the Panel appears not to have made *any* finding with respect to the amount of the decoupled payments it examined for purposes of Brazil’s serious prejudice claim. It is not possible to make a finding that the effect of the subsidy is serious prejudice without first identifying the amount of the subsidy.

273. Brazil needed to advance evidence and arguments sufficient to make its case, which included identifying the amount of the decoupled subsidies that benefitted upland cotton.²⁹⁶

- Brazil failed to bring forward evidence and arguments to allow non-tied payments to be allocated according to a neutral methodology, such as that set out in Annex IV – for example, Brazil never provided evidence relating to “the total value of the recipient firm[s’] sales.”

²⁹⁶See, e.g., U.S. Answer to Panel Question 256, paras. 183-186 (December 22, 2003); U.S. Comments on the Comments of Brazil to U.S. Data Submitted on December 18 and 19, 2003, paras. 22-34 (February 11, 2004).

- In the ongoing discussion in the Negotiating Group on Rules, Brazil has proposed that Members adopt a “guideline” on calculating the amount of the subsidy for countervailing measures precisely along these lines: “If the benefit of a subsidy is limited to a particular product, the denominator should reflect only sales of that product. If this is not the case, the denominator should be the recipient’s total sales.”²⁹⁷
- In this regard, we note that Brazil never explained why it would make economic sense and be consistent with the Subsidies Agreement to allocate a non-tied subsidy across the total value of the recipient firms’ sales for purposes of countervailing measures and Part V – *as Brazil proposes all Members should*²⁹⁸ – but not for purposes of serious prejudice and Part III.

Therefore, Brazil failed to identify the amount of the decoupled subsidies that benefitted upland cotton, and the Panel could not make a serious prejudice finding with respect to counter-cyclical and market loss assistance payments.

274. In closing, we note that Brazil and the Panel’s approach ignores the economic reality that decoupled payments benefit all of the recipient’s sales. By failing to employ a neutral allocation methodology that recognizes this commonsense point, the Panel must have attributed subsidy payments that benefit *other* subsidized products to upland cotton. By assuming that 100 percent of these decoupled subsidies benefitted upland cotton, the Panel relieved Brazil of its burden of proof. Thus, the Panel’s failure to find the amount of decoupled payments benefitting upland cotton invalidates its serious prejudice finding with respect to counter-cyclical and market loss assistance payments.

²⁹⁷See U.S. Further Rebuttal Submission, para. 12 (November 18, 2003) (citing Paper by Brazil, Countervailing Measures: Illustrative Major Issues, TN/RL/W/19, at 6 (7 October 2002)).

²⁹⁸In fact, some Members, such as the European Communities, already do. See U.S. Further Rebuttal Submission, para. 12 n.4 (November 18, 2003) (citing EC Guidelines for the Calculation of the Amount of Subsidy in Countervailing Duty Investigations, OJ C 394/6, at 13 (17 December 1998) (“If the benefit of a subsidy is limited to a particular product, the denominator should reflect only sales of a product. If this is not the case, the denominator should be the recipient’s total sales.”)).

F. The Panel Erred in Making Serious Prejudice Findings with respect to Past Recurring Subsidies That No Longer Existed

1. Introduction

275. In this dispute, Brazil challenged annually recurring subsidy payments not only with respect to the marketing year underway at the time of its panel request and panel establishment, but also with respect to past recurring subsidy payments that related to marketing years 1999-2001 (that is, between the period August 1, 1999 - July 31, 2002). The United States requested the Panel to find that no serious prejudice findings could be made with respect to these past recurring subsidies. Because those subsidies are allocated (“expensed”) to the marketing year to which they relate and benefit production in that year, there is no benefit, and therefore no subsidy exists, in a subsequent marketing year. In that subsequent year, a new annually recurring subsidy payment is made and could be subject to challenge (in the present case, the marketing year 2002 payments).

276. The Panel rejected this view of annually recurring subsidies. In so doing, the Panel made two related legal errors.

277. First, the Panel erroneously concluded that the payments need not be allocated to the marketing year to which they relate (that is, need not be “expensed”), despite the fact that the Panel fully (and appropriately) expensed those payments to their respective marketing years for Peace Clause purposes. Thus, the Panel could not have found that the effect of those past subsidy payments “is” significant price suppression and present serious prejudice because those subsidies for marketing years 1999-2001 no longer existed at the time of panel establishment.

278. Second, the Panel never found (as Brazil had alleged) that the past recurring subsidy payments at issue (that is, those from marketing years 1999-2001) had continuing effects at the

time of panel establishment, such that “the effect of” those expired payments “is” significant price suppression. Thus, in the absence of a finding that past recurring subsidy payments had continuing effects, the Panel erred in making a finding of present serious prejudice related to past recurring subsidy payments.

279. As a result, the Panel erred in making serious prejudice findings with respect to the annually recurring subsidy payments at issue – marketing loan payments, Step 2 payments, counter-cyclical payments, and market loss assistance payments – for marketing years 1999-2001. The United States first explains the proper allocation of subsidy benefits for annually recurring subsidy payments, then turns to each legal error by the Panel.

2. Annually recurring subsidies cannot benefit a subsequent year’s production and should be allocated (expensed) to the marketing year to which they relate

280. Brazil’s claims with respect to annually recurring subsidies provided with respect to past marketing years (1999-2001) raises the question of how subsidies should be allocated over time. This issue arises because a subsidy does not exist in perpetuity; rather, Article 1 establishes that a constituent element of a subsidy is that it confers a benefit.²⁹⁹ Thus, if a past subsidy payment no longer provides a benefit, the “subsidy” ceases to exist within the meaning of the Subsidies Agreement.

281. The issue of for what period of time a subsidy confers a benefit is not handled with great precision in the Agreement. Nonetheless, in basic economic terms, if a payment recurs annually and could be deemed to affect a recipient’s production decisions or subsidize a product in a given year (“recurring” subsidies), it would make sense to allocate the benefit of that payment to that particular year. On the other hand, if the payment is such that its benefits could be deemed to

²⁹⁹Subsidies Agreement, Article 1.1(b).

extend over time and continue to affect production decisions (“non-recurring” subsidies), it would make sense to allocate the benefit of that payment over time.

282. Several sources provide contextual support for this interpretation. For example, Annex IV, paragraph 7, provides:

- “Subsidies granted prior to the date of entry into force of the WTO Agreement, *the benefits of which are allocated to future production*, shall be included in the overall rate of subsidization” (emphasis added).

The italicized phrase indicates that the drafters took it for granted that the benefits of certain subsidies should be allocated to future production, and, for them, the only question was whether this principle should extend to subsidies provided before the WTO Agreement entered into force.

283. That the drafters took the principle of allocation over time for granted is not surprising. The concept is long-standing and familiar in the subsidies and antidumping duty context. Other supporting sources include:

- The Tokyo Round Subsidies Code Committee adopted *Guidelines on Amortization and Depreciation*, the first sentence of which states: “Certain subsidies exist which should be spread over time.”³⁰⁰
- Article 2.2.1.1 of the *Agreement on Implementation of Article VI of the General Agreement on Tariffs and Trade 1994* (“Antidumping Agreement”), which deals with the calculation of cost of production, singles out “*non-recurring items of cost which benefit future and/or current production*” [italics added].

³⁰⁰SCM/64, BISD 32S/154, para. 1 (April 25, 1985).

- In *US - Lead Bar II*, the Appellate Body found that it was permissible for an investigating authority in a countervailing duty proceeding to rely on a rebuttable presumption “that a ‘benefit’ continues to flow from an untied, *non-recurring* ‘financial contribution’” [italics added].³⁰¹ Thus, the Appellate Body has acknowledged that “non-recurring” subsidies may be allocated over time.
- The *Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures*, G/SCM/W/415/Rev. 2 (15 May 1998), recommends that certain subsidies be expensed to the year of receipt and that the benefits from other subsidies be allocated over time.³⁰²

Thus, although the Subsidies Agreement does not expressly identify those subsidies “the benefits of which are allocated to future production,” these additional sources suggest that subsidies that are “non-recurring” should be allocated over time, while subsidies that are “recurring” should be expensed to the year to which they relate.³⁰³

284. If subsidy benefits are *not* allocated to future production, they must be expensed – that is, allocated to production in the time period during which the subsidy is received.

³⁰¹Appellate Body Report, *U.S. – Certain Hot-Rolled Steel Products*, para. 62.

³⁰²The Group recommended that, as a general proposition, recurring subsidies be expensed and non-recurring subsidies be allocated. See Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures, G/SCM/W/415/Rev. 2 (15 May 1998), Recommendation 1 & paras. 1-12. The Informal Group also specifically recommended that price support payments generally be expensed. See *id.*, Recommendation 1. In making these recommendations, the Informal Group follows the logic noted above: where there are not reasons to allocate subsidy benefits to future production, the subsidy must be expensed, and once the benefit was exhausted in the time period during which the subsidy is received, the subsidy ceased to exist. See, e.g., *id.* para. 12 (“Whether a subsidy is oriented towards production in future periods, consists of equity, or is carried forward in the recipient’s accounts were viewed as related to the question whether its benefits persist beyond a single period, and hence whether it should be allocated to future periods.”).

³⁰³Indeed, Brazilian, EU, and U.S. countervailing duty practice all employ this very distinction between recurring and non-recurring subsidies. See U.S. Further Rebuttal Submission, paras. 22-24 (November 18, 2003).

- Thus, in the context of this dispute, a subsidy the benefits of which are expensed to production/sales in 2001 cannot be said to be causing serious prejudice in 2002 because the subsidy has ceased to exist. The “benefit” – one of the constituent elements of a “subsidy” under Article 1 – was used up in 2001. Once the benefit was exhausted, the subsidy ceased to exist.

Because the recurring subsidies provided in each of marketing years 1999, 2000, and 2001 ceased to exist when the benefit was used up for production in those years, the effect of those subsidies cannot be the subject of subsidies claims in marketing year 2002. Thus, these past payments could not form part of Brazil’s present (marketing year 2002) serious prejudice claims nor the Panel’s findings.

285. Consider a hypothetical situation in which annually recurring subsidies were provided through marketing year 1999 and then stopped. Could a complaining party bring an action in marketing year 2002 alleging serious prejudice? If the subsidy was, in fact, recurring, then it benefitted production in marketing year 1999 and could not also benefit production in marketing year 2002. That is, there could be no adverse effects in marketing year 2002 because no subsidy benefit exists. On the other hand, if the subsidy could be deemed to be benefitting production in marketing year 2002, it would properly be characterized as a non-recurring subsidy. It could then be challenged in marketing year 2002 because part of the subsidy benefit would have been allocated to future production, including production in marketing year 2002.

3. The Panel erred by failing to expense the challenged recurring subsidies

286. *The Panel’s explanation for not expensing the challenged recurring subsidies does not withstand scrutiny:* Against the foregoing interpretation, the Panel has only this rejoinder:

If the text of Part III of the agreement imposes no such general requirement to quantify the overall amount of the subsidy, then it also, logically, cannot impose any more precise conceptual or methodological requirements. Thus, we find no textual support in the serious prejudice provisions in Part III for the United States argument that annually recurring subsidies must be “expensed” to one year alone, so that the “benefit” of the measure does not survive past that year. The concept of “benefit” is a definitional element of a subsidy pursuant to Article 1.1(a)(2) of the SCM Agreement. Inasmuch as we are not required to calculate an amount of “benefit”, we cannot logically be required to conduct any sort of precise “expensing” of the “benefit”.³⁰⁴

There are several errors in the Panel’s statement.

287. First, as explained previously, the text of Articles 5(c) and 6.3(c), read in their context, do require that the amount of the subsidy that benefits upland cotton be identified in order to determine whether serious prejudice results from the subsidy. Therefore, the premise to the Panel’s first sentence is false.

288. Second, the Panel states that it finds no text that requires annually recurring subsidies to be expensed so that the benefit would not survive past that year. However, the very notion of a “benefit” raises the question of whether and how long the benefit exists. Brazil provided no evidence beyond mere assertion that subsidy payments for past marketing years have ongoing effects, currently causing serious prejudice. The Panel has not provided *any* analysis or made any findings that suggest that the benefits of these annually recurring subsidies should be “allocated to future production” (in the words of Annex IV, paragraph 7). In fact, both parties and the Panel treat these recurring subsidies as fully expensed in the year to which they relate.

³⁰⁴Panel Report, para. 7.1179 (footnote omitted).

289. Third, the Panel’s statement that “[i]nasmuch as we are not required to calculate an amount of ‘benefit’, we cannot logically be required to conduct any sort of precise ‘expensing’ of the ‘benefit’” is flawed. The Panel *is* required to calculate an amount of benefit – that is, the amount of the subsidy in question that benefits the subsidized product, upland cotton. Moreover, *even if* the Panel were *not* required to calculate an amount of benefit, it does not follow that it would not be necessary to determine *how long* the benefit exists. As the Panel notes, a “benefit” is a definitional element of a “subsidy” under Article 1. The Appellate Body has already recognized that it is necessary in certain situations to analyze whether a subsidy has “passed through” to a purchaser. This pass-through analysis requires examining whether there is any longer a benefit. Similarly, if the benefit for a subsidy provided for marketing year 1999 no longer exists in marketing year 2002, then no subsidy exists in marketing year 2002 to cause serious prejudice, whatever the amount of subsidy in marketing year 1999. There could be no “effect of the subsidy” in marketing year 2002 because there is no “subsidy” in that year. Thus, the Panel should have determined whether to expense these annually recurring payments or to allocate their benefits to future production.

290. ***The challenged payments are recurring and those for past years no longer existed and could not be causing serious prejudice:*** There is no question in this dispute that the challenged payments are annually recurring subsidies. Brazil has conceded the point,³⁰⁵ and the Panel agrees.³⁰⁶ Moreover, we note that Brazil allocated the entire amount of the payments for a given marketing year to that year’s production for purposes of its economic model estimating the effect of the subsidies in each year between marketing year 1999-2002.³⁰⁷ Thus, Brazil and the Panel implicitly concede that these annually recurring subsidies are appropriately expensed to the year

³⁰⁵For example, Brazil’s allocation methodology, which it argues can apply for both Peace Clause and serious prejudice purposes, allocates decoupled payments for marketing year 1999 solely to marketing year 1999. The methodology does not allocate any portion of those marketing year 1999 payments to future production.

³⁰⁶Brazil and the Panel allocated these payments in full to the marketing year for which they were given for purposes of the Peace Clause analysis of the “support” that current measures “grant.” *See, e.g.*, Panel Report, para. 7.596 (table showing comparison of support using budgetary outlays for each of the 1999-2002 marketing years).

³⁰⁷Brazil’s Further Submission, Annex I, paras. 27 - 61 (description of modeling of programs, applying subsidies for each crop year to that crop year).

to which they relate. The subsidy benefit of such payments then exists only in that marketing year, and that subsidy would not benefit a subsequent year’s production.

291. Thus, the Panel erroneously concluded that the payments need not be allocated to the marketing year to which they relate. Because these payments are made annually with respect to a particular marketing year, they are appropriately expensed to, and therefore deemed to be used up in, that marketing year. Thus, the Panel could not have found that “the effect of the subsidy” – that is, past recurring payments – “is” significant price suppression and present serious prejudice because those subsidies for marketing years 1999-2001 no longer conferred a benefit – and therefore were not longer “subsidies” within the meaning of the Subsidies Agreement – at the time of panel establishment.

4. The Panel did not find, and could not have found, that past recurring subsidy payments had continuing effects

292. Brazil alleged continuing effects from these past payments despite its concession that these subsidies were recurring.³⁰⁸ The United States does not believe that past recurring subsidy payments could have continuing effects within the meaning of Articles 5(c) and 6.3(c) because those payments were no longer conferring a “benefit” and therefore were no longer “subsidies” within the meaning of the Subsidies Agreement.

- However, even if past subsidies that have ceased to exist could have continuing effects, the Panel never found that the past recurring subsidy payments at issue (that is, those from marketing years 1999-2001) did, in fact, have continuing effects at the time of panel establishment.

³⁰⁸See Brazil’s Further Submission, paras. 193-96 (September 9, 2003).

That is, the Panel never found that “the effect of” those past payments (that no longer conferred a benefit) “is” significant price suppression. In fact, the Panel’s finding of significant price suppression “in the period MY 1999-2002” suggests that it found that the payments it *expensed* to past marketing years had effects *in those marketing years*. It does not suggest that they could also have effects in subsequent marketing years. Thus, Brazil alleged that past recurring subsidy payments “have caused and continue to cause”³⁰⁹ serious prejudice through continuing effects, but the Panel did not so find. Without such a finding (which itself would have been legal error), the Panel could not have found that past recurring subsidy payments were causing present serious prejudice.

293. We note that the Panel in its report appeared to countenance the possibility that a subsidy that no longer exists could continue to have an effect: “Subsidies granted under expired measures may have had adverse effects at the time they were in effect, and may still have lasting adverse effects.”³¹⁰ However, the Panel does not explain how this is so.

- If such past payments “still have lasting adverse effects,” they must be continuing to affect current production of the subsidized product. In that case, they would be *non-recurring subsidies*, such as investment subsidies or equity infusions, allocated to future production.
- However, if payments affect production in a given year and subsidize products in a given year, then those payments are recurring subsidies and will not “still have lasting adverse effects” in later years. As noted earlier, there can be no “effect of the subsidy” in a later year because no “subsidy” still exists.

³⁰⁹See, e.g., Brazil’s Further Submission, section 3 (September 9, 2003) (heading).

³¹⁰Panel Report, para. 7.1201. The footnote to this sentence cites to “Panel Report, *Indonesia - Autos*, para. 14.206.”

294. We note that, even if the Panel had made a finding with respect to crop years before marketing year 2002, such a finding would have lacked a legal basis under the WTO Agreement. Under Article 5(c) and 6.3 of the Subsidies Agreement, Brazil’s burden of proof required it to demonstrate what “the effect of the subsidy is.” As the terms of reference of the Panel were established in marketing year 2002, Brazil was obligated to show (and the Panel obligated to examine) was the “effect of the subsidy is” in that marketing year.

295. However, as already explained, because the recurring subsidies provided in each of marketing years 1999, 2000, and 2001 ceased to exist when the benefit was used up for production in those years, they could not also benefit production in marketing year 2002. Thus, such past payments could not form part of Brazil’s subsidies claims.

296. It follows that the Panel could not make findings with respect to payments in such past marketing years. For example, under DSU Article 11, a panel’s task is to make an objective assessment of the “matter before it, including an objective assessment of ... the applicability of and conformity with the relevant agreements,” and the “matter” comprises the complaining party’s measures and claims.³¹¹ A panel’s task does not extend to making findings of conformity outside the “matter before it”, and therefore this Panel could not make findings in respect of payments that could not form part of Brazil’s claims. Furthermore, DSU Article 19.1 provides that “[w]here a panel or the Appellate Body concludes that a measure *is inconsistent* with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement [footnotes omitted and emphasis added].” Panels are not authorized to make recommendations about a measure that, because it no longer exists, is no longer inconsistent with the WTO Agreement (regardless of whether it in fact ever was).³¹²

³¹¹See, e.g., Appellate Body Report, *Guatemala Cement*, para. 72.

³¹²See also Section VIII(C) below.

297. It bears noting that there would not be any utility to making findings on claims regarding expensed payments from past years since no remedy would be available: those subsidies have already ceased to exist and therefore cannot be withdrawn and no longer could be having adverse effects.

298. The United States would like to make clear, however (as it also explained to the Panel), that the foregoing analysis does not mean that market conditions or payments made during marketing years 1999, 2000, and 2001 were necessarily irrelevant to the Panel's work. For example, to the extent payments made in marketing year 2002 are similar in structure or operation to past payments, evidence relating to those past payments could provide useful context for understanding the operation and effect of current (*i.e.*, marketing year 2002) subsidies. Similarly, market conditions in past marketing years could provide useful context for understanding current and projected market conditions and alleged effects of challenged payments. However, *using evidence* with respect to past marketing years is different from *considering claims and making findings* with respect to payments expensed in those years.

5. Conclusion: The U.S. interpretation does not preclude challenges to all past payments nor to recurring subsidies generally

299. The Panel appears to have been concerned that precluding claims against the payments (such as the challenged payments for previous marketing years) would somehow prevent any serious prejudice challenges from being made. This is incorrect. If a past payment is non-recurring, the simple fact that it was made in the past (for example, in a previous year) does not shield it from challenge. Rather, that portion that is allocated to future production is susceptible to challenge. The "amount of the subsidy in question" for a given year would be the amount of the total subsidy that is allocated to that year – that is, the portion that benefits the current year's production. Thus, under the U.S. interpretation of Articles 5(c) and 6.3(c), non-recurring subsidies paid in the past are susceptible to serious prejudice challenge.

300. With respect to recurring payments for past marketing years, because the subsidy no longer exists, no serious prejudice challenge can be brought. There would not be any utility to making findings on claims regarding expensed payments from past years since no remedy would be available: those subsidies have already ceased to exist and therefore cannot be withdrawn and no longer could be having adverse effects. However, the recurring subsidies for the year in which the panel is established *are* subject to challenge. Moreover, with respect to *future* years, a complaining party could bring (as Brazil did) a challenge to a subsidy program “as such” or a claim of threat of serious prejudice. Thus, the U.S. interpretation of Articles 5(c) and 6.3(c), read in the context of Article 1 and Annex IV, would not shield recurring subsidies from meaningful challenge and disciplines.

G. The Panel erred in failing to determine the extent to which processed cotton benefitted from subsidies provided with respect to raw cotton

301. Another error committed by the Panel was that it failed to determine – and excused Brazil from having to demonstrate – the extent to which processed cotton benefits from subsidies provided with respect to raw cotton.³¹³ This was a significant error, because many of the subsidies at issue are paid to producers of raw cotton that is processed and sold before being traded.³¹⁴ Whether a subsidy to cotton producers can properly be attributed to processed cotton depends upon the facts of the case. For example, a subsidy to a cotton producer cannot be attributed to processed cotton produced by an independent processor, unless it can be demonstrated that all, or some portion, of the subsidy benefit passed through to the processor. Accordingly, absent a detailed analysis of the facts, the Panel could not find that sales of processed cotton had any adverse effects.³¹⁵ Put differently, the fact that raw cotton is a

³¹³ Panel Report, para. 7.1180-7.1181.

³¹⁴Marketing loan payments and crop insurance payments are paid to cotton farmers who plant or produce cotton. Step 2 payments are paid to domestic mills or exporters of processed cotton. Production flexibility contract payments, market loss assistance payments, direct payments, and counter-cyclical payments were and/or are paid to holders of base acres, who may or may not be farmers producing cotton.

³¹⁵ Similarly, the effect of the subsidy would presumably be affected if only part of it passed through to the recipient. However, the Panel made no findings in this connection either.

“subsidized product” does not provide a basis to *assume* that processed cotton is a subsidized product. However, Brazil made no showing, and the Panel made no findings, regarding whether there was a factual basis to find that the benefit to the direct recipient of the subsidy – the cotton producer – flowed to the cotton processor.

302. The Panel acknowledged the possible relevance of a pass-through analysis.³¹⁶ It even quoted from the relevant Appellate Body report – *US – Softwood Lumber IV* – and stated that the principles identified by the Appellate Body related to the definitional elements of a subsidy.³¹⁷ However, the Panel brushed all of this off with the pronouncement that “again, the textual distinctions between Parts III and V lead us to believe that while the countervailing ‘pass-through’ principles may well be relevant, they are not directly applicable to our examination of serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*.”³¹⁸

303. Presumably, by the use of “again,” the Panel was referring to its theory that because this dispute involved a claim of serious prejudice under Part III of the *Subsidies Agreement*, the Panel did not need to determine the amount of the subsidy that benefits the subsidized product. Rather, the Panel improperly assumed that 100 percent of the subsidy provided to producers of the input passed through to producers of the processed product. However, there was no basis for this assumption.

304. The Panel erred in dismissing the relevance of the *US – Softwood Lumber IV* dispute. As the Appellate Body explained in that dispute, the question is: “Where the producer of the input is not the same entity as the producer of the processed product, it cannot be presumed, however, that the subsidy bestowed on the input passes through to the processed product.”³¹⁹ As the Appellate Body further explained:

³¹⁶ Panel Report, para. 7.1181 (“These principles ... are also of relevance to our examination ...”).

³¹⁷ Panel Report, para. 7.1180-7.1181.

³¹⁸ Panel Report, para. 7.1181.

³¹⁹ Appellate Body Report, *US – Softwood Lumber IV*, para. 140.

This interpretation is also borne out by the general definition of a “subsidy” in Article 1 of the SCM Agreement. According to that definition, a subsidy shall be deemed to exist only if there is both a financial contribution by a government within the meaning of Article 1.1(a)(1), and a benefit is thereby conferred within the meaning of Article 1.1(b). If countervailing duties are intended to offset a subsidy granted to the producer of an input product, but the duties are to be imposed on the processed product (and not the input product), it is not sufficient for an investigating authority to establish only for the input product the existence of a financial contribution and the conferral of a benefit to the input producer. In such a case, the cumulative conditions set out in Article 1 must be established with respect to the processed product, especially when the producers of the input and the processed product are not the same entity. The investigating authority must establish that a financial contribution exists; and it must also establish that the benefit resulting from the subsidy has passed through, at least in part, from the input downstream, so as to benefit indirectly the processed product to be countervailed.³²⁰

305. In other words, the Appellate Body was relying on the *definition* of a subsidy in determining that it cannot be presumed that a subsidy to an input passed through in arm’s-length sales to a processor. The definition is not unique to part V, and the Panel erred concluding that the pass-through principle does not apply to Part III.

306. Accordingly, the Panel made no findings, and did not require Brazil to submit any evidence, concerning the pass-through issue, despite the fact that the United States called it to the Panel’s attention. As a result, the Appellate Body should reverse the Panel’s conclusion that Brazil need not establish, and the Panel need not find, the extent to which subsidies provided to producers of raw cotton could properly be attributed to processors. Furthermore, in the absence

³²⁰Appellate Body Report, *US – Softwood Lumber IV*, para. 142.

of such findings, the Panel could not find that the measures at issue caused serious prejudice to the interests of Brazil.

H. The Panel erred in interpreting the phrase “same market” in Article 6.3(c) as including a “world market”

307. The Panel erroneously interpreted the phrase “in the same market” in Article 6.3(c) as including a “world market.” A proper interpretation of the phrase “in the same market” indicates that the price suppression must result in a market in which both the subsidized product and the like product are found. The Panel’s interpretation would allow a finding of significant price suppression in the same world market even if the subsidized product did not compete in any particular market with the complaining party’s product.

308. The Panel’s interpretation of “in the same market” also cannot be reconciled with its own interpretation of “world market” in the context of Article 6.3(d) since the Panel’s own findings demonstrate that the alleged “world market” price does not prevail throughout that “market.” Finally, the Panel never found that U.S. and Brazilian upland cotton competed in any “world market” during the period in question, which follows from its own findings concerning different conditions of competition in different third-country markets.

1. The text and context of Article 6.3(c) do not support the Panel’s interpretation of “in the same market” as including a “world market”

309. *Text of Article 6.3(c):* Article 6.3(c) establishes that serious prejudice may arise in any case where “the effect of the subsidy is a significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market or significant price suppression, price depression or lost sales in the same market.” The Panel interpreted the phrase “in the same market” to allow for significant price suppression to be demonstrated in the “world market.” However, in reaching this interpretation, the Panel interpreted the word

“market” but failed to interpret the word “same” at all.³²¹ A valid interpretation of the phrase “in the same market” must give meaning to *all* of the words in the text.

310. “Market” means “[a] place or group with a demand for a commodity or service”³²² or, in the Panel’s preferred meaning, “the area of economic activity in which buyers and sellers come together and the forces of supply and demand affect prices.”³²³ “Same” means “[i]dential with what has been indicated in the preceding context” and “previously alluded to, just mentioned, aforesaid.”³²⁴ In the context of Article 6.3(c), the market that is “[i]dential with what has been indicated in the preceding context” could be that market in which there is “significant price undercutting by the subsidized product as compared with the price of a like product of another Member” or simply that market in which the subsidized product and the like product are found. The latter would appear to be the better interpretation because the phrase “significant price suppression, depression, or lost sales” is preceded by the word “or,” signifying that the second group of effects may be found without a finding of “significant price undercutting.” Thus, as Brazil recognized, Brazil may only advance claims with respect to those markets in which U.S. upland cotton and Brazilian cotton are both found.³²⁵

311. On its face, the Panel’s interpretation that the “same market” can be a “world market” appears contradictory. One can speak of a “same” regional or national market because there are “other” regional or national markets where the subsidized and like product may (or may not) compete. One cannot speak of a “same” world market in the same way because there is no “other” world market where the products can be found.

³²¹Panel Report, paras. 7.1236-7.1244.

³²²*The New Shorter Oxford English Dictionary*, vol. 1, at 1699 (1993 ed.).

³²³Panel Report, para. 7.1236. The Panel found this preferred definition in the “Merriam-Webster Dictionary online.”

³²⁴*The New Shorter Oxford English Dictionary*, vol. 2, at 2678 (1993 ed.).

³²⁵*See, e.g.*, Brazil’s Answer to Question 233 from the Panel, para. 113 (“[T]hese indices are benchmarks for prices *in those ‘same markets’ where U.S. and Brazilian cotton were exported . . .*”) (emphasis added).

312. In rejecting the U.S. argument that Brazil’s reading renders the “same market” phrase inutile since the products of both the complaining and responding parties will always be in the “world,” the Panel contradicted its own analysis. The Panel stated that “the world market *is* a geographic market,” and therefore “competition exists between Brazilian and United States upland cotton.”³²⁶ Logically, U.S. exports to that “market,” the world, must compete with Brazilian exports to that “market.” However, the Panel earlier explained:

“This would not, however, permit, for example, coupling an examination of Brazil’s product under the conditions of competition prevailing in one Member’s market with an examination of the United States’ product under the conditions of competition prevailing in *another* Member’s market.”³²⁷

While we *agree* with the Panel that the conditions in each such “same market” would have to be examined separately, the Panel here implicitly concedes that there cannot plausibly be a “same” world market within the meaning of Article 6.3(c).

313. If there *is* a “same” world market that is “the area of economic activity in which buyers and sellers come together,” then that area (the world) must share the same conditions of competition. If the conditions of competition in each national market are *different* and must be examined separately, however, then there *cannot* be a “same” world market with the same conditions of competition throughout. Theoretically, it may be possible for a panel to undertake a market-by-market analysis and conclude that, in fact, the same conditions of competition exist in *every* Member’s market, but we view such a possibility as highly implausible (and, in this case, impossible given the Panel’s own factual findings).

³²⁶Panel Report, paras. 7.1252, 7.1251.

³²⁷Panel Report, para. 7.1248.

314. The Panel's interpretation would allow the possibility that, if a panel finds that there is a "world market," one Member could be deemed to have caused significant price suppression in that world market *even if* that Member's exports go to completely different national markets than those of the complaining party. Indeed, under the Panel's interpretation, a Member could be deemed to have caused significant price suppression in a world market even if the Member did not export at all. Either outcome would read the word "same" out of the phrase "in the same market" in Article 6.3(c). At a minimum, each Member's market is affected by border measures that may be in place, such as tariffs, that would mean it cannot be presumed that the pricing in one market is the same as the pricing in another market.

315. The point is further illustrated by considering another of the effects under Article 6.3(c), "lost sales in the same market." The Panel's interpretation would mean that a complaining party could advance a claim with respect to a lost sale anywhere in the "world," even if the responding party did not export to the particular market in which the lost sale occurred. Such a result would render the "in the same market" language superfluous. The logical outgrowth of the Panel's interpretation is that a complaining party must simply show "lost sales" because those lost sales necessarily occurred somewhere in the "world." Or, to put it another way, any showing of lost sales will necessarily mean a party has shown lost sales in the "world market." The Panel's interpretation reads the "in the same market" language out of the Agreement.

316. **Context in Article 6.6 and Annex V:** The Panel's interpretation also does not make sense of important context for Article 6.3(c). Article 6.6 states that "[e]ach Member *in the market of which* serious prejudice is alleged to have arisen shall . . . make available . . . all relevant information . . . as to the changes in market shares of the parties to the dispute as well as concerning *prices of the products involved*" (emphasis added). This provision makes clear that a "each Member" is a "market" for purposes of serious prejudice. If the "world" could be a "market" for purposes of Article 6.3, moreover, Article 6.6 read literally would oblige *every* WTO Member to provide data on market share and prices since every Member would be a

“Member in the market of which serious prejudice is alleged to have arisen.” The Panel ignores this implication of its interpretation.³²⁸

317. Annex V similarly suggests that the “same market” must be an area with the same conditions of competition, be it the market of the subsidizing Member or a third-country. For example, where Article 7.4 has been invoked, “any third-country Member concerned” – for example, any Member in whose market significant price suppression is alleged to have occurred – “shall notify to the DSB” the organization responsible for responding to information requests and the procedures to be used to comply.³²⁹ Furthermore, the information gathered during the information-gathering process “should include, *inter alia*, data concerning . . . prices of the subsidized product, prices of the non-subsidized product, prices of other suppliers *to the market*, changes in the supply of the subsidized product *to the market in question* and changes in market shares.”³³⁰ Again, these provisions suggest (as does Article 6.6) that Article 6.3(c) is directed at particular markets where competition exists between Brazilian and U.S. upland cotton.

2. The Panel’s interpretation that the “world market” can be a “same market” contradicts its reading of “world market” under Article 6.3(d)

318. The Panel fails to reconcile its interpretation that the “same market” under Article 6.3(c) can be a “world market” with its reading of the phrase “world market” under Article 6.3(d). In pertinent part, Article 6.3(d) reads: “[T]he effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity.” The Panel correctly interpreted the term “world market” as a “geographic term inclusive of *all*

³²⁸Panel Report, para. 7.1250-7.1251 (“Our interpretation allows these provisions to be read *also* as applying to particular markets where competition exists between Brazilian and United States upland cotton.”) [italics added].

³²⁹Subsidies Agreement, Annex V, para. 1.

³³⁰Subsidies Agreement, Annex V, para. 5 [italics added].

national ‘markets’” which would include the domestic market of the subsidizing Member.³³¹ The Panel further stated that a Member’s world market share equals its “portion of the world’s supply” and therefore reasoned that “developments within the domestic market of the Member,” such as supply, are relevant.³³² Thus, the Panel interpreted the “world market” for purposes of Article 6.3(c) as encompassing relevant developments within all of the markets of Members.

319. Under Article 6.3(c), however, the Panel did not apply this view that the “world market” is a “geographic term inclusive of *all* national ‘markets’.” That is, the Panel found that the A-index was the “price” in the same “world market”³³³ (although the Panel later amended its description to “the A-index may serve as an *indication* of the ‘world price’,”³³⁴ which would seem to be a different finding). But the Panel also found that the U.S. price for upland cotton was *not* the same as the A-index.³³⁵ The same can be seen in Chart 1 of paragraph 7.1287 of the Panel’s report: the A-index and the U.S. spot price, although broadly correlated over time, are not the same. Thus, the price in the “world market” does not extend to all of the markets of Members since, at the very least, the A-index does not prevail in the U.S. market. There can be no “world market” that is “inclusive of all national ‘markets’” if there is no price that prevails across “all of the national ‘markets’” that would make up that “world market.”

3. The Panel never found that U.S. and Brazilian imports actually were “in the same market” it identified

320. The Panel failed to identify whether there were U.S. and Brazilian imports in the “world market” it found to be a “same market.” That is, the Panel never determined that those products were present and competing “in the same market.” The Panel merely found that both Brazilian

³³¹Panel Report, para. 7.1432 [italics added].

³³²Panel Report, paras. 7.1434-7.1435.

³³³Panel Report, para. 7.1265.

³³⁴Panel Report, para. 7.1272.

³³⁵Panel Report, para. 7.1213 (“For example, although some [studies] address possible movements in the A-index, others, including certain studies of USDA, *do not address the issue of world price movements* at all, but rather *focus on effects on United States prices.*”) [italics added].

and U.S. price quotes could be constituent parts of the average of price quotes that make up the A-index. This is not enough. If U.S. and Brazilian upland cotton were not present in that “world market,” then they could not be “in the same market” within the meaning of Article 6.3(c).

321. The Panel never found that U.S. and Brazilian cotton were both present in that “world market,” presumably because, in fact, the A-index is an average of the five lowest price quotes for delivery to northern Europe ports.³³⁶ To find that U.S. and Brazilian upland cotton were present in that market would have required making a finding with respect to imports into particular northern European markets, undermining the Panel’s notion of the A-index as a “world market” price. Thus, the Panel made no finding that U.S. and Brazilian upland cotton were present and competing “in the same market,” and the Panel erred in finding significant price suppression in the “world market.”

I. The Panel Failed to Meet the Requirements of DSU Article 12.7

322. A panel itself bears the obligation to adequately explain its findings concerning a competent authority’s conclusions. In this regard, Article 12.7 of the DSU requires that the panel include in its report its “findings of fact, the applicability of relevant provisions, and the basic rationale behind any findings and recommendations it makes.”³³⁷ The Appellate Body has stated that Article 12.7 therefore requires a panel to “set forth [in its report] explanations and reasons sufficient to disclose the essential, or fundamental, justification for those findings and recommendations.”³³⁸ Accordingly, in their reports, panels must “identify the relevant facts and the applicable legal norms. In applying those legal norms to the relevant facts, the reasoning of the panel must reveal how and why the law applies to the facts.”³³⁹

³³⁶See, e.g., Exhibit Bra-8 (Appendix table 13, n. 2: “The A Index is an average of the five lowest priced types of 1-3/32 inch staple length cotton offered in the European market.”).

³³⁷DSU, Article 12.7.

³³⁸Appellate Body Report, *Mexico - High Fructose Corn Syrup (Recourse to Article 21.5)*, para. 106.

³³⁹Appellate Body Report, *Mexico - High Fructose Corn Syrup (Recourse to Article 21.5)*, para. 108.

323. The Appellate Body went on to note that:

We do not believe that it is either possible or desirable to determine, in the abstract, the minimum standard of reasoning that will constitute a “basic rationale” for the findings and recommendations made by a panel. Whether a panel has articulated adequately the “basic rationale” for its findings and recommendations must be determined on a case-by-case basis, taking into account the facts of the case, the specific legal provisions at issue, and the particular findings and recommendations made by a panel. *Panels must identify the relevant facts and the applicable legal norms. In applying those legal norms to the relevant facts, the reasoning of the panel must reveal how and why the law applies to the facts.* In this way, panels will, in their reports, disclose the essential or fundamental justification for their findings and recommendations.³⁴⁰

The report of the Panel in this dispute does not meet the standards established by Article 12.7 of the DSU. Though lengthy, the report fails to do so because it fails to identify the relevant facts and the applicable legal norms and to reveal how and why the law applies to the facts.

324. For example, the Panel failed to set out the basic rationale behind its findings and recommendations contrary to Article 12.7 of the DSU with respect to the Panel’s analysis of the “effect of the subsidy.”³⁴¹ The Panel failed to set out its reasoning on how and why the applicable legal norms apply to the facts of this dispute, for example, rejecting the shared view of the parties of the proper way to analyze “the effect of the subsidy.” The Panel simply never explained why it did not analyze the farmer’s planting decision and the use of expected prices to gauge which crop will maximize projected net revenue. Further, the Panel did not make findings

³⁴⁰Appellate Body Report, *Mexico - High Fructose Corn Syrup (Recourse to Article 21.5)*, para. 108 (footnotes omitted and emphasis added).

³⁴¹Panel Report, paras. 7.1348-7.1354.

or set out its “basic rationale” as to how the panel accounted for the evidence that U.S. cotton farmers respond to market signals just as farmers in the rest of the world do.

325. Likewise, the Panel failed to make findings as to the amount of the subsidy and failed to meet the requirements of Article 12.7 in connection with its finding on price suppression of the “world market” price when it prejudged, without explanation, the outcome of its causation analysis. The Panel was “assess[ing] whether or not ‘price suppression’ has occurred in the same ‘world market.’”³⁴² The Panel looked to “the relative magnitude” of U.S. production and exports, general price trends, and “the nature of the subsidies at issue, and in particular, whether or not *the nature of these subsidies is such as to have discernible price suppressive effects.*”³⁴³ However, this portion of the Panel report is purportedly analyzing whether *price suppression* has occurred, *not* what is “the effect of the subsidy.” The Panel does not take up that analysis until paragraph 7.1334 of its report, 12 pages and 54 paragraphs later.³⁴⁴ Therefore, in analyzing “whether or not . . . these subsidies . . . have price suppressive effects,” the Panel prejudices the outcome of its analysis of “the effect of the subsidy.” The Panel consequently failed to provide the basic rationale for its finding, inconsistent with Article 12.7.

326. Similarly, the Panel failed to set out the basic rationale behind its findings and recommendations contrary to Article 12.7 of the DSU with respect to the amount of the subsidy.³⁴⁵ Article 6.8 states that, “[i]n the absence of circumstances referred to in paragraph 7, *the existence of serious prejudice should be determined on the basis of the information submitted to or obtained by the Panel, including information submitted in accordance with the provisions of Annex V*” [italics added]. Annex V, paragraph 2, establishes that this information includes “such information . . . as necessary to establish the . . . amount of subsidization.” Paragraph 5 of Annex V further confirms that the information shall include “data concerning the amount of the subsidy

³⁴²Panel Report, para. 7.1280.

³⁴³Panel Report, para. 7.1280 (italics added).

³⁴⁴Panel Report, para. 7.1334.

³⁴⁵Panel Report, para. 7.1171.

in question.” Thus, to determine “the existence of serious prejudice,” the Panel should have considered information relating to the amount of the subsidization and subsidy in question. Since the Panel found that a serious prejudice analysis “does not call for any precise quantification of the subsidy at issue,”³⁴⁶ the Panel provided no explanation of what was the amount of the payments not tied to (decoupled from) upland cotton production that benefitted upland cotton.³⁴⁷ Therefore, the Panel also failed to set out the basic rationale behind its findings and recommendations contrary to Article 12.7 of the DSU.

327. In addition, in discussing recurring subsidies provided in the period 1999 to 2001, the Panel failed to adequately set out the legal basis for its examination of subsidies that no longer existed at the time of panel establishment.³⁴⁸

328. The Panel also failed to make findings of fact and set out its rationale for why the processed cotton was a “subsidized product” and why it could assume that all of the subsidies paid to cotton producers for raw cotton passed through to the processor.

329. In addition, the Panel failed to make findings of fact and set out its rationale as to why any price suppression that it found meant that there was serious prejudice to the interests of Brazil. The Panel failed to explain how Brazil's interests were affected – the panel report did not examine any particular market where U.S. and Brazilian cotton were competing, and if it had, the panel report also holds no findings or explanation as to why any suppression would affect Brazil when Brazilian cotton was priced below U.S. cotton.

³⁴⁶Panel Report, para. 7.1171.

³⁴⁷*Compare* Panel Report, paras. 7.1301-7.1302 (no finding relating to the amount of the counter-cyclical or market loss assistance payments) *with* Panel Report, para. 7.1349 (asserting that “while we do not believe that it is strictly necessarily to calculate precisely the amount of the subsidies in question, we observe that we have readily available information on the record showing us that the price-contingent subsidies in question involve very large amounts of United States government money benefiting United States upland cotton production”).

³⁴⁸Panel Report, para. 7.1179.

330. Finally, the Panel provided no explanation of what degree of price suppression it had found to be “significant.” The Panel simply concluded that, whatever the degree of price suppression it believed existed, “we are certainly not, by any means, looking at an insignificant or unimportant world price phenomenon.”³⁴⁹ By failing to set out the degree of price suppression that it was determining to be “significant,” the Panel failed to set out the basic rationale behind its findings and recommendations contrary to Article 12.7 of the DSU.

331. The importance of panels fulfilling the requirements of Article 12.7 is highlighted when one examines the consequences for the dispute settlement system of the Panel’s failure to set out the price suppression it had found. Members have agreed to procedures for the settlement of disputes in order to promote the “prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly . . . are being impaired.”³⁵⁰ Further, “[r]ecommendations or rulings made by the DSB shall be aimed at achieving a satisfactory settlement of the matter in accordance with the rights and obligations . . . under the covered agreements.”³⁵¹ The Panel concluded that the challenged price-contingent U.S. subsidy payments cause serious prejudice to Brazil’s interests; pursuant to Article 7.8 of the Subsidies Agreement, if that conclusion were upheld on appeal, the United States would be obligated to “take appropriate steps to remove the adverse effects or . . . withdraw the subsidy.”

- However, the United States would be prevented from complying with the recommendations and rulings of the DSB by “tak[ing] appropriate steps to remove the adverse effects” if it were impossible to discern what are “the adverse effects” resulting from the challenged price-contingent subsidies.
- Further, the “prompt settlement” of the situation might be seriously delayed if the option of “tak[ing] appropriate steps to remove the adverse effects” were not available.

³⁴⁹Panel Report, para. 7.1332.

³⁵⁰DSU, art. 3.3.

³⁵¹DSU, art. 3.4.

Thus, the Panel's failure to set out the basic rationale behind its finding – that is, the degree of price suppression it found and why it determined it to be “significant” – is contrary to Article 12.7 of the DSU and undermines the aims of the dispute settlement system.

V. CCC Export Credit Guarantees are Not Subject to Export Subsidy Disciplines under Article 10.1 of the Agreement of Agriculture or Article 3 of the Agreement on Subsidies and Countervailing Measures (SCM Agreement)

A. Introduction: The Panel Erred as a Matter of Law in Finding that United States Agricultural Export Credit Guarantee Programs Provide Export Subsidies Within the Meaning of the *Agreement on Agriculture* and in a Manner both Inconsistent with Article 8 of the Agreement on Agriculture and Prohibited under Article 3 of the SCM Agreement

332. The Panel erred in finding that the United States Export Credit Guarantee Programs in respect of exports of upland cotton and other unscheduled agricultural products, and in respect of rice, are export subsidies applied in a manner which results in circumvention of United States export subsidy commitments within the meaning of the *Agreement on Agriculture* and are therefore inconsistent with Article 8 of the *Agreement on Agriculture*. In addition, although the Panel did not find that the United States had circumvented such commitments with respect to scheduled commodities other than rice, it nevertheless erred in also concluding that the programs as applied to these unscheduled agricultural products constitute export subsidies within the meaning of the *Agreement on Agriculture*. In both instances the erroneous conclusions of the Panel arise in significant part because it has ignored the text and context of Article 10.2 of the *Agreement on Agriculture*. The United States asks the Appellate Body to reverse these incorrect determinations.

B. Export Credit Guarantees Are not Measures Subject to Disciplines under Article 10.1 of the *Agreement on Agriculture*

333. Fundamentally, the *Agreement on Agriculture* permits certain practices in agricultural trade that would otherwise be prohibited under the SCM Agreement. It contemplates that certain practices shall nevertheless be permitted to the limited extent of the respective export subsidy “reduction commitments” applicable to each respective WTO Member. Article 9.1 delineates the practices, and Articles 3.3 and 8 articulate the limited permissibility of such practices. Similarly, Article 10 recognizes that certain practices – involving export credits, guarantees, and international food aid transactions, constitute a separate category of practices to be treated apart from the limited export subsidy disciplines. The separate treatment of export credits and credit guarantees is found in Article 10.2. International food aid transactions are addressed in Article 10.4.

334. Article 3 of the SCM Agreement recognizes the distinct treatment to be afforded certain agricultural trade practices that would otherwise fall within the ambit of the disciplines of the SCM Agreement. Agriculture is different. Export subsidies are permitted to a limited extent, and certain practices continue to be permitted outright. As a result, Article 3 of the SCM Agreement necessarily broadly begins: “Except as provided in the Agreement on Agriculture []”.

335. Nevertheless aware that Members could devise export subsidies not described in Article 9.1, the drafters included the anti-circumvention provision of Article 10.1, to subject such export subsidies to the agreed disciplines. In contrast, although the drafters foresaw the eventual development of disciplines on export credits and credit guarantees under Article 10.2, the drafters also recognized that such practices were not themselves subject to the discipline of Article 10.1.

1. The Proper Context for the Interpretation of Article 10.1 of the Agreement on Agriculture is Found Within Article 10 Itself and Not by Reference to the SCM Agreement

336. The Panel has found that the CCC Export Credit Guarantee programs are “export subsidies applied in a manner which results in circumvention of United States export subsidy commitments, within the meaning of Article 10.1 of the *Agreement on Agriculture*.”³⁵² To render this conclusion, however, the Panel has improperly and illogically turned to the *SCM Agreement* exclusively to interpret the disciplines in Article 10.1, instead of the more immediate text and context provided in Article 10 of the *Agreement on Agriculture* itself.

337. The Panel makes no pretense about its utter disregard for the other provisions of the Agreement on Agriculture in proceeding directly to the *SCM Agreement*. Although it frames the issue as “whether the United States export credit guarantee programs at issue constitute ‘export subsidies’ within the meaning of Article 10.1 of the *Agreement on Agriculture*,”³⁵³ the Panel ignores Articles 10.2, 10.4, and 21.1 of the *Agreement on Agriculture* and rejects out-of-hand the relevance and applicability of the entire *Agreement on Agriculture* for this interpretive purpose: “The *Agreement on Agriculture* does not contain any further textual or contextual elaboration of the terms ‘subsidies’ ‘contingent upon export performance’, beyond the list of export subsidies defined in Article 9.1.”³⁵⁴ Pre-judging its own conclusion, the Panel states: “Nor does the *Agreement on Agriculture* contain any specific guidance on the criteria that may be applied to determine when export credit guarantee programs, in particular, in respect of agricultural products may constitute ‘export subsidies.’”³⁵⁵ “We see no reason to consider that, in this factual situation, the concept of ‘export subsidy’ in Article 10.1 of the *Agreement on Agriculture* differs from the same term in the *SCM Agreement*. [] We therefore believe that it is appropriate to seek

³⁵²Panel Report Section VIII, Panel Report, para. 8.1(d)(1).

³⁵³Panel Report, para. 7.794.

³⁵⁴Panel Report, para. 7.797.

³⁵⁵Panel Report, para. 7.797.

contextual guidance in the relevant provisions of the *SCM Agreement* for our interpretation of the term ‘export subsidies’ in Article 10.1 of the *Agreement on Agriculture* in this factual situation.”³⁵⁶

338. The proper question for the Panel should have been if the *Agreement on Agriculture* provides guidance *whether* agricultural export credit guarantees are subject to the disciplines on export subsidies at all, instead of simply assuming they are and looking for guidance on the specific criteria for such a determination.

339. Without regard to Article 10.2 of the *Agreement on Agriculture*, the Panel improperly asserts that its first analytical step to interpret Article 10.1 is “to determine what, if any, are the relevant contextual elements provided in the SCM Agreement (i.e. item (j) of the Illustrative List of Export Subsidies in Annex I of the SCM Agreement and/or Articles 1 and 3 of the SCM Agreement.”³⁵⁷ Ignoring the evident separate treatment of export credit guarantees in the *Agreement on Agriculture* itself, it “looks for guidance to the overall disciplines contained in the *SCM Agreement* governing export credit guarantees granted under a Member’s export credit guarantee programs.”³⁵⁸ This approach effectively prejudices the determination that *agricultural* export credit guarantee programs that do not cover long-term operating costs and losses must also constitute export subsidies. Not surprisingly, as the Panel has taken this improper tautological approach of looking to a separate agreement in which the Members have agreed in the non-agricultural context to subject export credit guarantees to export subsidy disciplines, it finds that to the extent the programs constitute an export subsidy within the meaning of item (j) the programs therefore are subject to the export subsidy disciplines of the *Agreement on Agriculture*.³⁵⁹ The Panel readily acknowledges that it is doing nothing more than “transpose this

³⁵⁶Panel Report, para. 7.799.

³⁵⁷Panel Report, para. 7.789.

³⁵⁸Panel Report, para. 7.802.

³⁵⁹Panel Report, paras. 7.869, 7.802.

contextual guidance to make a finding, with respect to the scheduled and unscheduled products at issue, under Articles 10.1 (and 8) of the *Agreement on Agriculture*.³⁶⁰

340. Curiously, the approach of the Panel runs wholly contrary to the approach it elsewhere correctly notes as proper: “[W]e [] believe that it is appropriate to examine an alleged export subsidy in respect of an agricultural product first under the *Agreement on Agriculture* before, if and as appropriate, turning to any examination of the same measure under the *SCM Agreement*.”³⁶¹ Therefore, the Panel erred as a matter of law in determining that its analysis of whether export credit guarantees are export subsidies subject to the disciplines of Article 10.1 solely by reference to the Subsidies Agreement, ignoring important context in Article 10 of the Agreement on Agriculture.

2. The Plain Meaning of the Text of Article 10.2 of the Agreement on Agriculture is to Defer the Application of Disciplines on Such Measures Until They Are Agreed

341. The proper context in which to analyze the meaning of Article 10.1 with respect to export credit guarantees is Article 10.2 of the *Agreement on Agriculture*, the only provision that explicitly addresses these specific kinds of measures. As reflected in the text of Article 10.2 of the *Agreement on Agriculture*, during the Uruguay Round WTO Members simply did not agree on disciplines to be applicable to agricultural export credits, export credit guarantees, and insurance programs. Unable to reach agreement on such disciplines within the Uruguay Round, Members opted to continue discussions, deferring the imposition of substantive disciplines until a consensus was achieved.

³⁶⁰Panel Report, para. 7.763.

³⁶¹Panel Report, para. 7.673.

342. The text of Article 10.2 of the *Agreement on Agriculture* reflects the deferral of disciplines on export credit guarantee programs contemplated by WTO Members at the time:

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

343. Article 10.2, specifically addresses export credit guarantees and foresees the imposition of disciplines after their development as “internationally agreed disciplines.” Agricultural export credit guarantees are not measures currently subject to the existing export subsidy disciplines of Article 10.1. As the Panel acknowledges,³⁶² Article 10.2 pointedly does not say “in addition to the export subsidy commitments” of this Agreement or “in addition to existing disciplines.” To the contrary, the Article provides that the WTO Members would work toward the development of “internationally agreed disciplines” and only “*after agreement on such disciplines*” would the Members “provide export credits, export credit guarantees or insurance programs only in conformity therewith.”

3. The Context of Articles 10.1 and 10.2 of the Agreement on Agriculture and the Object and Purpose of that Agreement Demonstrate that the CCC Export Credit Guarantee Programs are Not Subject to Export Subsidy Disciplines

a. The Inapplicability of Article 10.1 to CCC Export Credit Guarantees is Harmonious with Article 10 As a Whole

³⁶²Panel Report, para. 7.926.

344. The Panel dismisses this interpretation of Article 10.2, because its “reading of the text of Article 10.2 of the *Agreement on Agriculture*, in light of its context and the object and purpose of the Agreement, leads us to the opposite conclusion.”³⁶³

345. The Panel asserts that its erroneous interpretation of the text of Article 10.1 “finds support in the immediate context of Article 10.2, as well as in the object and purpose.”³⁶⁴ The Panel appears to focus largely on the title of Article 10: “Prevention of Circumvention of Export Subsidy Commitments” without regard to the remainder of the text of Article 10 itself. However, the Panel’s interpretation and reasoning are in error.

346. First, the interpretation advanced by the United States with respect to Article 10.2 presents no conflict with the theme of the title of Article 10. Article 10.2 contributes to the prevention of circumvention of export subsidy commitments by imposing two obligations on Members: first, they must undertake to work toward the development of internationally agreed disciplines on export credit guarantees; and second, “after agreement on such disciplines,” they must provide export credit guarantees “*only* in conformity therewith.” Thus, Members agreed that those internationally agreed disciplines would constrain the provision of export credit guarantees, which in turn would contribute to a goal of Article 10: to prevent the circumvention of export subsidy commitments.

b. To Exclude CCC Export Credit Guarantees from the Application of Article 10.1 is Both a Reasonable and Correct Result and Wholly Consistent with the Treatment under Article 10 of International Food Aid Transactions

³⁶³Panel Report, para. 7.901.

³⁶⁴Panel Report, para. 7.912.

347. The Panel expresses its view that the approach advocated by the United States has “entirely unreasonable implications.”³⁶⁵ With respect, the implications are only unreasonable if they were not precisely what the drafters intended to accomplish. In contrast, it is the interpretation of the Panel that presents unreasonable implications. In fact, the Panel’s interpretation would result in an un-bargained-for windfall for Brazil when U.S. export credit guarantees would have been well within U.S. export subsidy reduction commitments *had Members agreed that they were export subsidies subject to such commitments.*

348. Members’ schedules of export subsidy commitments are part of the WTO Agreement. They provide context for Article 10.2. It is telling then that neither the United States nor any other WTO Member schedules were based on the amounts or budgetary outlays for export credits or credit guarantees. Similarly, the practice by WTO Members under the Agriculture Agreement is that no WTO Member reports its export credit guarantees as export subsidies. This is not because the United States is alone in the world in providing them. Unlike other export subsidy practices, no reporting requirement exists for export credit guarantees. This is consistent with an understanding among Members in concluding the WTO Agreement that agricultural export credit guarantees were outside export subsidy disciplines. In December, 1994, the Preparatory Committee for the World Trade Organization issued *Notification Requirements and Formats Under the WTO Agreement on Agriculture*.³⁶⁶ These notification requirements remain in effect. Elaborate reporting requirements are set forth for Members with respect to numerous aspects of the disciplines of the agreement, including with respect to export subsidies.³⁶⁷ However, no reporting requirement is indicated for export credit guarantees. This is consistent with treatment of such programs as outside export subsidy disciplines.

³⁶⁵Panel Report, para. 7.915.

³⁶⁶See, U.S. Closing Statement at the Second Panel Meeting (3 December 2003), para. 5 and PC/IPL/12 circulated 2 December 1994 (Exhibit US-99).

³⁶⁷See, e.g., Exhibit US-99, paras. 1(c), 1(e), 1(I), 2; Table ES:1 and Supporting Tables ES:1 and ES:2.

349. In its rejection of the United States interpretation, the Panel focuses on the absence of a more explicit expression of deferral of the applicability of export subsidy disciplines: “if Members had intended to defer export subsidy disciplines on export credit guarantees, they would have done so.”³⁶⁸ This approach ignores the text and context of the remainder of Article 10. Article 10.4 is as much a part of Article 10, as are Articles 10.1 and 10.2.³⁶⁹ Article 10.4, too, does not contain any text explicitly deferring the applicability of Article 10.1 export subsidy disciplines that the Panel demands. The logical result of the Panel’s interpretive approach is that all food aid constitutes an export subsidy under Article 10.1, subject to the full array of export subsidy disciplines. If this were the intended result, then separate provisions for the treatment of international food aid transactions would have been unnecessary. Article 9.1(b), addressing the disposal of non-commercial stocks by governments at below-domestic market prices, would have rendered such transactions export subsidies.

350. International food aid undeniably provides a benefit. It is inherently contingent on export performance. Under the Panel’s analysis, in the absence of an express carve-out, such a practice constitutes an export subsidy.³⁷⁰ This approach, however, would consign export credit guarantees and international food aid to the category of most malign practices. This cannot be right. Such an implausible assault on food security in the less developed world cannot reasonably be construed as the intent of the drafters.

351. To the contrary, the Decision on Measures Concerning the Possible Negative Effects of the Reform Programme on Least-Developed and Net Food-Importing Developing Countries, among the Ministerial Decisions and Declarations, agreed to concurrently with the Agreement on Agriculture and the SCM Agreement, expresses the paramount concern of the Ministers

³⁶⁸Panel Report, para. 7.920.

³⁶⁹Curiously, the Panel has no problem inserting language where none exists. The Panel claims that Article 10.2 “identifies the possibility that export credit guarantees may constitute export subsidies within the meaning of Article 10.1.” (Panel Report, para. 7.922). Yet Article 10.2 not only contains no such identification, it makes no reference to export subsidies whatsoever.

³⁷⁰See Panel Report, paras. 7.903, 7.940.

regarding food aid and food needs. In particular, Ministers agreed “to establish appropriate mechanisms to ensure that the implementation of the results of the Uruguay Round on trade in agriculture does not adversely affect the availability of food aid at a level which is sufficient to continue to provide assistance in meeting the food needs of developing countries, especially least-developed and net food-importing developing countries.”

352. In paragraph 3(i) of such Decision, and without any indication that the levels of international food aid were already confined or circumscribed by the export subsidy commitments of Articles 3 or 8 of the Agreement on Agriculture, the Ministers further agreed to review levels of food aid established periodically by the Committee on Food Aid under the Food Aid Convention 1986.

353. In addition, in Article 3(ii), the Ministers specifically agreed only prospectively “to adopt guidelines to ensure that an increasing proportion of basic foodstuffs is provided . . . in fully grant form and/or on appropriate concessional terms.”

354. Perhaps most significantly, in paragraph 4 the Ministers expressed the clear intention to treat international food aid and export credit guarantees in a category separate from the export subsidies disciplined under the Agreement on Agriculture: “Ministers further agree to ensure that any agreement relating to agricultural export credits makes appropriate provision for differential treatment in favor of least-developed and net food-importing developing countries.”

355. The Panel’s interpretive approach, however, would preclude such differential treatment in favor of least-developed and net food-importing countries. Instead, it would ensure that export credit guarantees for food exports would be significantly reduced irrespective of destination or recipient.

c. The Panel’s Interpretation of Article 10 is Internally Inconsistent

356. Not surprisingly, the Panel’s flawed finding emanates from its illogical and erroneous textual interpretation of Article 10. The structure of Article 10 provides similarly for food aid under Article 10.4 and export credit guarantees under Article 10.2. Once internationally agreed disciplines on export credits and credit guarantees are achieved, then it would be possible for a given export credit practice to circumvent export subsidy disciplines as a result of failure to comply with those export credit disciplines. Such an approach would be not unlike the current disciplines applicable to international food aid transactions. The Members recognized the possibility that food aid could be applied in a manner that would circumvent export subsidy disciplines, and agreed – separate from Article 10.1 – to govern that possibility. Accordingly, the *Agreement on Agriculture* imposes specific disciplines on food aid on the basis of terms negotiated elsewhere: the Food Aid Convention and the Food and Agriculture Organization (FAO).

357. These disciplines are set forth in Article 10.4. International food aid transactions are subject to the tied aid restrictions of 10.4(a), the FAO “Principles of Surplus Disposal and Consultative Obligations” under 10.4(b), and the generally concessional provisions contemplated by 10.4(c). The Panel appears not to recognize these provisions as substantive disciplines, however. Apparently regarding these merely as some form of normative guidelines, the Panel blithely indicates that “Article 10.4 provides additional guidance with respect to international food aid, setting out criteria . . . which might help to identify when international food aid might be considered to constitute an export subsidy for the purposes of the anti-circumvention disciplines of Article 10.1.”³⁷¹

358. Article 10.4, however, clearly imposes substantive disciplines. As a result of the Panel’s interpretation, not only would international food aid transactions be subject to these disciplines, but they would *also* be subject to all export subsidy disciplines. Under this approach, pursuant to Articles 10.1 and 8 of the Agreement on Agriculture, to the extent a Member did not schedule

³⁷¹Panel Report, para. 7.922

export subsidy reduction commitments for food aid, then such food aid would constitute a prohibited export subsidy. This absurd result arises because the Panel ignores the obvious context of Article 10 that export credit guarantees and international food aid were intended to be treated separately from practices otherwise deemed to constitute export subsidies subject to Article 10.1.

359. The Panel purports to “see no contradiction” between its interpretation of Article 10.4 and Article 10.2.³⁷² This appears to be true in that the Panel has simply ignored the separate treatment of the practices governed by each and simply applied Article 10.1 to all practices covered in Articles 10.2 and 10.4. However, to the extent the Panel may believe it is imposing less draconian discipline on food aid than export credit guarantees it has created a contradiction. Article 10.4 reflects no explicit carve-out from export subsidy disciplines. Under the Panel’s analysis compelling an explicit carve-out from the rigor of the export subsidy disciplines, it would treat the effect of such absence in one instance (10.4) to have different effect than in another (10.2).

360. Furthermore, as the United States noted to the Panel³⁷³, the language of Article 10.1 itself highlights the intended treatment of export credit guarantees as distinct from export subsidies. That article explicitly recognizes that “non-commercial transactions” shall not be used to circumvent export subsidy commitments. This phraseology is distinctly similar to a formulation initially used in the drafting history of Articles 9 and 10 of the Agreement on Agriculture: “Export credits provided by governments or their agencies on less than fully commercial terms.”³⁷⁴

361. However, instead of making any connection between “non-commercial transactions” and export credits, the Members drafted Article 10.2 to provide wholly distinct treatment for export

³⁷²*Id.*

³⁷³U.S. Answers to Panel’s Question 219 (December 22, 2003) paras. 80-82.

³⁷⁴U.S. Answers to Panel’s Question 219 (December 22, 2003) paras. 80-82; Exhibit US-27.

credits and credit guarantees without any such reference. If the drafters had intended export subsidy disciplines to apply to “non-commercial” export credits and guarantees in agricultural trade and thereby draw a distinction between “commercial” and “non-commercial” export credits, then Article 10.2, immediately following Article 10.1, would have been the obvious place to do it.

362. The Panel dismisses this textual and contextual point by drawing the unsupported and incongruous conclusion that “it understand[s] the reference [to non-commercial transactions] in this final clause of Article 10.1 to refer, *inter alia*, to international food aid.”³⁷⁵ The Panel has to make this implausible interpretive stretch in order to give some meaning to the phrase without acceding to the argument of the United States.

363. As already noted, however, the drafters plainly intended to treat food aid and export credit guarantees separately from the anti-circumvention provisions of Article 10.1. Furthermore, the Panel’s view of the meaning of “non-commercial transactions” is inconsistent with its own interpretive approach. Having previously asserted that the drafters would have been so precise to include a more explicit deferral than appears in Article 10.2 had it intended to create one, the Panel has no trouble discerning a reference by the drafters to international food aid transactions in Article 10.1 in the absence of either a reference from Article 10.1 to Article 10.4 or a reference in Article 10.4 to “non-commercial transactions.” Indeed, to the contrary, Article 10.4 refers explicitly and exclusively to “international food aid transactions.” If the drafters had intended “non-commercial transactions” to mean “international food aid transactions,” it seems logical that the drafters would have used such a phrase, particularly as it appears elsewhere in the very same article.

364. The Panel’s analytical approach ignores the physical separation and treatment of export credits, guarantees, and international food aid transactions from the export subsidy practices and

³⁷⁵Panel Report, para. 7.922

disciplines. The Panel's decision also poses a serious threat to the continued viability of the decision of the drafters to permit practices that serve to promote food security and differential treatment for developing and net-food-importing countries. The findings of the Panel should be reversed.

365. Interestingly, although the Panel looked to item (j) of the Illustrative List to the SCM Agreement for context, it did not look to item (k). Item (k) however is highly relevant context. Article 10.2 of the Agriculture Agreement deals not just with export credit guarantees, but also with export credits, a fact seemingly ignored by the Panel. Item (k) is the item in the Illustrative List that deals with export credits. In item (k), Members agreed that export credits applied in conformity with the disciplines of a different international agreement "shall not be considered an export subsidy."

366. The parallel with Article 10.2 is striking, since Article 10.2 also calls for Members to apply their export credits in conformity with internationally agreed disciplines. In addition, the agreement referenced in item (k) did not apply to export credits for agricultural products. It should not be surprising then that Article 10.2 calls for the negotiation of international disciplines that do apply to export credits for agricultural products and also included export credit guarantees. Item (k) provides an illustration of what the situation could look like for agricultural export credits and guarantees once the negotiations called for are completed. It is also not surprising that Uruguay Round negotiators did not intend Article 10.1 to apply to agricultural export credits and credit guarantees pending the conclusion of the negotiations, since that would have pre-judged the outcome of those negotiations.

4. The Negotiating History of the Agreement on Agriculture Further Supports the Interpretation that CCC Export Credit Guarantees are Not Subject to Export Subsidy Disciplines

367. Under customary rules of interpretation of public international law, as reflected in Article 32 of the Vienna Convention on the Law of Treaties, recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty, in order to confirm the meaning of treaty text. The ordinary meaning of the text of Articles 10.1 and 10.2 of the *Agreement on Agriculture*, read in their context and in light of the object and purpose of the WTO Agreements, indicates that CCC export credit guarantees are measures not intended to be subject to the export subsidy disciplines of Article 10.1. The negotiating history confirms this interpretation, reflecting the purposeful choice of WTO Members to segregate export credit guarantee programs and their treatment from export subsidies described elsewhere in the text and from the disciplines applicable to export subsidies.

368. This segregation and separate treatment is first exposed in a comparison of Articles 10.2 and 9.1 of the *Agreement on Agriculture*. “Article 9.1 of the *Agreement on Agriculture* lists a number of specifically identified export subsidies. The terms ‘export credit guarantees’ do not explicitly appear in the text listing such practices.”³⁷⁶ The six very specific practices listed were notorious to the drafters and deemed to constitute export subsidies under the *Agreement*. In this respect, Article 9.1 serves a function similar to the Illustrative List of Export Subsidies in Annex I of the SCM *Agreement*. That Illustrative List, however, explicitly addresses export credit guarantees in its item (j). In contrast, conspicuously absent in Article 9.1 is any provision addressing such practices, even though U.S. export credit guarantees had been in existence for nearly 15 years preceding the inception of obligations under the Uruguay Round Agreements.³⁷⁷

369. Noting only that “the text of Article 10.1 refers to ‘export subsidies’[, and] the text of Article 10.2 refers to ‘export credit guarantees,’”³⁷⁸ the Panel ignores the point that the well-known export credit guarantee programs do not appear in the list of notorious export subsidy

³⁷⁶Panel Report, para. 7.919

³⁷⁷See U.S. First Written Submission (July 11, 2003), para. 151. The date of inception of the program is not in dispute.

³⁷⁸Panel Report, para. 7.918

practices listed in Article 9.1, offering the unremarkable observation of “the possibility that other forms of export subsidies might exist, apart from those that appear in the list.”³⁷⁹

370. The negotiating history of the provisions, however, highlights the intended segregation of export credit guarantee programs from export subsidies. On July 11, 1990, the so-called “DeZeeuw Text” was circulated.³⁸⁰ Paragraph 20(e) of that text contemplated that Members would provide “data on financial outlays or revenue foregone . . . in respect of export credits provided by governments or their agencies on less than fully commercial terms.” Under paragraph 22, the document envisioned concurrent negotiations to govern the use of export assistance, including “disciplines on export credits.”

371. Chairman DeZeeuw was succeeded by Chairman Dunkel, and on June 24, 1991, he circulated a Note on Options in the Agriculture Negotiations.³⁸¹ In paragraph 48 of that Note, the Chairman requested decisions by the principals on “whether subsidized export credits and related practices . . . would be subject to reduction commitments.” Subsequently, on August 2, 1991, he circulated a series of addenda on the Note on Options “aimed at exploring certain options in greater detail.”³⁸²

372. Included among the addenda was Addendum 10 on “Export Competition: Export Subsidies to be subject to the terms of the Final Agreement.”³⁸³ Section 3 of that Addendum sets forth a proposed “Illustrative List of Export Subsidy Practices.” Item (h) is explicitly “Export Credits provided by governments or their agencies on less than fully commercial terms.” Similarly item (i) is “Subsidized export credit guarantees or insurance programs.”

³⁷⁹Panel Report, para. 7.920

³⁸⁰MTN.GNG/NG5/W/170 (Exhibit US-25)

³⁸¹MTN.GNG./AG/W/1 (24 June 1991) (Exhibit US-26)

³⁸²MTN.GNG./AG/W/1/Add. 1 (2 August 1991) (Exhibit US-27)

³⁸³MTN.GNG./AG/W/1/Add. 10 (2 August 1991) (Exhibit US-27)

373. On December 12, 1991, the chairman circulated for discussion a “Draft Text on Agriculture.”³⁸⁴ Article 8.2 of that Draft Text is substantially similar to the current Article 9.1 of the Agreement on Agriculture.³⁸⁵ Article 9.1 of the Draft Text is virtually identical to Article 10.1 of the current Agreement.

374. Only 8 days later, the Chairman of the Trade Negotiations Committee issued the “Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations.”³⁸⁶ It is important to compare and contrast the relevant provisions of the Draft Final Act with the text that ultimately emerged. Article 10.2 of the Draft Final Act reads as follows:

“Participants undertake *not to provide* export credits, *export credit guarantees* or insurance programs *otherwise than in conformity with* internationally agreed disciplines [italics added].”

375. This draft text already contemplated that there would be separate internationally agreed disciplines for agricultural export credits and export credit guarantees. Industrial export credits were already subject to separate disciplines, and had been since the Tokyo Round Subsidies Code.

376. The language of Article 10.2 of the Draft Final Act as adopted was further refined to clarify that Members were committed to negotiate these disciplines, and to apply them once agreed.

377. The negotiating history reflects that the Members very early specifically included export credits and export credit guarantees as a subject for negotiation and specifically elected *not* to

³⁸⁴Exhibit US-28

³⁸⁵See also Annex 7 of the Draft Text (Exhibit US-28)

³⁸⁶MTN.TNC/DFA (20 December 1991); the Agriculture text of the Draft Final Act is Exhibit US-29.

include such practices among export subsidies in the WTO Agreements with respect to those goods within the scope of the product coverage of Annex 1 of the *Agreement on Agriculture*.

378. In its rejection of the arguments of the United States, the Panel simply *assumes* that the “reference to agricultural export credit guarantee programs in the context of Article 10” means “that the Members were very well aware of the possibility that such export credit guarantees may constitute export subsidies *per se* and that Members were, in fact, concerned about the potential for such programs to circumvent Members’ export subsidy reduction commitments.”³⁸⁷ This assumption of the meaning of Article 10.2 is contradicted by the text and structure of Article 10 as well as the drafting history. By deleting an explicit reference to export credit guarantees from the illustrative list of export subsidies in Article 9.1, Members demonstrated that they had not agreed in the case of agricultural products that export credit guarantees constitute export subsidies that should be subject to export subsidy disciplines.

379. To address this contradiction, without any support in the negotiating history, the Panel simply asserts: “The omission of paragraph 3 of Article 9 of the December 1991 Draft Text is consistent with a decision that the words were mere surplusage, because export credits, export credit guarantees and insurance programs were within the disciplines on export subsidies according to the terms of the agreement captured.”³⁸⁸

380. This unsubstantiated assertion that the drafters viewed the removed language as “mere surplusage” contradicts the Panel’s own approach to drafting history in that it fails to explain the continued presence of other practices in the Article 9.1 that ultimately emerged. In at least one other context in this dispute the Panel recognizes that the omission of substantive text from the

³⁸⁷Panel Report, para. 7.924.

³⁸⁸Panel Report, para. 7.940.

ultimate provisions of the *Agreement on Agriculture* is “deliberate” and reflects a choice of substantive terms to apply.³⁸⁹

381. In addition, because export credit guarantees would already be subject to the disciplines of paragraphs (j) and (k) of the Illustrative List of Export Subsidies in the SCM Agreement³⁹⁰ the Panel’s approach argues too much. By this analytical measure other export subsidies that remained listed in Article 9 should also have been deleted as “mere surplusage”. For example, Article 9.1(a) applies to “the provision by governments or their agencies of direct subsidies . . . to a firm, to an industry, . . . contingent on export performance.” Item (a) of the SCM Agreement applies to: “The provision by governments of direct subsidies to a firm or an industry contingent on export performance.” Article 9.1(e) applies to: “internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favorable than for domestic shipments.” Item (c) of the SCM Agreement’s Illustrative List of Export Subsidies applies *identically* to: “internal transport and freight charges on export shipments, provided or mandated by governments, on terms more favorable than for domestic shipments.”

382. Under the Panel’s simplistic analytical approach both Articles 9.1(a) and 9.1(e) should not have survived to appear in the *Agreement on Agriculture* because they were “mere surplusage” already “within the disciplines on export subsidies according to the terms of the agreement captured.”³⁹¹ Yet there they remain. The removal of export credit guarantees from

³⁸⁹Panel Report, para. 7.323. “Given that draft Article 18:2 [of the Text on Agriculture of the Draft Final Act] was the predecessor of parts of the final Article 13 [of the WTO *Agreement on Agriculture*], this in an indication that the omission of Article 13 from the final list of special or additional rules or procedures [in the draft DSU text] was deliberate and that the negotiators did not intend it to operate as a special dispute settlement procedure.” The Panel also ascribes far more substantive meaning to drafting history in other contexts. *See, e.g.*, Panel Report, paras. 7.495-7.501 (Using drafting history of the agriculture text of the Draft Final Act to interpret the meaning of Article 13).

³⁹⁰Panel Report, para. 7.937.

³⁹¹Panel Report, para. 7.940.

Article 9 is not a mere editorial choice, but a reflection of the decision of the drafters not to apply export subsidy disciplines to export credit guarantees.³⁹²

5. The Panel’s Interpretation of the Agreement on Agriculture Leads to a Manifestly Unreasonable Result

383. Article 32 of the Vienna Convention on the Law of Treaties also permits recourse to supplementary means of interpretation, including the preparatory work of the treaty to determine the meaning of language where the meaning is “ambiguous” or if the interpretation provided “leads to a result which is manifestly absurd or unreasonable.” As explained above, the negotiating history demonstrates that CCC export credit guarantees are measures not intended to be subject to the export subsidy disciplines of Article 10.1.

384. The conscious decision of the drafters to exclude export credit guarantees from Article 9 is not a mere editorial choice, but a reflection of an agreement with major substantive consequence. As the Panel notes, “Article 9.1 lists specific types of export subsidies which are subject to reduction commitments under the *Agreement on Agriculture*.”³⁹³ Had export credit guarantees remained in Article 9, then the United States and other providers of export credits and credit guarantees would have been expressly permitted to include such measures in their

³⁹²In an argument not adopted by the Panel, Brazil and New Zealand suggested that the omission of export credit guarantees from Article 9.1 is “because export credit guarantees are not, *per se*, export subsidies.” (New Zealand Answers to Question 35 of the Panel to Third Parties). New Zealand further suggested that export credit guarantees may or may not involve export subsidies, relative to the marketplace (*i.e.*, “the extent to which the premium rates charged on current export credit guarantees are lower than the corresponding financing rates that a commercial bank would normally require given a similar level of risk.”) Brazil appears to concur with this approach in its Answer to Panel Question 71(a): “Although export credit guarantees do not automatically confer benefits [”

The negotiating history, however, reveals that as early as 1991 the Members understood that “Export credits provided by governments or their agencies on less than fully commercial terms” and “Subsidized export credit guarantees or insurance programs” – that is, not *all* export credit guarantees but rather only some – were export practices subject to discussion and negotiation. (MTN.GNG/AG/W/1/Add. 10 (2 August 1991) (Exhibit US-27)) Yet neither of these two formulations, which would reflect Brazil and New Zealand’s interpretations, appears in Article 9.1.

³⁹³Panel Report, para. 7.662.

respective export subsidy reduction commitments. In the absence of a reference in Article 9, then the United States was foreclosed from including them. It defies logic, as well as the obvious object and purpose of the agreement, to take the view of the Panel in which such practices would be treated as already disciplined export subsidies yet not permitted to be included within the applicable reduction commitments expressly contemplated by the text. The United States is unfairly whipsawed by this interpretive approach, and Brazil finds itself the beneficiary of an unbargained-for multi-billion dollar windfall. The Panel result in this instance is manifestly unreasonable.

385. During the relevant base period for determining the levels from which export subsidy reduction commitments were to be calculated (1986-1990), the United States had export activity for scores of commodities under the export credit guarantee programs.³⁹⁴ It provided export credit guarantees in connection with 37 commodities in addition to those thirteen with respect to which it has reduction commitments. Among those, for example, were *yearly averages* of 5.5 million tons of corn and 859,000 metric tons of cotton. Similarly, the quantities of coarse grains would have been double the amount included, triple for vegetable oils, ten-fold for bovine meat and a multiple of 1,700 for “other milk products.”³⁹⁵ Such a magnitude of export credit guarantees during this period simply could not have been overlooked by either the United States or its negotiating partners. The Panel dismisses this as a unilateral interpretation of the United States, not “representative of an agreed interpretation or understanding of all Members.”³⁹⁶ Yet no export credit guarantees are reported in the schedules of the United States or any other Members. Nor are they currently subject to reporting as export subsidies.³⁹⁷

³⁹⁴See, U.S. Further Rebuttal Submission (August 22, 2003), para. 148.

³⁹⁵See, U.S. Rebuttal Submission (August 22, 2003), paras. 147-153; U.S. Further Rebuttal Submission (November 18, 2003), paras. 178-183.

³⁹⁶Panel Report, para. 7.942.

³⁹⁷See, U.S. Closing Statement at the Second Panel Meeting (3 December 2003), para. 5, and PC/IPL/12 circulated 2 December 1994 (Exhibit US-99).

386. To avoid the manifestly unreasonable result sought by Brazil, recourse to the negotiating history of Article 10 would be appropriate, which confirms that CCC export credit guarantees are measures not intended to be subject to the export subsidy disciplines of Article 10.1.

B. The Panel’s Findings Under Article 3 of the SCM Agreement with respect to the CCC Export Credit Guarantee Programs Should be Reversed

1. Introduction

387. The Panel erroneously concludes that the United States Export Credit Guarantee Programs in respect of unscheduled agricultural products and one scheduled agricultural product (rice) are *per se* export subsidies prohibited under Articles 3.1(a) and 3.2 of the SCM Agreement. In reaching this conclusion the Panel has reversed the applicable burden of proof, misinterpreted the relationship between Article 10.2 of the *Agreement on Agriculture*, incorrectly found that the program for each agricultural product constitutes an export subsidy, and incorrectly determined that the programs are provided by the United States at premium rates which are inadequate to cover the long-term operating costs and losses of the programs within the meaning of item (j) of the Illustrative List of Export Subsidies in Annex I of the SCM Agreement.

388. The Panel found that the programs “are provided by the United States government at premium rates which are inadequate to cover long-term operating costs and losses of the programs within the meaning of item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*, and therefore constitute *per se* export subsidies prohibited by Articles 3.1(a) and 3.2 of the *SCM Agreement*.”³⁹⁸

389. To arrive at this conclusion the Panel has misinterpreted the meaning of Article 10.2 of the *Agreement on Agriculture* and ignored the meaning and purpose of Article 21.1 of the

³⁹⁸ Section VIII: 8.1(d)(1).

Agreement on Agriculture. The Panel has also repeatedly reversed the applicable burden of proof for such a determination under the *SCM Agreement*.³⁹⁹ In addition, the Panel failed to apply properly the test in item (j) of the Illustrative List of Export Subsidies, invalidating its conclusion.

2. CCC Export Credit Guarantees are Not Prohibited Export Subsidies for Purposes of Article 3 of the *SCM Agreement* by Virtue of Article 21.1 of the *Agreement on Agriculture* and the Introductory Phrase to Article 3 of the *SCM Agreement*

390. For the reasons noted in the foregoing sections, Article 10.2 of the *Agreement on Agriculture*, read in its proper context, establishes that CCC export credit guarantees are not measures subject to the export subsidy disciplines of Article 10.1. Furthermore, it is undisputed that export credit guarantees are not subsumed within the export subsidies described in Article 9.1 of the *Agreement on Agriculture*.⁴⁰⁰ In addition, as a result of Article 21.1 of the *Agreement on Agriculture* and the introductory phrase of Article 3 of the *SCM Agreement*, they are not prohibited export subsidies under the *SCM Agreement*.

391. The Panel, however, concludes to the contrary. To reach its erroneous determination that the CCC export credit guarantees are in fact prohibited export subsidies under Articles 3.1(a) and 3.2 of the *SCM Agreement*⁴⁰¹ the Panel ignores the effect of Article 21, misapplies Article 13(c) of the *Agreement on Agriculture*, reverses the applicable burden of proof, and fails to make necessary findings of fact.

³⁹⁹The Panel articulates the “usual burden of proof in WTO proceedings” to rest “upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defense. If that party adduces evidence sufficient to raise a presumption that what it asserts is correct, the shifts to the other party.” Panel Report, para. 7.270, citing Appellate Body Report, *U.S. - Wool Shirts*, p. 14

⁴⁰⁰Panel Report, para. 7.788.

⁴⁰¹Panel Report, para. 8.1(d)(1).

392. Article 21.1 of the *Agreement on Agriculture* provides:

“The provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement.”

393. The *SCM Agreement* is of course one of the Multilateral Trade Agreements to which Article 21.1 applies. Article 3 of the *SCM Agreement* therefore is subject in its application to Article 21.1 of the *Agreement on Agriculture*. Indeed, the Panel expresses its view that “the introductory phrase of Article 3.1 [] refers to the *Agreement on Agriculture* as a whole [].”⁴⁰² Article 3, furthermore, expressly limits its application with respect to the *Agreement on Agriculture*: the introductory phrase states: “Except as provided in the Agreement on Agriculture.” As export credit guarantees are not subject to the disciplines of export subsidies for purposes of the *Agreement on Agriculture*, Article 21.1 of that Agreement renders Article 3.1(a) of the *SCM Agreement* inapplicable to such measures.

394. Article 13(c) of the *Agreement on Agriculture* provides in relevant part that “export subsidies that conform fully to the provisions of Part V of [the] Agreement, as reflected in each Member’s Schedule, shall be: [] exempt from actions based on Article ... 3 ... of the Subsidies Agreement.” As the United States has demonstrated, pursuant to Article 10.2, the export credit guarantee programs are not measures subject to the disciplines of Article 10.1 of the *Agreement on Agriculture*.

395. The exemption from action under Article 13(c) is inapplicable, because it only is effective with respect to export subsidies disciplined under the Agreement on Agriculture.

⁴⁰²Panel Report, para. 7.277.

396. The Panel purports to recognize the interpretive hierarchy in which, pursuant to Article 21.1, “the provisions of the *SCM Agreement* [] apply subject to the *Agreement on Agriculture*.”⁴⁰³ However, ignoring Article 21.1, the Panel asserts that even if export credit guarantees are not export subsidies disciplined under the *Agreement on Agriculture* they are nevertheless subject to challenge under Article 3 of the *SCM Agreement*. “[I]f we were to accept the United States argument that export credit guarantees cannot constitute export subsidies for the purposes of the *Agreement on Agriculture* and that the export subsidy disciplines in Article 10.1 of the *Agreement on Agriculture* do not apply to export credit guarantees, then export credit guarantees cannot ‘conform fully to the provisions of Part V’ of that Agreement within the meaning of Article 13(c)(ii) of the Agreement. That is, they are not ‘export subsidies’ for the purposes of the Agreement, and it is, in any event, conceptually not possible to conform with non-existent disciplines and trigger the exemption from action provided for in Article 13(c). They would thus not be ‘exempt from actions’ based on Article 3 of the *SCM Agreement* (and Article XVI of the *GATT 1994*) within the meaning of Article 13(c)(ii) of the *Agreement on Agriculture*.”⁴⁰⁴

397. However, Article 10.2 contemplates the development of internationally agreed disciplines applicable to export credit guarantees and indeed requires that once such disciplines are agreed Members shall only apply export credit guarantees in conformity with such disciplines. The drafters may well have anticipated that such disciplines would be developed and agreed during the nine years of 1995-2004 constituting the implementation period for purposes of Article 13 of the *Agreement on Agriculture*, as provided in Article 1(f) of that Agreement. Article 10.2 is within Part V of the Agreement, and Article 13(c) would have had effect with respect to export credit guarantees at that time. Until then, however, the question of conformity with Part V would not be relevant to export credit guarantees, and pursuant to Article 21.1 of that Agreement and the chapeau of Article 3 of the *SCM Agreement*, Article 3 simply would not apply to them.

⁴⁰³Panel Report, para. 7.657.

⁴⁰⁴Panel Report, para. 7.944. See also, Panel Report, para. 7.751.

3. In Its Analysis the Panel Reversed the Burden of Proof Applicable Under the SCM Agreement

398. With respect to an examination of the programs in connection with item (j) of the Illustrative List of Export Subsidies under Annex I of the *SCM Agreement*, the normal rules concerning the burden of proof apply.⁴⁰⁵ It is incumbent on Brazil as the complaining party to fulfill the burden with respect to the requisite elements of item (j). However, in multiple instances the Panel has wrongly placed the onus on the United States, thus invalidating its finding with respect to item (j).

399. This misguided analytical approach culminates in the Panel's misapplication of Article 10.3 of the Agreement on Agriculture to the *SCM Agreement*, where it has no application at all.

400. Immediately preceding its conclusion that U.S. export credit guarantee programs run afoul of item (j) in Annex I of the SCM Agreement⁴⁰⁶, the Panel "recall[s] the burden of proof articulated in Article 10.3 of the *Agreement on Agriculture*, [to conclude that] the United States has not established that it does not provide these export credit guarantee programs at premium rates which are inadequate to cover the long-term operating costs and losses."⁴⁰⁷ *But the burden of proof articulated in such Article 10.3 has no application to the SCM Agreement.* The Panel has wrongly reversed the ordinary burden of proof applicable under the SCM Agreement, which remains with the complaining party.

401. The Panel has simply ignored the text of the *Agreement on Agriculture* limiting the application of Article 10.3 to very specific circumstances. Curiously, elsewhere in its report the Panel appears to understand the limitation. In paragraphs 7.271-7.273, the Panel correctly notes: "As regards agricultural export subsidies, the text of Article 10.3 of the *Agreement on*

⁴⁰⁵See, e.g., Panel Report, para. 7.270.

⁴⁰⁶Panel Report, para. 7.869.

⁴⁰⁷Panel Report, para. 7.868.

Agriculture articulates a special rule that alters the usual rule on burden of proof in certain disputes under Articles 3, 8, 9, and 10 of the *Agreement on Agriculture*.⁴⁰⁸ Citing the Appellate Body,⁴⁰⁹ the Panel further correctly articulates that the burden of proof allocated under Article 10.3 applies in the limited circumstance of an allegation of export subsidy in excess of export subsidy reduction commitments set forth in the defending party’s particular schedule. “Where a Member exports an agricultural product in quantities that exceed its quantity commitment level, that Member will be treated as if it has granted WTO-inconsistent export subsidies, for the excess quantities, unless the Member presents adequate evidence to ‘establish’ the contrary.”⁴¹⁰

402. The reversal of burden of proof under Article 10.3 of the *Agreement on Agriculture* is limited to those very particular disputes and has no bearing on disputes or determinations under the SCM Agreement.

a. As a Result of Reversing the Applicable Burden of Proof the Panel Has Wrongly Found the United States Has Conferred Export Subsidies on Agricultural Goods for which it Does Not Have Export Subsidy Reduction Commitments

403. The Panel has misapplied Article 10.3 with respect to Brazil’s claims that export credit guarantee programs confer export subsidies to agricultural commodities for which the United States does not have reduction commitments. The Panel reverses the applicable burden of proof in examining whether export subsidies “have been provided under the programs in question during the period we have examined in respect of exports of upland cotton and certain other unscheduled agricultural products.” With respect to such unscheduled products, the Panel states: “The United States has not shown that no export subsidy has been granted in respect of

⁴⁰⁸Panel Report, para. 7.271.

⁴⁰⁹Appellate Body Report, *Canada-Dairy (Second Recourse to Article 21.5)*, paras. 70-73.

⁴¹⁰Panel Report, para. 7.273. In this respect, the only commodity with respect to which the burden would properly shift is rice. See Panel Report, para. 7.881.

such products.” This approach reverses the well-established application of the rule of Article 10.3 as explained by the *FSC* panel: “[W]e consider that Article 10.3 of the Agreement on Agriculture places the burden on the United States to present evidence and argument sufficient to establish that no export subsidy has been granted in respect of any quantity of a product exported in excess of the reduction commitment levels found in its Schedule for that product. In the case of unscheduled products, however, the burden remains with the [complaining party] to present evidence and argument sufficient to establish that export subsidies have been provided with respect to that product.”⁴¹¹

404. Such an error cannot be ascribed to confusion over the distinction between “scheduled” and “unscheduled” commodities. The Panel understands the distinction between “scheduled” commodities, with respect to which export subsidy reduction commitments apply, and “unscheduled” commodities, with respect to which export subsidies are prohibited. For the United States, upland cotton is in the latter category.⁴¹² Article 10.3 of the *Agreement on Agriculture* does not even apply in circumstances of an alleged export subsidy of agricultural goods that are prohibited (*i.e.*, the defending party has no reduction commitment with respect to such good, and export subsidies for such good are therefore prohibited). Consequently, in addition to reversing the burden of proof applicable to any determination under the SCM Agreement, the Panel has also reversed the applicable burden of proof for its findings under Article 10.1 of the *Agreement on Agriculture* in respect of upland cotton and the other unscheduled agricultural products. As Article 10.3 does not even apply to such circumstances under the *Agreement on Agriculture*, it cannot and does not apply to any determinations with respect to the SCM Agreement or any other WTO Agreement. The Panel has looked to the wrong agreement for context and applied the wrong burden of proof against the United States.

⁴¹¹Panel Report, *U.S. – FSC*, para. 7.143. This aspect of the Panel Report was not appealed.

⁴¹²See Panel Report, paras. 7.793, 7.876-7.878.

b. The Panel has Three Times Wrongly Imposed on the United States the Burden of Proof Applicable to Determinations under Item (j) of the SCM Agreement

405. The Panel found that the programs “are provided by the United States government at premium rates which are inadequate to cover long-term operating costs and losses of the programs within the meaning of item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*.” In at least three instances, however, the Panel imposed the burden of proof on the United States to make demonstrations the Panel deemed necessary, instead of imposing the standard applicable burden of proof on Brazil, as claimant under the SCM Agreement:

406. *First:* The Panel asserts that “the premiums are not geared toward *ensuring* adequacy to cover long-term operating costs and losses for the purposes of item(j).”⁴¹³ Nowhere does item (j) require a Member to *ensure* such adequacy. This is a much higher threshold than the text provides.

407. *Second:* Similarly, the Panel concludes that “[i]n terms of the structure, design, and operation of the programs [we] believe that the programs are not designed to avoid a net cost to government.”⁴¹⁴ To “avoid a net cost” prospectively is simply not the requirement of item (j). To similar effect, the Panel imposes on the United States a “likelihood” standard of performance higher than that found in item (j): “whether revenue would be likely to cover the total of all operating costs and losses under the program.”⁴¹⁵

408. *Third:* The Panel also rejects the argument of the United States with respect to the trend toward profitability of the export credit guarantee programs demonstrated in certain budget data. The Panel states: “We have not been persuaded that cohort re-estimates over time, will

⁴¹³Panel Report, para. 7.859.

⁴¹⁴Panel Report, para. 7.857.

⁴¹⁵Panel Report, para. 7.805. *See also*, Panel Report, para. 7.835.

necessarily not give rise to a net cost to the United States government.”⁴¹⁶ The Panel elsewhere states: “While there may be a possibility (based on the experience of certain of other cohorts) that this figure may diminish over the lifetime of the cohort concerned, there is no assurance that this figure will *necessarily* evolve towards, and conclude as, zero or a negative figure.”⁴¹⁷ Under the applicable burden of proof, however, it is not for the United States to make such incontrovertible demonstrations to the Panel, and the Panel erred in requiring it. Rather, in all of these examples, it is for Brazil to demonstrate that the challenged programs are provided at premium rates which are inadequate to cover long-term operating costs and losses.

409. For the foregoing reasons, the Appellate Body should reverse the Panel’s determination that the CCC export credit guarantee programs are provided at premium rates which are inadequate to cover long-term operating costs and losses of the program within item (j) of the Illustrative List of Export Subsidies in Annex I of the SCM Agreement. In addition, the Panel should reverse the Panel’s findings under Paragraph 8.1(d)(I) that such programs constitute prohibited subsidies under Article 3.1 and 3.2 of the SCM Agreement.

4. The Panel has Failed to Make Necessary Findings of Fact to Support its Conclusion that the CCC Export Credit Guarantee Programs are Provided at Premium Rates Which Are Inadequate to Cover Long-Term Operating Costs and Losses Within the Meaning of Item (j)

410. Having reversed the applicable burden of proof, the Panel finds against the United States despite an absence of factual findings to support its conclusions with respect to item (j). The Panel appears to base its conclusions largely on the accounting methodology of the United States reflected in the U.S. budget.⁴¹⁸ The Panel assesses whether long-term operating costs and losses

⁴¹⁶Panel Report, para. 7.853.

⁴¹⁷Panel Report, fn. 1028

⁴¹⁸See generally, Panel Report, paras. 7.842-7.856.

have occurred principally as a function of the figures set forth in the U.S. budget.⁴¹⁹ Conspicuously absent from the Panel’s application of the figures in the U.S. budget is an actual finding of fact, however. First, the Panel acknowledges that the budget figures on which it purports to rely are only “*initial estimates* of the long-term costs to the United States government.”⁴²⁰ [italics in original] The Panel further recognizes that they are not “historically verifiable real amounts that have been, or actually will be, disbursed by the United States government. Rather, this is a methodology used and relied upon by the United States government[.]”⁴²¹

411. It is important to note that the budget figures on which the Panel and Brazil principally rely are a net present value on an estimated projection into the future of potential payment and receipts.⁴²² These estimates are themselves subject to re-estimation over the lifetime of the particular guarantees involved.⁴²³ Brazil has relied on a constructed “cost” formula derived from such budget data.⁴²⁴ In response to financial arguments of Brazil based on such “estimates” and “methodology”, the United States proffered evidence that “total revenues exceed total expenses of the programs by approximately \$630 million.”⁴²⁵ In contrast, figures submitted by Brazil allege a net loss of \$1.083 billion. Comparing these conclusions, the Panel notes, shows “a major difference between the parties’ approaches relates to the treatment of re-scheduled debt.”⁴²⁶

⁴¹⁹“We believe that it is relevant for our item (j) analysis that, netting re-estimates against original subsidy estimates on a cohort-specific basis yields a positive subsidy which reveals that over the long term the United States government anticipates that it may not break even with its export credit guarantee programs.” Panel Report, para. 7.854. Recognizing that these estimates only present a projection of what *may* occur, the Panel recognizes that the estimates have no *necessary* correlation with what in fact does occur.

To similar effect the Panel notes that CCC financial statements indicate a “credit guarantee liability” of \$411 million and \$22 million for the respective years 2002 and 2003. Although the Panel specifically notes that “*these amounts are not actual losses*, [t]hey are [an] indicator []to assess the estimated long-term cost to the United States government of export credit guarantees” (italics added). Panel Report, para. 7.855.

⁴²⁰Panel Report, para. 7.843.

⁴²¹*Id.*

⁴²²Panel Report, para. 7.842 and fn. 997.

⁴²³Panel Report, para. 7.843 and fns. 1003 and 1004.

⁴²⁴Panel Report, para. 7.844.

⁴²⁵Panel Report, para. 7.846.

⁴²⁶Panel Report, para. 7.847.

412. The precariousness of reliance on the budgetary figures for any assessment of whether the programs are covering long-term operating costs and losses becomes more evident with a fuller understanding of what such figures are and are not. As the figures are reviewed annually, the estimates will change until all relevant data is in. This re-estimation process is hugely significant. As the Panel notes, “over the lifetime of the cohorts issued in 1992 and since, the record indicates an overall lifetime downward re-estimate [i.e. better net performance than originally estimated] of \$1.9 *billion*.”⁴²⁷ (Italics added). In addition, for the entire period examined (1992-2002), “with the exception of 2002, for which only very recent data is necessarily available [] the trend for all cohorts is uniformly favorable as compared to the original subsidy amount.”⁴²⁸ Consequently, with respect to the most recent years the data indicates a trend for overall profitability, but significant data regarding actual operating experience is simply not reflected yet in the budgetary figures.⁴²⁹

413. Brazil has repeatedly and correctly acknowledged that in the budgetary figures for the programs the “original estimates were too high.”⁴³⁰ As the budgetary figures are prepared the same way for each year, it is as true for the more current years as for the earlier years. The only distinction, however, is that more recent years lack the actual operational data to permit the now-routine re-estimation toward profitability. These original estimates are compelled by government-wide accounting rules for credit programs and are not unique to the CCC programs.⁴³¹ Consequently, the budgetary estimate figures inherently tend to project an exaggerated negative performance, which is more pronounced in the more recent years because they have not yet been able to reflect the more favorable actual operational data.⁴³²

⁴²⁷Panel Report, para. 7.853.

⁴²⁸Panel Report, para. 7.853. See also, U.S. Rebuttal Submission (August 22, 2003), para. 161, and U.S. Answers to Panel Question 221(a) (December 22, 2003), correcting table for such para. 161.

⁴²⁹See generally U.S. Further Submission (September 30, 2003), paras. 145-149.

⁴³⁰Second Oral Statement of Brazil (October 7, 2003), para. 70; Comments on U.S. Rebuttal Submission; para. 60.

⁴³¹Panel Report, para. 7.842 and fns. 996, 997; Panel Report, para. 7.843 and fn. 1003.

⁴³²See generally U.S. Answers to Panel Question 221(g)(December 22, 2003), paras. 96-99

414. The tenuousness of this factual basis for Brazil’s argument and the Panel’s assessment that the “major difference between the parties’ approaches relates to the treatment of re-scheduled debt” compels a specific finding of fact on this major difference.

415. Ultimately, however, the Panel made no factual finding on this important disparity. Indeed, the Panel explicitly states that, in its view, it is “not called upon to make a precise quantification of the amount by which premiums *may or may not* be sufficient.”⁴³³ [italics added] Despite the fact that the “United States indicates that the standard accounting treatment of reschedulings by the CCC is to no longer treat them as an outstanding claim, but rather as a new direct loan,” the Panel simply “shares Brazil’s concerns that the United States’ treatment of rescheduled debt before us understates the net cost to the United States government associated with the export credit guarantee programs at issue.”⁴³⁴ But the Panel never makes a factual basis concerning the treatment of rescheduled debt and thereby fails to support its determination under item (j).

416. The Panel did not conclude that the rescheduled debt was an operating cost or loss. The United States indicated that the standard accounting treatment of reschedulings by the United States government is to no longer treat them as an outstanding claim, but rather as a new direct loan.⁴³⁵ In response, the Panel stated only vaguely that it “share[s] Brazil’s concerns that the United States’ treatment of rescheduled debt before us understates the net cost to the United States government associated with the export credit guarantees as issue.”⁴³⁶

417. If so, by how much? The absence of this factual finding is not a mere academic exercise, because the 10-year net *estimate* figures on which Brazil relies in both the U.S. budget and the CCC financial statements involve razor-thin amounts of \$230 million and \$22 million,

⁴³³Panel Report, para. 7.825.

⁴³⁴Panel Report, para. 7.851.

⁴³⁵Panel Report, para. 7.851, fn. 1021.

⁴³⁶Panel Report, para. 7.852.

respectively.⁴³⁷ These figures are less than one percent and one tenth of one percent, respectively, of the overall \$35.098 billion of actual sales registrations under the program during the 1992-2002 period⁴³⁸, constituting “long-term” for purposes of this dispute.⁴³⁹ These figures necessarily include recent years for which little actual operating experience is reflected in the pertinent estimate.

418. The proportionally tiny \$230 million and \$22 million figures indicate only that “CCC believes, based upon its own assessment, that it *may not*, even over the long term, be able to operate the export credit guarantee programs without some net cost to government [italics added].”⁴⁴⁰ That is, the estimates do *not* establish that CCC *has not operated* the programs without a net cost to the government. On this highly tenuous basis, and without resolving the disparity between the data and treatment of reschedulings by the United States and Brazil, the Panel concludes “the above considerations relating to the past performance of the programs support a view that the programs are run at a net cost to the United States government.”⁴⁴¹

419. Under the totality of the circumstances, the absence of a specific factual finding on the basis for and monetary extent to which the United States has allegedly not covered its long-term operating costs and losses for the CCC export credit guarantee programs, compels the reversal of the Panel’s finding in respect of item (j).

420. The Panel further identifies myriad considerations set forth in both the authorizing statute and implementing regulations for the programs that restrict the use of the program for reasons of financial prudence.⁴⁴² Yet the Panel dismisses these constraints because they do not set forth

⁴³⁷Panel Report, para. 7.853, 7.854.

⁴³⁸See table entitled “Annual President’s Budgets and Actual Sales Registrations, Fiscal Years 1992-2004. (U.S. Further Submission, 30 September 2003, para. 148). The total of actual sales registered and guaranteed under the programs for years 1992-2002 are known and noted in year 3 of the table. The figure \$35.098 billion is the sum of the figures in year 3 for each of program years 1992-2002.

⁴³⁹Panel Report, para. 7.831.

⁴⁴⁰Panel Report, para. 7.855.

⁴⁴¹Panel Report, para. 7.856.

⁴⁴²Panel Report, para. 7.862.

explicit criteria for “what might constitute an acceptable level of risk in evaluating whether countries can adequately service their debt. Nor does the statute impose any limitation on the amount of guarantees that can be provided annually to a high-risk country.”⁴⁴³ This dismissive view of the statutory provisions contrasts with its own recognition that the same statutory provisions “indicate to us that there exists a discretion (on the part of the Secretary) to determine situations in which guarantees cannot be made available,”⁴⁴⁴ such that the programs do not pose a threat of circumvention of export subsidy commitments even for products for which the United States is not allowed to provide export subsidies at all.

VI. The Step 2 Program is not a Prohibited Import Substitution Subsidy

A. The Panel’s Decision Fails to Give Meaning to the Introductory Phrase of Article 3 with Respect to Article 3.1(b)

421. Article 3.1 of the SCM Agreement provides:

“Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

- (a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I;
- (b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods.”

⁴⁴³Panel Report, para. 7.862.

⁴⁴⁴Panel Report, para. 7.888.

422. The introductory phrase “Except as provided in the Agreement on Agriculture” applies not only to Article 3.1(a) but also to 3.1(b). The Panel’s conclusions with respect to the Step 2 import substitution subsidy would improperly require a reading of the provision such that the introductory phrase does not apply to 3.1(b). The Panel may interpret the text but not amend it.

423. The Panel explicitly asserts an identity between subsidies covered by the exception and export subsidies under the Agreement on Agriculture: “subsidies covered by this introductory phrase (i.e. export subsidies provided for in the *Agreement on Agriculture*).”⁴⁴⁵ The Panel further expresses its view that “the introductory phrase of Article 3.1 forms part of the scheme referred to [] in paragraph 7.261. The introductory phrase refers to the *Agreement on Agriculture* as a whole [].”⁴⁴⁶

424. The Panel correctly recognizes that as a result of Article 3.1 the SCM Agreement “defers to the *Agreement on Agriculture*.”⁴⁴⁷ The Panel further correctly notes that “the text of Article 3.1(a) of the SCM Agreement indicates that the obligation it contains (and consequently the related obligations in Article 3.2 of that agreement) applies except as provided in the *Agreement on Agriculture*.”⁴⁴⁸ Similarly, the obligation of Article 3.1(b) is limited in application by the same exception provided in the *Agreement on Agriculture*.

425. Although the Panel elsewhere views the words “except as provided” as a semaphore for an express articulation that “the existing disciplines do not apply”⁴⁴⁹, in the context of SCM Article 3.1(b) this language means nothing to the Panel unless “an explicit carve-out or exemption from the disciplines in Article 3.1(b) of the SCM Agreement existed in the *text* of the *Agreement on Agriculture*.”⁴⁵⁰ Similarly, the Panel indicates that had the drafters intended “to undermine the

⁴⁴⁵Panel Report, para. 7.277.

⁴⁴⁶Panel Report, para. 7.277.

⁴⁴⁷Panel Report, para. 7.670.

⁴⁴⁸Panel Report, para. 7.672.

⁴⁴⁹See Panel Report, para. 7.909.

⁴⁵⁰Panel Report, para. 7.1038.

fundamental disciplines applicable to import substitution subsidies [] they would have so indicated.”⁴⁵¹ The application of the introductory phrase “except as provided” to Article 3.1(b) is such an indication.

426. Implausibly, the Panel states: “Neither the introductory phrase in Article 3.1 of the SCM Agreement, nor Article 21.1 of the Agreement on Agriculture mean that the Agreement on Agriculture must *necessarily* [italics in original] contain a provision that would have the effect of carving out certain domestic support measures from the prohibition on import substitution in Article 3.1(b) of the SCM Agreement or rendering those disciplines inapplicable to agricultural domestic support.”⁴⁵²

B. The Permissibility of the Import Substitution Subsidy is Congruent with Both the SCM Agreement and the Agreement on Agriculture and Gives Current Effect to the Introductory Phrase of Article 3 As Applied to Article 3.1(b)

427. In the Panel’s view, payments to processors of agricultural commodities must be made without regard to the origin of such commodities. The Panel asserts that it “can conceive of domestic support measures provided to processors which provide support ‘in favor of domestic producers’ and that are *not* contingent upon the use of domestic over imported goods.”⁴⁵³ The example it offers is “subsidies paid to processors regardless of the origin of the basic agricultural product.”⁴⁵⁴ But this example renders the subsidy a simple input subsidy not in favor of agricultural producers but of processors. As such, the subsidy would be subject to the disciplines of the *SCM Agreement*, where such subsidies are permitted (provided they do not cause adverse effects to other Members) and not subject to budgetary limitation.

⁴⁵¹Panel Report, para. 7.1074.

⁴⁵²Panel Report, fn. 1202

⁴⁵³Panel Report, para. 7.1065.

⁴⁵⁴Panel Report, fn. 1212

428. The Step 2 program provides a benefit to U.S. cotton producers because it serves to maintain the price competitiveness of U.S. cotton vis-a-vis foreign cotton through a payment to processors without regard to the origin of the cotton would cause the benefit to cotton producers to evaporate. The subsidy would be transformed from a subsidy “in favor of agricultural producers” to a simple input subsidy in favor of industrial manufacturers. It would be a *textile* subsidy, not a cotton subsidy, and outside the coverage of the *Agreement on Agriculture* altogether.⁴⁵⁵ As a result, the Panel’s interpretation would render Paragraph 7 of Annex 3 of the Agriculture Agreement “inutile”. Under the Panel’s analysis, in effect, no payments directed at agricultural processors may benefit the domestic producers of the basic agricultural product, even though Annex 3 of the *Agreement on Agriculture* expressly contemplates that such payments may occur and should be included in the AMS.

429. The Panel posits the necessity of a conflict between the SCM Agreement and the *Agreement on Agriculture* to give effect to the exception in connection with Article 3.1(b). Then it creates the straw men of several hypothetical situations not present in this dispute that would create a “conflict”. In the absence of these straw men, the Panel then sees no conflict and therefore no current effect to the exception.⁴⁵⁶ The Panel states it plainly: “We have concluded that the *Agreement on Agriculture* does not ‘provide’ otherwise so as to affect the prohibition on import substitution subsidies in Article 3.1(b) of the SCM Agreement.”⁴⁵⁷

430. The Panel correctly notes that there is an interpretive presumption against conflict among agreements.⁴⁵⁸ The United States, however, does not posit that a conflict exists or is necessary.

⁴⁵⁵Annex I of the *Agreement on Agriculture* only extends to raw cotton, waste and cotton carded or combed (HS 52.01-52.03). In contrast, Article I:7 of the Agreement on Textiles and Clothing and the Annex to that Agreement set forth the list of products covered by that Agreement. That Annex includes a wide array of manufactured cotton goods under the remainder of Chapter 52 of the HTS.

⁴⁵⁶Panel Report, paras. 7.1038-7.1040

⁴⁵⁷Panel Report, para. 7.1072.

⁴⁵⁸Panel Report, para. 7.1040 and fn. 1205.

Nor does the United States argue the Article 3.1(b) does not apply at all. To the contrary, the drafters needed the introductory phrase of Article 3 to apply to Article 3.1(b) to maintain harmony between the domestic support provisions of the *Agreement on Agriculture* and the *SCM Agreement*.⁴⁵⁹ If the drafters intended the exception to apply currently solely to export subsidies, then they would not have applied the introductory phrase to Article 3.1(b) at all. The United States submits that this gives more proper effect to the introductory phrase of Article 3.1(b) than the interpretation of the Panel, which views the exception as applicable only to a non-existent set of measures.

431. The Panel appears to rely in part on the absence of a reference to Article 3 of the *SCM Agreement* in Article 13(b)(ii) of the *Agreement on Agriculture*.⁴⁶⁰ A reference to Article 3 is not necessary to achieve the intended result with respect to the relationship between the *Agreement on Agriculture* and Article 3.1(b).

432. Article 13(b) does not refer to Article 3 of the *SCM Agreement* because the substantive obligation of Article 3.1(b) does not apply in the case of domestic content subsidies in favor of agricultural producers. It would be no more necessary to refer to such a potential claim than a potential claim under, say, the *Agreement on Safeguards* or any other equally irrelevant provision

⁴⁵⁹The Panel overstates the argument of the United States, which it characterizes as: “The United States contends that user marketing (Step 2) payments to upland cotton domestic users that provide support to domestic producers contingent on the use of domestic goods is [sic] consistent with the *Agreement on Agriculture*.” Panel Report, para. 7.1056. The United States submits, however, that such payments are permissible only to the extent the United States domestic support measures, including such Step 2 payments, are within the domestic support reduction commitments of the United States, in accordance with Article 6 of the *Agreement on Agriculture*.

The Panel further mischaracterizes the argument of the United States: “We believe there is a clear distinction between a provision that requires a Member to include a certain type of payment (or part thereof) in its AMS calculation and a provision that requires inclusion in the AMS of subsidies contingent upon import substitution. The United States, in this dispute, would have us read such provisions synonymously.” The United States did not so argue. The United States does argue that it is illogical for paragraph 7 of Annex 3 of the *Agreement on Agriculture* to contemplate inclusion of such payments within the AMS, if they are already prohibited. It would make no sense to compel inclusion of an already-prohibited subsidy.

⁴⁶⁰According to the Panel, “[t]he negotiators were [] fully aware of how to insert a reference to Article 3 of the *SCM Agreement* when they deemed it appropriate to do so (as they did in Article 13(c)). However, they inserted no such cross-reference when addressing obligations relevant to domestic support measures in Article 13(b).” Panel Report, para. 7.1049. See also Panel Report, para. 7.1070.

of the WTO Agreements. Article 13(b) applies to “domestic support measures that conform fully to the provisions of Article 6 of this Agreement.” The character of the domestic subsidy is not relevant to the disciplines. The *Agreement on Agriculture* never defines “domestic support”. Domestic support in any form is permitted so long as the Member adheres to its reduction commitments. Under the *Agreement on Agriculture* domestic content subsidies are permitted. The only qualification on any form of domestic support is the domestic support reduction commitments. In contrast, although it is not the case in this dispute, it is certainly possible that (in the absence of the Peace Clause) a domestic support measure in conformity with Article 6 of the *Agreement on Agriculture* could cause adverse effects or serious prejudice within the meaning of Articles 5 and 6 of the *SCM Agreement* or Article XVI:1 of GATT 1994.

433. Under the *Agreement on Agriculture* all annual domestic support provided for an agricultural product, like cotton, in favor of the producers of that product that is not otherwise exempt under the “green box” (Annex 2 of the *Agreement on Agriculture*) from reduction commitments, or as otherwise provided in Articles 6.4 and 6.5 of the Agreement, is included in the Aggregate Measure of Support (AMS), as defined in Article 1(a) of the Agreement.

434. The definition further contemplates that support provided during any one year is to be calculated in accordance with the provisions of Annex 3 of the *Agreement on Agriculture*. Paragraph 7 of Annex 3 requires that “measures directed at agricultural processors shall be included [in the AMS] to the extent such measures benefit the producers of the basic agricultural products.” Accordingly, Step 2 user payments, paid to upland cotton processors and other users but benefitting U.S. producers of upland cotton, are included in the annual AMS calculation of the United States. As a result, such payments are subject to reduction commitments applicable to the United States.

435. This approach and the inclusion of such payments is consistent with the articulated objective of the Agreement “to provide for substantial progressive reductions in agricultural

support and protection sustained over an agreed period of time.” The text does not indicate that any particular kind of domestic support in favor of agricultural producers is prohibited outright.

436. Since the inception of the Uruguay Round commitments, Step 2 payments have been reported among the domestic support measures of the United States in favor of its agricultural producers. The United States has consistently reported Step 2 as “amber box” product-specific support included within its calculation of Total AMS and therefore within its domestic support reduction commitments as set forth in Part IV of its Schedule.

437. Article 6.3 of the *Agreement on Agriculture* provides that “a Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favor of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member’s Schedule.”

438. Where a particular program exists in favor of agricultural producers within such Current Total AMS, the text of the *Agreement on Agriculture* is entirely agnostic as to the method of delivery of such support. Consequently, under Article 6.3 of the *Agreement on Agriculture* a Member may opt to provide “amber box” support in any direct or indirect way as long as that Member’s “Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member’s Schedule.”

439. Annex 3, paragraph 7, of the *Agreement on Agriculture* specifically requires that “[m]easures directed at processors to be included” in the calculation of AMS to subject these measures to the domestic support reduction commitments. As the European Communities⁴⁶¹ and the United States pointed out to the Panel, the *Agreement on Agriculture* envisions domestic

⁴⁶¹Answers of the European Communities to Panel Question 40, paras. 72-78

content subsidies in favor of agricultural producers, albeit paid to processors, provided such subsidies are provided consistently with the Member's domestic support reduction commitments.

440. To give proper meaning to the introductory phrase of Article 3 of the SCM Agreement in connection with Article 3.1(b) as well as to give effect to the recognized concept of *agricultural* subsidies paid to processors under the *Agreement on Agriculture* the Appellate Body should reverse the Panel's legal conclusion that section 1207 (a) of the 2002 Act providing for user marketing (Step 2) payments to domestic users of upland cotton is an import substitution subsidy prohibited under Articles 3.1(b) and 3.2 of the SCM Agreement.

VII. The Step 2 Program does Not Confer an Export Subsidy Under Article 3 of the Subsidies Agreement

441. The Appellate Body should also reverse the Panel's legal conclusion that same provision of law is an export subsidy listed in Article 9.1(a) of the *Agreement on Agriculture*, inconsistent with U.S. obligations under Articles 3.3 and 8 of that Agreement and not exempt under Article 13(c) of that Agreement.

A. Step 2 Payments are Not Contingent on Export Performance

442. Payment of the subsidy under the user marketing (Step 2) program is not contingent on export performance. The Panel accurately summarizes certain core characteristics of the program: user marketing (Step 2) payments are governed by a single legislative provision; a single set of regulations apply; pursuant to statute and regulations the form and rate of payment to domestic users and exporters are identical; the fund from which the payments are made is a unified fund available to both domestic users and exporters; and upland cotton does not have to

be exported to trigger eligibility for a user marketing (Step 2) payment as domestic users are also eligible.⁴⁶²

443. Payments are made to any user only when the price of the lowest-priced U.S. cotton exceeds the price of equivalent lowest-priced growths of upland cotton from other countries over four consecutive weeks. These payments are made to users of upland cotton, whose use can be manifest either by opening the bale of cotton or by export. The program is indifferent to whether recipients of the benefit of this program are exporters or parties that open bales for processing. Accordingly, the United States reports the benefits conferred under the Step 2 program as product-specific amber box domestic support for cotton within its Aggregate Measure of Support under Part IV of U.S. Schedule XX.⁴⁶³

B. The Panel has Made Factual Findings that Do Not Support Characterization of Step 2 Payments as an Export Subsidy

444. As the payments are contingent on use, without regard to the nature of the use, in any given year the payments may in theory be extended solely in connection with domestic use. A WTO dispute settlement panel has already determined that such facts do not involve an export subsidy for purposes of both Articles 9 and 10 of the *Agreement on Agriculture*, because the subsidy is not “contingent on export performance.” In *Canada-Measures Affecting the Importation of Milk and the Exportation of Dairy Products*, the United States and New Zealand challenged numerous aspects of Canada’s dairy export regime as contrary to its applicable export subsidy commitments. The United States and New Zealand successfully asserted that certain milk classes within the milk class system of Canada conferred export subsidies upon dairy processors. These classes were denominated “Special Classes 5(d) and 5(e).”

⁴⁶²Panel Report, para. 7.709.

⁴⁶³G/AG/N/USA/43, at 20 (Supporting Table DS:6) (Exhibit Bra-47)

445. In addition, however, the United States challenged the application of milk Classes 5(a) to 5(c). These classes “covered milk for domestic use as well as milk for export.”⁴⁶⁴ The panel specifically noted “that milk under such other classes is also available (often exclusively) to processors which produce for the domestic market.” The subsidy of these classes was also of course available in connection with exported product. Nevertheless, the panel found that because of the availability of the subsidy to processors producing for the domestic market, “access to milk under such other classes is not ‘contingent on export performance.’ We therefore find that such other milk classes do not involve an export subsidy under Article 9.1(a).”⁴⁶⁵ For precisely the same reasons, the panel also found that “these other milk classes do not involve an export subsidy in the sense of Article 10.1.”⁴⁶⁶

446. Rejecting the direct analogy of this case, the Panel attempts to draw factual distinctions between the Step 2 subsidy and the measures in *Canada-Dairy*:

447. First, it asserts that in *Canada-Dairy* “there was no explicit condition limiting a discrete segment of the payments of the subsidies concerned to exporters, nor was there a subsidy expressly combining the two contingency components before us: that is, use of domestic products and exportation.”⁴⁶⁷

448. The Panel is not correct. In that dispute, the United States and New Zealand specifically and successfully challenged “Special Classes 5(d) and 5(e)” of Canada’s milk class system, which conferred export subsidies to processors solely in their capacity as exporters.⁴⁶⁸ Those were a discrete segment of the Special Milk Class payments regime expressly limited to exporters. The export subsidies of Special Classes 5(d) and 5(e) were also only one part of the

⁴⁶⁴Panel Report, *Canada-Dairy*, fn. 373 and para. 7.41.

⁴⁶⁵Panel Report, *Canada-Dairy*, para. 7.41.

⁴⁶⁶Panel Report, *Canada-Dairy*, fn. 496, para. 7.124.

⁴⁶⁷Panel Report, para. 7.718

⁴⁶⁸U.S. First Written Submission (11 July 2003), para. 133. Panel Report, *Canada – Dairy*, paras. 7.40, 7.41.

Special Milk Class 5 subsidy regime combining two contingency components: use of domestic products and exportation. More importantly, in contrast, Classes 5(a) to 5(c) conferred an import substitution subsidy for dairy products destined for either domestic use or export.⁴⁶⁹ Yet the panel in that dispute found that the subsidy of Classes 5(a) through 5(c) did not constitute an export subsidy.

449. Second, the Panel focuses on the identification of two ostensibly “distinct situations”: “We consider it determinative that the text of the single legal provision at issue explicitly identifies the two distinct situations in which user marketing (Step 2) payments are made. The text does not identify a single monolithic situation in which payments are made to a single class of recipients.”⁴⁷⁰ The Special Milk Classes 5(a)-(c) payment system also did not “identify a single monolithic situation.” It had distinct classes for domestic and export use.⁴⁷¹

450. Third, the Panel also seeks to distinguish the nature of the documentation necessary for entitlement to receive the subsidy. “We note further that a distinction is drawn in the measure itself between domestic users and exporters in terms of the proof needed to be eligible for the subsidy []. Documentation to be submitted is also different. There are separate regulatory subsections and separate conditions pertaining to fulfillment of either of the two situations in which a user marketing (Step 2) subsidy can be granted.”⁴⁷²

451. In *Canada-Dairy*, however, the Canadian Dairy Commission issued two types of permit for Class 5 milk. Permits for Classes 5(a)- (c) were annual permits to processor/exporters. The

⁴⁶⁹Panel Report, *Canada-Dairy*, para. 2.39.

⁴⁷⁰Panel Report, para. 7.725.

⁴⁷¹As noted in *Canada-Dairy*, para. 2.39, the definition of the Special Milk Classes under Class 5 as contained in the Comprehensive Agreement on Special Class Pooling is as follows:

Class 5(a): Cheese ingredients for further processing for the domestic and export markets.

Class 5(b): All other dairy products for further processing for the domestic and export markets

Class 5(c): Domestic and export activities of the confectionary sector.

⁴⁷²Panel Report, para. 7.727.

permits for Classes 5(d) and (e) were on a transaction-by-transaction basis.⁴⁷³ The price for the respective classes were also established through separate mechanisms.

452. Notwithstanding the erroneous attempts of the Panel to draw factual distinctions between the Step 2 subsidy and the *Canada-Dairy*, the facts are analogous and the reasoning applicable. The Step 2 subsidy is not contingent on export.

453. The apparent determination of the Panel to find an export subsidy appears to arise from an erroneous fixation on finding a prohibited import substitution under the program. Twice invoking the colorful language that “two wrongs cannot make a right”⁴⁷⁴, the Panel appears to assert that *because* it believes that payment of the Step 2 subsidy to domestic mills constitutes a prohibited subsidy under Articles 3.1(b) and 3.2 of the *SCM Agreement*, therefore the payment of the Step 2 use subsidy to recipients who export *must* be an export subsidy.

454. The inextricable linkage of the two in the reasoning of the Panel is evident: “Most importantly, here, we do not believe that it is possible for a Member to design two prohibited subsidy components - an export subsidy and an import substitution - and, merely through joining them in a single legal provision, somehow render one, or both, of them ‘unprohibited’. It is simply inconceivable to us that two prohibited subsidies could somehow become permitted because they are provided for in the same legal provision.”⁴⁷⁵ Although the United States has already noted the fallacy of the Panel’s approach in reaching its determinations with respect to a prohibited import substitution subsidy under the Step 2 program, the determination of whether or not an export subsidy exists should be made irrespective of such determination. The Step 2 program is indifferent as to whether the use triggering payment is domestic consumption or export. Therefore, the payment is not contingent on export. It is not an export subsidy. The Appellate Body should reverse this finding of the Panel.

⁴⁷³Panel Report, *Canada-Dairy*, paras. 2.49-2.51.

⁴⁷⁴Panel Report, paras. 7.741, 7.757

⁴⁷⁵Panel Report, para. 7.741. See also, Panel Report, para. 7.757.

VIII. The Panel Improperly Examined Measures That Were Not Within Its Terms of Reference and Measures for Which Brazil Did Not Meet the Procedural Prerequisites of the SCM Agreement

A. Export Credit Guarantees for Commodities Other Than Upland Cotton were not Within the Panel’s Terms of Reference

455. In paragraph 7.69 of its Report, the Panel concluded that “export credit guarantees to facilitate the export of ... other [*i.e.*, other than upland cotton] eligible agricultural commodities ... are within its terms of reference.” This conclusion was in error and must be reversed.

Contrary to the Panel’s conclusion, Brazil’s request that the Panel examine such export credit guarantees was inconsistent with the DSU, because it asks for an examination of measures that were not included in the request for consultations. That request covered exclusively “subsidies provided to US producers, users and/or exporters of upland cotton,” including “export credit guarantees . . . to facilitate the export of US upland cotton.”

456. “Export credit guarantees to facilitate the export of ... other eligible agricultural commodities” were not a measure within the scope of the consultations in this dispute, and consequently could not constitute part of the matter within the Panel’s terms of reference.

1. Brazil Did Not Include Export Credit Guarantees for Other Commodities in its Consultation Request and Therefore They Were Not in the Panel’s Terms of Reference

457. In a request for preliminary ruling submitted as part of its first written submission to the Panel, the United States explained that Brazil’s consultation request identified the challenged measures as follows:

The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton^{1/}, as well as legislation, regulations, statutory instruments and amendments thereto providing such subsidies (including export credits), grants, and any other assistance to the US producers, users and exporters of upland cotton (“US upland cotton industry”).⁴⁷⁶

Thus, on its face, the challenged measures were “subsidies provided to US producers, users and/or exporters of upland cotton.” Footnote 1, which followed the first reference to “upland cotton,” read: “Except with respect to export credit guarantee programs as explained below.”

458. However, there were only two subsequent references to export credit guarantee programs – and thus only two possible “explan[at]ions] below” – within the consultation request. The first such reference was the following further description in Brazil’s identification of the measures at issue:

Export subsidies, exporter assistance, *export credit guarantees*, export and market access enhancement *to facilitate the export of US upland cotton* provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, and the Step 1 and Step 2 certificate programs, among others.⁴⁷⁷

Nothing in this reference expanded the scope of the measures at issue beyond “US producers, users and/or exporters of upland cotton”.

⁴⁷⁶WT/DS267/1, at 1 (text of footnote omitted).

⁴⁷⁷WT/DS267/1, at 2 (italics added).

459. Near the end of its consultation request, as part of a series of paragraphs devoted to the indication of the legal basis of the complaint,⁴⁷⁸ Brazil set forth a list of claims applicable to the measures it had identified:

Regarding export credit guarantees, export and market access enhancement provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, Brazil is of the view that these programs, as applied and as such, violate Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture and are prohibited export subsidies under Article 3.1(a) and item (j) of the Illustrative List of Export Subsidies included as Annex I to the SCM Agreement.⁴⁷⁹

Once again, nothing in that paragraph made reference to any “other” commodities.

460. Thus, Brazil’s consultation request identified as a challenged measure export credit guarantees “to facilitate the export of upland cotton”; the consultation request nowhere identified export credit guarantees with respect to any other commodity as a measure at issue.

461. Furthermore, as detailed in Section VIII(B) below, the statement of evidence attached to Brazil’s consultation request provides further proof that the request did not extend beyond export credit guarantees for upland cotton; the text of that statement of evidence mentions no commodities other than upland cotton.

⁴⁷⁸Article 4.4 of the DSU provides that a consultation request shall include an “identification of the measures at issue” and an “indication of the legal basis of the complaint.”

⁴⁷⁹WT/DS267/1, at 4.

462. However, when Brazil filed its *panel* request, the language referring to export credits had been altered.⁴⁸⁰ Brazil broadened the first reference to export credits dramatically:

Export subsidies, exporter assistance, *export credit guarantees*, export and market access enhancement *to facilitate the export of US upland cotton, and other eligible agricultural commodities as addressed herein*, provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, and the Step 1 and Step 2 certificate programs, among others.⁴⁸¹

Thus, Brazil added an entirely new reference to “export credit guarantees . . . to facilitate the export of . . . other eligible agricultural commodities” – a reference that had not appeared in the consultation request.

463. A second reference to export credits in Brazil’s list of claims relating to the measures previously identified was similarly enhanced:

Regarding export credit guarantees and export and market access enhancement provided under the Agricultural Trade Act of 1978, as amended, and *export credit guarantee measures relating to eligible US agricultural commodities*, such as the GSM-102, GSM-103, and SCGP programmes, these programs violate, as applied and as such, Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture and are

⁴⁸⁰Another change between the consultation request and the panel request occurred in the footnote quoted above following the first reference to “upland cotton” in the first paragraph identifying the challenged measures. The footnote in the panel request was changed to read: “The term ‘upland cotton’ means raw upland cotton as well as the primary processed forms of such cotton including upland cotton lint and cottonseed. The focus of Brazil’s claims relate to upland cotton with the exception of the US export credit guarantee programs as explained below.” WT/DS267/7, at 1 n.1.

⁴⁸¹WT/DS267/7, at 2 (emphasis added).

prohibited export subsidies under Articles 3.1(a), 3.2 and item (j) of the Illustrated List of Export Subsidies included as Annex I to the SCM Agreement.⁴⁸²

The italicized language above was entirely new; in its consultation request, Brazil had simply written: “and other measures such as the GSM-102, GSM-103, and SCGP programs.”⁴⁸³ Thus, the language in the panel request was plainly re-written in order to bring within its scope “export credit guarantee measures relating to [other] eligible US agricultural commodities,” since the consultation request specifies measures, including export credits, relating *only* to upland cotton. The United States drew Brazil’s attention to this problem at the first meeting of the Dispute Settlement Body at which Brazil’s panel request was considered.⁴⁸⁴

464. A panel’s terms of reference are determined by the complaining party’s request for the establishment of a panel, which pursuant to Article 6.2 of the DSU, must *inter alia* “identify the specific measures at issue.” However, a Member may not request the establishment of a panel with regard to *any* measure; rather, it may only file a panel request with respect to a measure upon which the consultation process has run its course. Specifically, Article 4.7 of the DSU provides that a complaining party may request establishment of a panel only if “the consultations fail to settle a dispute.”

465. In turn, Article 4.4 of the DSU provides that a request for consultations must be in writing and must state the reasons for the request “including *identification of the measures at issue* and an indication of the legal basis for the complaint” (emphasis added).

466. Thus, there is a clear progression between the measures discussed in Article 4 consultations and the measures identified in the panel request which form the basis of the panel’s terms of reference. Indeed, the Appellate Body in *Brazil – Aircraft* considered that:

⁴⁸²WT/DS267/7, at 5 (emphasis added).

⁴⁸³WT/DS267/1, at 4.

⁴⁸⁴*Dispute Settlement Body: Minutes of Meeting Held on 19 February 2003*, WT/DSB/M/143, para. 27.

Articles 4 and 6 of the DSU . . . set forth a process by which a complaining party must request consultations, and consultations must be held, before a matter may be referred to the DSB for the establishment of a panel.⁴⁸⁵

467. Furthermore, the Appellate Body has considered issues similar to this one before. In the *U.S. – Import Measures* dispute, the Appellate Body upheld the panel’s finding that a particular action taken by the United States was not part of the panel’s terms of reference because the EC (despite referring to the action in its panel request) had failed to consult upon it. In particular, the EC’s request for consultations referred to the increased bonding requirements levied by the United States as of March 3, 1999, on EC listed products in connection with the *EC Bananas* dispute, but *not* to U.S. action taken on April 19, 1999, to impose 100 percent duties on certain designated EC products.⁴⁸⁶ When the EC sought findings with respect to both the March 3rd measure *and* the April 19th action, the panel found that the March 3rd measure and April 19th action were legally distinct, and that the April 19th action did not fall within the panel’s terms of reference.⁴⁸⁷

468. The situation in this dispute resembles that in *U.S. – Import Measures*. As in that or any other dispute, the scope of the measures subject to consultation is delineated by the consultation request and, absent consultations, a measure may not be placed before a panel. Brazil’s consultation request mentioned no agricultural commodity other than upland cotton. Furthermore, just as the additional reference in the EC’s panel request to a measure not referred to in the consultation request could not bring that measure within the panel’s terms of reference in *U.S. – Import Measures*, the addition of the phrase “other agricultural commodities” in

⁴⁸⁵ Appellate Body Report, *Brazil – Aircraft*, para. 131.

⁴⁸⁶ Appellate Body Report, *United States – Import Measures*, para. 70.

⁴⁸⁷ Appellate Body Report, *U.S. Import Measures*, para. 82.

Brazil’s panel request could not bring export credit guarantees regarding such “other agricultural commodities” within this Panel’s terms of reference.⁴⁸⁸

469. The Panel in this dispute should therefore have reached the opposite conclusion from the one it reached in paragraph 7.69.

2. The Panel Analyzed the Issue Incorrectly and Reached the Wrong Conclusion

470. The Panel committed a number of errors in its analysis of this issue.

471. It made its first error when it said, in paragraph 7.61, that “the *actual* consultations did include export credit guarantee measures relating to all eligible agricultural commodities.”⁴⁸⁹ In the first place, the Panel’s logical basis for this conclusion is flawed: the Panel drew its conclusion from the single fact that Brazil posed written questions to the United States that included questions about export credit guarantees on commodities other than cotton. But this is a *non sequitur*; the fact that *one party* to a consultation asks questions about a topic does not mean that the *two parties* held a consultation about that topic. Were it otherwise, complaining parties could unilaterally expand the scope of the consultation request at any time, without regard to the

⁴⁸⁸We note that the situation in this dispute is unlike that presented in *Brazil – Aircraft*, in which the Panel examined a measure which was substantively the same as that consulted on. See Appellate Body Report, *Brazil – Aircraft*, paras. 127-133. In this dispute, the export credit guarantee programs mentioned in the panel request – covering a large and indeterminate number of products – are distinct from those in the consultation request, which were explicitly limited to upland cotton. As the United States explained to the Panel: “The CCC export credit guarantee program (GSM-102), the CCC intermediate export credit guarantee program (GSM-103), and the Supplier Credit Guarantee Program (SCGP) each constitute separate programs. The distinct operation of the programs themselves is manifested in both the terms of the particular programs as well as in the nature of the obligation guaranteed. ... Within each program, allocations are made by country, by commodity, and by amount. Thus, discrete programming decisions are made in connection with each such country, commodity, program, and amounts (in terms of a guarantee value). As a result, for the last 10 fiscal years, for example, as described in the First Written Submission of the United States, no cotton transactions occurred under the GSM-103 program.” Answers of the United States of America to the Questions from the Panel to the Parties following the First Session of the First Substantive Panel Meeting (August 11, 2003), paras. 9-10 (footnotes omitted).

⁴⁸⁹Italics in original.

requirements of Article 4.4, the time frames triggered by the consultation request, or the impact on third parties seeking to determine whether they have a substantial trade interest in the consultations.

472. In the second place, the Panel ignored the undisputed facts about the consultation. The facts were these: Prior to the first set of consultations (there were three rounds in total) Brazil did give the United States a set of written questions that included questions about export credit guarantees on other commodities. At the first set of consultations, the United States informed Brazil that the consultation request with respect to export credit guarantees was clearly limited to upland cotton and that therefore the consultations could cover only that commodity.⁴⁹⁰ Brazil confirmed that “the United States stated at the first consultations meeting that the export credit guarantee claims subject to the consultation were only about support for upland cotton.”⁴⁹¹ Thus, the parties agreed that no discussion of export credit guarantees for any commodities other than upland cotton took place during consultations.

473. In the third place, the Panel never explained why it would matter whether the consultations “actually” included export credit guarantees for other commodities if the request omitted them (nor did the Panel explain why it began its analysis with this question rather than the question of what the consultation request actually said). One wonders whether the Panel’s view was that the text of Brazil’s *questions* – and not the text of Brazil’s *consultation request* – defined the scope of consultations. Of course, nothing in the text of the DSU Article 4 refers to a complaining party’s questions; Article 4.4 provides instead for a written consultation request that meets certain requirements as to the reasons for the request.

⁴⁹⁰First Written Submission of the United States, para. 198.

⁴⁹¹Statement of Brazil at the First Substantive Meeting with the Parties, 22 July 2003, para. 94. Brazil’s only response to the U.S. statement was to state its disagreement about the scope of the consultations.

474. When it did turn to Brazil’s consultation request, the Panel made a second error. It read the consultation request as including a reference to export credit guarantees with respect to other (non-cotton) commodities.⁴⁹²

475. Like the United States, the Panel noted that there were only two paragraphs in the consultation request “below” footnote 1 that referred to export credit guarantees. The Panel ignored the first paragraph. With respect to the second paragraph,⁴⁹³ the Panel said the following:

The second of these paragraphs referred to the three export credit guarantee programmes at issue “as applied and as such” and made no specific reference to upland cotton, yet almost every other substantive paragraph and *tiret* of the request made such a specific reference. Therefore, a plain reading of that paragraph includes all eligible agricultural commodities.⁴⁹⁴

476. Once again, the Panel’s reasoning is fallacious. In the first place, whatever else that second paragraph may mean, it is simply not the case that a “plain reading” of the paragraph “includes all eligible agricultural commodities.” A “plain reading” of the paragraph shows that the paragraph mentions *no* commodities at all – the opposite of the Panel’s reading.

477. In the second place, by ignoring the first paragraph of the consultation request mentioning export guarantee programs, the Panel overlooked the context that this first paragraph provided for the second. The first paragraph is limited to “[e]xport subsidies, exporter assistance, export credit guarantees, export and market access enhancement *to facilitate the export of US upland*

⁴⁹²See, e.g., Panel Report, para. 7.65.

⁴⁹³“Regarding export credit guarantees, export and market access enhancement provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, Brazil is of the view that these programs, as applied and as such, violate Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture and are prohibited export subsidies under Article 3.1(a) and item (j) of the Illustrative List of Export Subsidies included as Annex I to the SCM Agreement.” WT/DS267/1, at 4.

⁴⁹⁴Panel Report, para. 7.64 (footnote omitted).

cotton provided under” a series of listed measures.⁴⁹⁵ Had the Panel simply compared these two paragraphs, it would have seen that the second did not describe measures, but, rather, described the *legal basis* for Brazil’s complaint. The Panel would thus have concluded that, despite the difference in wording, the two paragraphs complemented one another, and the second fulfilled a different purpose than the first (namely to give an indication of why Brazil considered the earlier-identified measures to be WTO-inconsistent). That being the case, there is no reason to believe (and certainly the Panel gave none) that the product scope of the second paragraph was broader than the “upland cotton” mentioned in the first paragraph.

478. Rather than comparing the two paragraphs dealing with export credit guarantees, the Panel referred as context to “almost every other substantive paragraph,” noting the references to cotton in these paragraphs. But Brazil’s failure to specify products other than cotton in the cited paragraph does not logically mean that such products are covered by that paragraph. To the contrary, the fact that Brazil was able to identify the product scope precisely elsewhere in the consultation request means that Brazil would have been perfectly capable of specifying products other than cotton had it so wished. Brazil did not specify such products, and the Panel should not have read into the request words that were not there.

479. In the third place, the Panel did not grapple with an obvious difficulty implicit in its analysis. Even assuming that the omission of the words “upland cotton” from the second paragraph had some significance (and, as we have explained, there is no such significance), the question would be, what would that significance be? In particular, the Panel gives no explanation of why the omission of those words should extend the product scope to “all eligible agricultural commodities” rather than some other product scope. Brazil cited to the SCM Agreement in the second paragraph, and that agreement is not limited to agricultural

⁴⁹⁵By contrast, the corresponding paragraph in Brazil’s panel request referred to “[e]xport subsidies, exporter assistance, export credit guarantees, export and market access enhancement *to facilitate the export of US upland cotton, and other eligible agricultural commodities as addressed herein*, provided under” the same series of listed measures.

commodities. The Panel's limitation of the second paragraph's product scope to eligible agricultural commodities derives from the panel request that Brazil eventually filed; it does not come from the text of the consultation request itself.

480. For these reasons, the Panel erred in its conclusion that the text of the consultation request included a reference to export credit guarantees with respect to other (non-cotton) commodities.

481. The Panel made a number of other statements in support of its conclusion that export credit guarantees with respect to non-cotton commodities were within its terms of reference. The Panel committed additional errors in these statements.

482. For example, the Panel erroneously stated that, “[i]f a Member is uncertain as to the scope of the measures referred to by another Member in a request for consultations, and chooses not to seek clarification, it cannot rely on its own uncertainty as a jurisdictional bar to a Panel finding on the measures.”⁴⁹⁶ In the first place, the United States was not “uncertain” about what the consultation request referred to; the U.S. position was and is that the consultation request did not “identify” (as required by DSU Article 4.4) export credit guarantees with respect to commodities other than upland cotton.

483. And while the Appellate Body need not reach this issue (because the U.S. position is not based on “uncertainty”), we note that the Panel's statement lacks any textual support in the DSU. As noted, Article 4.4 of the DSU provides that the consultation request must be in writing and must identify the measures at issue. It further provides that the consultation request must be notified to the Dispute Settlement Body and the relevant WTO Councils and Committees by the Member requesting consultations. Other Members must make a decision whether they have a substantial trade interest in the consultations and therefore wish to join such consultations,

⁴⁹⁶Panel Report, para. 7.67.

pursuant to DSU Article 4.11, within ten days of circulation of the request – in other words, on the basis of that written request. None of those provisions in any way supports the statement of the Panel. The Panel did refer to DSU Article 3.10, although it did not elaborate its reasoning; in this connection, it is worth noting that Article 3.10 does not purport to alter the scope of the “dispute” to which it applies and thus provides no basis to incorporate into a consultation request measures which that request omits.

484. Finally, we note that the Panel did not make any findings on the question of prejudice, which it raises briefly in paragraph 7.66 of its report. As the United States explained to the Panel, the issue of prejudice is not relevant to the question of whether a measure not consulted upon may be the subject of panel proceedings. The requirement of consultations at the beginning of a dispute is a central characteristic of the WTO dispute settlement system, and is reflected throughout DSU Article 4.⁴⁹⁷

485. Indeed, prejudice was not a consideration identified by the Appellate Body in its report the *U.S. Import Measures* dispute. As the Appellate Body noted:

The European Communities’ request for consultations of 4 March 1999 did not, of course, refer to the action taken by the United States on 19 April 1999, because that action had not yet been taken at the time. At the oral hearing in this appeal, in response to questioning by the Division, the European Communities acknowledged that the 19 April action, *as such*, was not *formally* the subject of the consultations held on 21 April 1999 [*i.e.* two days later]. We, therefore, consider that the 19 April action is also, for that reason, not a measure at issue in this dispute and does not fall within the Panel’s terms of reference.⁴⁹⁸

⁴⁹⁷See, e.g., DSU Article 4.1.

⁴⁹⁸Appellate Body Report, *U.S. – Import Measures*, para. 70.

Thus, the formal absence of the 19 April action from the EC's consultation request was the reason for concluding that that action was not a measure at issue in the dispute and thus not within the Panel's terms of reference. Prejudice was not an issue; nor was the question of what was "actually" discussed at the consultations.

486. In any case, the United States did identify prejudice that it had and would suffer if the dispute were expanded to include export credit guarantees for products other than upland cotton, stating, *inter alia*:

The United States has suffered an inability to prepare, respond, and consult with respect to allegations on measures never presented to the United States in accordance with the DSU. The United States was entitled to rely on the measures identified by Brazil in its request for consultations and also rely on that which Brazil declined to put at issue by its failure to so state in its request.⁴⁹⁹

487. By contrast, the burden on Brazil was light. Brazil's consultation request identified export credit guarantees on upland cotton as the sole export credit guarantee measures within the scope of the consultations and, hence, the dispute. As Brazil acknowledged, the United States brought this matter to Brazil's attention at the first of the three sets of consultations that the parties held. Had Brazil wished to include export credit guarantees with respect to other products within the scope of the consultations, Brazil could have re-filed its consultation request to include these guarantees, much as other Members have re-filed consultation requests when they have wished to expand the scope of the dispute.⁵⁰⁰ Rather than taking this simple step, Brazil was willing to gamble that it could simply disregard its Article 4.4 obligation to identify the measures at issue, without adverse consequences. Regrettably, the Panel confirmed Brazil's

⁴⁹⁹Answers of the United States of America to the Questions from the Panel to the Parties following the First Session of the First Substantive Panel Meeting (August 11, 2003), para. 23.

⁵⁰⁰*See, e.g.*, WT/DS204/1 & WT/DS204/1/Add.1 (consultation request supplemented to add measures); WT/DS174/1 & WT/DS174/1/Add.1 (consultation request to add consultations under additional covered agreement).

assumption that, months into a complex and burdensome dispute, a panel would not be willing to hold a Member to its Article 4.4 obligation by excluding significant measures from consideration. In effect, the Panel's finding means that Members can relieve themselves of their DSU obligations simply by ignoring them.

488. Finally, as a result of its mistaken finding that the consultation request included export credit guarantees with respect to all eligible agricultural commodities, the Panel declined to decide whether the omission of a measure from a consultation request means that the panel request (and hence the panel's terms of reference) cannot include that measure.⁵⁰¹ As explained above, however, such a measure cannot be part of the panel's terms of reference. The texts of DSU Article 4.4, 4.7 and 6.2 make the answer clear, and in *U.S. – Import Measures* the Appellate Body so found.

489. For the above reasons, the Panel's conclusion in paragraph 7.69 must be reversed. Brazil's consultation request did not include export credit guarantees to facilitate the export of eligible agricultural commodities other than upland cotton, and such guarantees were thus not within the Panel's terms of reference. As a consequence, the Panel had no authority to make findings with respect to export credit guarantees for such commodities, and all such findings must therefore be reversed as well.

B. Brazil did not Provide a Statement of Available Evidence as Required by SCM Article 4.2 for Products Other than Upland Cotton

490. The United States requested that the Panel make a preliminary ruling that Brazil was not permitted to advance claims under either Article 4 of the SCM Agreement with respect to export credit guarantee measures relating to agricultural products other than upland cotton because Brazil did not include a statement of available evidence with respect to these measures.

⁵⁰¹Panel Report, para. 7.68.

491. The Panel concluded, in paragraph 7.103 of its report, that “Brazil provided a statement of available evidence with respect to export credit guarantee measures relating to ... eligible United States agricultural products other than upland cotton, as required by Article 4.2 of the SCM Agreement.”⁵⁰² This conclusion was in error and must be reversed. Contrary to the Panel’s conclusion, Brazil provided no statement of available evidence with respect to such products.

492. Article 4.2 of the SCM Agreement provides that “[a] request for consultations under paragraph 1 [*i.e.*, a request for consultations regarding an alleged prohibited subsidy] shall include a statement of available evidence with regard to the existence and nature of the subsidy in question.”

493. The Appellate Body has previously had occasion to consider the obligations of a complaining party under Article 4.2:

Thus, as well as giving the reasons for the request for consultations and identifying the measure and the legal basis for the complaint under Article 4.4 of the DSU, a complaining Member must also indicate, in its request for consultations, the evidence that it has available to it, at that time, “with regard to the existence and nature of the subsidy in question”. In this respect, it is available evidence of the character of the measure as a “subsidy” that must be indicated, and not merely evidence of the existence of the measure.⁵⁰³

494. As the Panel correctly noted,⁵⁰⁴ Brazil’s statement of available evidence, which was annexed to its consultation request, contained only two paragraphs specifically referring to U.S.

⁵⁰²Footnote and italics omitted.

⁵⁰³ Appellate Body Report, *US – FSC*, para. 161.

⁵⁰⁴Panel Report, para. 7.83.

export credit guarantee programs. These two paragraphs, which were placed next to each other in the statement, read as follows:

- US export credit guarantee programs have caused serious prejudice to Brazilian upland cotton producers by providing below-market financing benefits for the export of competing US upland cotton;

- US export credit guarantee programs, since their origin in 1980 and up the present, provide premium rates that are inadequate to cover the long-term operating costs and losses of the programs; in particular there were losses caused by large-scale defaults totalling billions of dollars that have not been reflected in increased premiums to cover such losses[.]

495. The Panel also correctly noted that the first of these paragraphs was textually limited to upland cotton.⁵⁰⁵ That paragraph, therefore, contained no information about the “existence” or “nature” of any alleged prohibited subsidy on a product other than upland cotton.

496. The Panel failed, however, to draw the proper conclusion about the second paragraph. That paragraph contains no suggestion that it expands on (or alters in any way) the programs described in the immediately preceding paragraph (*i.e.*, export credit guarantee programs that allegedly provide certain benefits to upland cotton). In the context of the paragraph that precedes it, therefore, the second paragraph must be understood to refer to the same programs – that is, to export credit guarantee programs that allegedly provide certain benefits to upland cotton.

497. Moreover, even if the second paragraph could be construed to refer to programs that provide benefits to products other than cotton, it is difficult to see how that paragraph – which refers to no other commodities at all – could provide any information on the “existence” of, or

⁵⁰⁵Panel Report, para. 7.84.

the “nature” of, subsidies allegedly provided by export credit guarantee programs with respect to any agricultural commodity other than upland cotton. For example, what information is there about the “existence” or “nature” of any subsidies with respect to exports of rice? The Panel considered that Brazil produced such evidence during the panel proceedings,⁵⁰⁶ and yet there is no hint of it in the Statement of Available Evidence.

498. For these reasons, neither of the two paragraphs that the Panel identified as a statement of available evidence addressed agricultural products other than upland cotton; consequently, Brazil’s statement of available evidence failed to include a statement of available evidence with respect to U.S. export credit guarantee programs on such other agricultural products. The Panel’s conclusion in paragraph 7.103 therefore must be reversed.

C. The Panel Should Have Excluded PFC and MLA Payments from its Terms of Reference

499. The United States requested that the Panel issue a preliminary ruling that two types of measures, PFC payments and MLA payments, were not within the Panel’s terms of reference.⁵⁰⁷ These two types of measures had in fact expired before Brazil’s consultation request and panel requests. The Panel rejected the U.S. preliminary ruling request, concluding in paragraph 7.122 of its report that:

For all of the above reasons, the Panel does not believe that Article 4.2, and hence Article 6.2, of the DSU excludes expired measures from the potential scope of a request for establishment of a panel.⁵⁰⁸

⁵⁰⁶See, e.g., Panel Report para. 7.880.

⁵⁰⁷Panel Report, para. 7.104.

⁵⁰⁸Italics omitted.

For the reasons that follow, the Panel was wrong to reject the U.S. request and wrong to consider that PFC and MLA payments were within its terms of reference.

500. It was common ground between the parties that the legislation authorizing PFC and MLA payments expired before Brazil’s consultation and panel requests, and that all the payments themselves had also been made before Brazil’s consultation and panel requests. MLA payments were annual appropriation payments enacted by the U.S. Congress between 1998 and 2001. Each such annual appropriation payment was made through a separate piece of legislation, the last of which was enacted on August 13, 2001, for the marketing year 2001 (August 1, 2001 - July 31, 2002) crop. At the time of Brazil’s consultation and panel requests MLA payments were no longer in place. Similarly, PFC’s were a form of decoupled income support (that is, not linked to current production) that existed under the 1996 Act, but they were discontinued with the passage of the 2002 Act in May 2002. The last payments were scheduled to be made “no later than” September 30, 2002,⁵⁰⁹ in connection with the marketing year 2002 (August 1, 2002 - July 31, 2003) crop. Thus, at the time of Brazil’s consultation request (which was dated September 27, 2002) the PFC program no longer existed, except, as discussed below, for the final year of payments for marketing year 2002. The Panel acknowledged that “[a]ll those measures and years of allocation expired prior to the date of Brazil’s request for establishment of a panel.”⁵¹⁰ The Panel added, “to the extent that the payments constituted programmes ‘as applied’, Brazil is challenging expired measures... .”⁵¹¹ It nonetheless erroneously concluded that all of these payments came within its terms of reference.

501. Article 4 of the DSU contains limitations on what measures may be the subject of consultations. Under DSU Article 4.2, consultations are to cover “any representations made by another Member *concerning measures affecting the operation of any covered agreement* taken

⁵⁰⁹See Answers of the United States of America to the Questions from the Panel to the Parties following the First Session of the First Substantive Panel Meeting (August 11, 2003), para. 35.

⁵¹⁰Panel Report, para. 7.107.

⁵¹¹Panel Report, para. 7.111 (emphasis in original).

within the territory of the former” (emphasis added). Measures that have expired before a request for consultations cannot be measures that are “affecting the operation of any covered agreement” at the time that request is made; consequently they cannot be measures within the scope of the “dispute” referred to in Article 4.7 with respect to which the complaining Member may request the establishment of a panel.

502. In this case, therefore, because the MLA payments and all but one year of the PFC payments were no longer in effect at the time of the request for consultations, these measures cannot have been within the scope of Article 4.2, and therefore they did not fall within the Panel’s terms of reference.

503. The Panel analyzed Article 4.2 differently (and incorrectly). It considered that the term “affecting” in that article (and its French and Spanish counterparts) “refers not to the status of measures but rather to the way in which they relate to a covered agreement.”⁵¹² The meaning of this explanation is difficult to follow (particularly since the phrase “status of measures” was not used, as far as we can tell, by either of the parties in this connection). However, to the extent that the Panel was implying that *because* the term “affecting” “refers ... to ... the way in which [measures] relate ...”, *therefore* it has no temporal significance, the Panel was mistaken. The two things are not mutually exclusive. The term “affecting” certainly can express a “relat[ionship]” to a covered agreement; however, as is the case with any other present-tense form of a verb, it can *simultaneously* also express a time at which that relationship exists.⁵¹³

⁵¹²Panel Report, para. 7.115.

⁵¹³The same is true of the Panel’s analysis of the Spanish equivalent of “affecting” in DSU Article 4.2, “*que afectan*”. The Panel seems to have overlooked that the drafters chose a present-tense form of the subjunctive; another form, expressing past time, also exists, namely “*que hayan afectado*”, but the drafters of the DSU did not use that past-time form. That the drafters could have chosen this formulation if they had meant to include past time (and thus measures that had expired) can be seen from the DSU itself, which contains the following text in Article 22.2 (emphasis supplied): “such Member shall, if so requested, and no later than the expiry of the reasonable period of time, enter into negotiations with any party *having invoked* the dispute settlement procedures”. In French, this text is: “ce Membre se prêtera, si demande lui en est faite et au plus tard à l’expiration du délai raisonnable, à des négociations avec toute partie *ayant invoqué* les procédures de règlement des différends”. In Spanish, this text is: “ese Miembro, si así se le pide, y no más tarde de la expiración del plazo prudencial, entablará negociaciones con cualesquiera de las partes *que hayan recurrido* al procedimiento de solución de diferencias”.

504. Curiously, the Panel quoted Article 3.3 of the DSU in support of its position. Properly understood, however, that article in fact provides context for Article 4.2 that supports the position of the United States, not the Panel. Article 3.3 provides in relevant part:

The prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members.

505. This provision (like Article 4.2) speaks about the present time. The Panel acknowledged this fact: “This provision focuses on the present nature of the alleged impairment of benefits ...

”⁵¹⁴

506. Despite this, the Panel asserted that Article 3.3 does not address whether the measure at issue must still be in effect. In fact, the Panel was simply ignoring the logical implication of its own statement that the provision focuses on the present nature of the alleged impairment; the Panel offered no explanation whatsoever of how an *expired* measure can result in benefits “being impaired” in the present. To be sure, the Panel noted that the provision speaks of measures that have been “taken” (a word that the Panel called a “past participle”) – but the question before the Panel was not whether or not a measure had been “taken” in the past (the parties agreed that PFC’s and MLA’s had indeed existed at some point in the past), but instead what the legal consequences were of Brazil’s seeking to consult on measures that had been “taken” in the past but were no longer in effect.

⁵¹⁴Panel Report, para. 7.117.

507. The Panel also appeared to be concerned that subsidy payments might never be subject to challenge in WTO dispute settlement, because it will often be the case that such payments were made before the date of the consultation request.⁵¹⁵ However, the United States acknowledged that subsidies paid in the past may in fact be challenged. As the United States explained, to determine whether past subsidies may currently be challenged, it is useful to distinguish between recurring and non-recurring subsidies.

508. A non-recurring subsidy is a type of subsidy the benefits of which are allocated to future production. As such, a non-recurring subsidy can be regarded as a measure that continues in existence beyond the time period during which the subsidy is granted.⁵¹⁶ For example, a subsidy to acquire capital stock to be used in future production would be non-recurring and allocated over the useful life of the stock. Where a subsidy is non-recurring and is allocated to future production,⁵¹⁷ the measure (subsidy) may continue to be actionable even if the authorizing program or legislation has expired. In contrast, a recurring subsidy is typically provided year-after-year and is made in respect of current rather than future production. Once production has occurred and the measure been replaced or superseded, there would no longer be any measure in existence to challenge. Accordingly, a Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures suggested that recurring subsidies – such as grants for purposes other than the purchase of fixed assets and price support payments – should be expensed, or attributed to a single year, rather than allocated over some multi-year period.⁵¹⁸

⁵¹⁵Panel Report, para. 7.110.

⁵¹⁶*See, e.g.*, Report by the Informal Group of Experts to the Committee on Subsidies and Countervailing Measures, G/SCM/W/415, para. 12 (25 July 1997) (“Whether a subsidy is oriented towards production in future periods, consists of equity, or is carried forward in the recipient’s accounts were viewed as related to the question whether its benefits persist beyond a single period, and hence whether it should be allocated to future periods.”).

⁵¹⁷SCM Agreement, Annex IV, para. 7 (referring to “[s]ubsidies . . . the benefits of which are allocated to future production”).

⁵¹⁸G/SCM/W/415, paras. 1-12; *id.*, Recommendation 1, at 26-27.

509. In the case of PFC payments and MLA payments, these measures were subsidies allocated to a particular crop or fiscal year by their respective authorizing legislation. Pursuant to the 1996 Act, the last production flexibility contract payment was made for fiscal year 2002 (October 1, 2001 - September 30, 2002). This payment is properly allocated to the marketing year 2002 (August 1, 2002 - July 31, 2003) crop. The last market loss assistance payment was for the 2001 marketing year (August 1, 2001 - July 31, 2002), that is, for market conditions prevailing in that year. Given that each of these payments was made for a given fiscal or marketing year, they were not to be allocated to agricultural production beyond that particular year. Once the relevant fiscal year or marketing year had been completed, these measures no longer existed. Thus, by the time of Brazil's consultation and/or panel requests, the only measure to consult upon and at issue under the DSU was the marketing year 2002 PFC payment; the other production flexibility contracts and market loss assistance payments therefore do not fall within the Panel's terms of reference.

510. The Panel chose not to address this argument.⁵¹⁹ The Panel simply "note[d]" that the text of Part III of the SCM Agreement does not indicate that requests for consultations are to be governed in the way subsidies are expensed, and that the conformity of "expired recurring subsidies" (the Panel's words) with Part III is a question not of procedure but of substance.

511. It appears from the Panel's choice of words that the Panel accepted the validity of the distinction between recurring and non-recurring subsidies. If so, it should have understood as well that an *expired* subsidy cannot be a subsidy that is "*affecting*" the operation of a covered agreement. The Panel's refusal to analyze (and thus its implicit decision to reject) the U.S. distinction between recurring and non-recurring subsidy payments was an error.

512. The Panel's conclusion is also inconsistent with Article 6.2 of the DSU. Article 6.2 provides that the request for a panel shall, *inter alia*, "identify the specific measures at issue". A

⁵¹⁹Panel Report, para. 7.120.

measure that has expired cannot be a measure that is “at issue”. This is plainly true for measures that had expired before the requests for consultations, for all the reasons given above. (It is equally true for measures that expire between the date of the consultation request and the date of the panel request.)

513. The context provided by other provisions of the DSU makes this clear. For example, DSU Article 3.7 provides that “... the first objective of the dispute settlement mechanism is usually to secure the withdrawal of the measures concerned if these are found to be inconsistent with the provisions of any of the covered agreements.” A reading of Article 6.2 that interpreted measures that have expired to be “measures at issue” would be difficult to reconcile with Article 3.7. The other options mentioned in Article 3.7 – compensation and suspension of concessions – are equally inapplicable to an expired measure. And, as discussed above, DSU Article 3.3, in the Panel’s own words, “focuses on the present nature of the alleged impairment of benefits.” Similarly, DSU Article 19.1 provides that “[w]here a panel or the Appellate Body concludes that a measure *is inconsistent* with a covered agreement, it shall recommend that the Member concerned bring the measure into conformity with that agreement.”⁵²⁰ While it is well understood that panels are expected to make findings in respect of measures that expired after establishment but before the panel is able to complete its work and issue its report,⁵²¹ panels are not authorized to make recommendations about a measure that “was” inconsistent. The Appellate Body has previously reversed one panel for making a recommendation under DSU Article 19.1 with respect to a measure that had ceased to exist before the date of the request for establishment of the panel.⁵²²

⁵²⁰(Footnotes omitted and emphasis added.)

⁵²¹Panel Report, *Indonesia – Automobiles*, para. 14.9; Panel Report, *U.S. – Wool Shirts*, para. 6.2; GATT Panel Report, *EEC – Dessert Apples*; GATT Panel Report, *U.S. – Tuna*; GATT Panel Report, *EEC – Animal Feed Proteins*.

⁵²²Appellate Body report, *U.S.–Import Measures*, paras. 62 (the date of the panel request was May 11, 1999), 79 (the measure at issue (the so-called “3 March Measure”) had been terminated as of April 19, 1999) and 81.

514. In this case, all the MLA payments and all but one year of the PFC payments (and their years of allocation) had expired before the date of Brazil’s request for establishment, and consequently they could not form part of the terms of the reference of the Panel.

515. For all of the above reasons, the Panel’s conclusion that PFC and MLA payments were within its terms of reference was an error and must be reversed.

IX. Conclusion

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

(1) the Panel’s legal conclusion that certain U.S. decoupled income support measures – that is, production flexibility contract payments under the Federal Agricultural Improvement and Reform Act of 1996 (“1996 Act”), direct payments under the Farm Security and Rural Investment Act of 2002 (“2002 Act”), and “the legislative and regulatory provisions which establish and maintain the [direct payments] programme” – are not exempt from actions under Article 13(a) of the *Agreement on Agriculture*⁵²³ is in error, including the Panel’s finding that these decoupled income support measures do not conform to Annex 2;

(2) the Panel’s legal conclusion that certain U.S. domestic support measures⁵²⁴ are not exempt from actions under Article 13(b) of the *Agreement on Agriculture*⁵²⁵ is in error, including the Panel’s findings that the challenged U.S. measures granted support to a specific commodity in excess of that decided in marketing year 1992 and therefore breached the proviso of Article 13(b) in each year from marketing year 1999-2002;

⁵²³See, e.g., Panel Report, paras. 8.1(b), 7.337-7.414.

⁵²⁴See Panel Report, para. 7.337.

⁵²⁵See, e.g., Panel Report, paras. 8.1(c), 7.415-7.647.

(3) the Panel’s legal conclusion that U.S. export credit guarantees under the GSM 102, GSM 103, and SCGP export credit guarantee programs in respect of unscheduled agricultural products supported under the programs and one scheduled commodity (rice) are “export subsidies applied in a manner which results in circumvention of United States export subsidy commitments, within the meaning of Article 10.1 of the *Agreement on Agriculture*,” are therefore inconsistent with Article 8 of the *Agreement on Agriculture*, and are not exempt from actions under Article 13(c) of the *Agreement on Agriculture*⁵²⁶ is in error, including the Panel’s finding that export credit guarantees, notwithstanding Article 10.2 of the *Agreement on Agriculture*, constitute measures subject to Article 10.1 of the *Agreement on Agriculture*;

(4) the Panel’s legal conclusion that U.S. export credit guarantees under the GSM 102, GSM 103, and SCGP export credit guarantee programs in respect of other scheduled agricultural products constitute export subsidies within the meaning of Article 10.1 of the *Agreement on Agriculture*⁵²⁷ is in error, including the Panel’s finding that export credit guarantees, notwithstanding Article 10.2 of the *Agreement on Agriculture*, constitute measures subject to Article 10.1 of the *Agreement on Agriculture*;

(5) the Panel’s legal conclusion that U.S. export credit guarantees under the GSM 102, GSM 103, and SCGP export credit guarantee programs in respect of unscheduled agricultural products supported under the programs and one scheduled commodity (rice) are *per se* export subsidies prohibited by Articles 3.1(a) and 3.2 of the *Agreement on Subsidies and Countervailing Measures* (“SCM Agreement”)⁵²⁸ is in error, including the Panel’s findings that the program for each product constitutes an export subsidy for purposes of the WTO Agreements and is provided by the United States at premium rates which are inadequate to cover long-term operating costs and losses of the programs within the meaning of item (j) of the Illustrative List of Export Subsidies in Annex I of the SCM Agreement;

⁵²⁶See, e.g., Panel Report, paras. 8.1(d)(1), 7.762-7.945.

⁵²⁷See, e.g., Panel Report, paras. 8.1(d)(2), 7.762-7.945.

⁵²⁸See, e.g., Panel Report, paras. 8.1(d)(1), 7.787-7.869, 7.946-7.948.

(6) the Panel's legal conclusion that section 1207(a) of the 2002 Act, which provides for user marketing (Step 2) payments to exporters of upland cotton, is an export subsidy that is listed in Article 9.1(a) of the *Agreement on Agriculture* that is inconsistent with U.S. obligations under Articles 3.3 and 8 of the *Agreement on Agriculture*, is not exempt from actions under Article 13(c) of the *Agreement on Agriculture*, and is inconsistent with Articles 3.1(a) and 3.2 of the SCM Agreement⁵²⁹ is in error, including the Panel's finding that payments under the user marketing (Step 2) program are contingent on export performance;

(7) the Panel's legal conclusion that section 1207(a) of the 2002 Act providing for user marketing (Step 2) payments to domestic users of upland cotton is an import substitution subsidy prohibited under Articles 3.1(b) and 3.2 of the *Agreement on Subsidies and Countervailing Measures*⁵³⁰ is in error, including the Panel's finding that domestic support payments that are consistent with a Member's domestic support reduction commitments under the *Agreement on Agriculture* may nonetheless be prohibited under the SCM Agreement;

(8) the Panel's legal conclusion that "the effect of the mandatory, price contingent United States subsidies at issue – that is, marketing loan programme payments, user marketing (Step 2) payments and MLA payments and CCP payments – is significant price suppression in the same world market for upland cotton in the period MY 1999-2002 within the meaning of Articles 6.3(c) and 5(c)" of the SCM Agreement⁵³¹ is in error, including the following:

(a) the Panel's finding that Brazil need not demonstrate, and the Panel need not find, the amount of the challenged subsidy that benefits the subsidized product, upland cotton;

⁵²⁹See, e.g., Panel Report, paras. 7.678-7.761, 8.1(e).

⁵³⁰See, e.g., Panel Report, paras. 7.1018-7.1098, 8.1(f).

⁵³¹Panel Report, paras. 7.1416, 7.1107-7.1416, 8.1(g)(i).

- (b) the Panel’s finding that subsidies not directly tied to current production of upland cotton (decoupled payments) need not be allocated to all products produced and sold by the firms receiving such subsidies;
- (c) that the Panel could make findings concerning subsidies that no longer existed at the time of panel establishment and that present serious prejudice could be, and was, caused by such subsidies;
- (d) the Panel’s finding that the challenged subsidies provided to cotton producers “passed through” to cotton exporters;
- (e) the Panel’s finding that there was price suppression “in the same market”;
- (f) the Panel’s finding that significant price suppression existed;
- (g) the Panel’s finding that the price suppression it found under an erroneous legal standard was “significant”;
- (h) the Panel’s finding that “the effect of” the U.S. subsidies “is” significant price suppression; and
- (i) the Panel’s finding that “significant price suppression” is sufficient to establish “serious prejudice” for purposes of Articles 5(c) and 6.3 of the SCM Agreement;
- (9) the Panel’s finding that decoupled payments made with respect to non-upland cotton base acres were within its terms of reference⁵³² is in error, including the Panel’s finding

⁵³²See, e.g., Panel Report, paras. 7.129-7.136.

that these payments were measures at issue within the meaning of Articles 4.4 and 6.2 of the DSU;

(10) the Panel failed to set out the findings of fact, the applicability of the relevant provisions, and the basic rationale behind its findings and recommendations, as required by Article 12.7 of the DSU;

(11) the Panel's finding that export credit guarantees to facilitate the export of "other eligible agricultural commodities" besides upland cotton were within its terms of reference⁵³³ is in error, including the Panel's finding that such export credit guarantees were included in Brazil's consultation request and its finding that, contrary to Articles 4.2, 4.4, and 6.2 of the DSU, it could examine measures that were not included in Brazil's request for consultations;

(12) the Panel's finding that Brazil provided the statement of available evidence required by Article 4.2 of the SCM Agreement with respect to export credit guarantee measures relating to eligible United States agricultural products other than upland cotton, and that accordingly, Brazil's claims concerning these measures were within the terms of reference of this dispute⁵³⁴ is in error; and

(13) the Panel's legal conclusion that two types of expired measures, namely production flexibility contract payments and market loss assistance payments, were within the Panel's terms of reference is in error, including the Panel's finding that measures that are no longer in existence as of the date of establishment of a panel are nonetheless within a panel's terms of reference.⁵³⁵

⁵³³See, e.g., Panel Report, para. 7.69.

⁵³⁴See, e.g., Panel Report, para. 7.103.

⁵³⁵See, e.g., Panel Report, para. 7.104-7.122.

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