

UNITED STATES – SUBSIDIES ON UPLAND COTTON:

Recourse to Article 21.5 of the DSU by Brazil

(WT/DS267)

**REBUTTAL SUBMISSION OF
THE UNITED STATES OF AMERICA**

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I. INTRODUCTION

1. Brazil purports to challenge the “existence” and “consistency with a covered agreement” of U.S. measures taken to comply with the DSB’s recommendations and rulings in *United States – Upland Cotton*. However, many of Brazil’s claims are not within the scope of this proceeding. Certain claims are against measures that were never the subject of any finding of WTO inconsistency or any DSB recommendations and rulings. The United States has shown that these include Brazil’s claims against guarantees issued under the CCC Export Credit Guarantee Program (“GSM 102”) with respect to exports of pig meat and poultry meat. They also include claims against the programs authorizing marketing loan and counter-cyclical payments (or as Brazil now clarifies, the programs *in addition to* the marketing loan and counter-cyclical payments). These are neither original measures that were subject to any recommendations and rulings nor are they measures that the United States has taken to comply with any recommendations and rulings. Similarly, Brazil’s claims about the “timeliness” of compliance or – put differently – compliance in periods before the referral of the matter to the Panel are not properly reviewed in an Article 21.5 compliance proceeding.

2. Brazil has not rebutted the U.S. showing. Instead, Brazil’s claims confuse the standard establishing the scope of a compliance proceeding. In particular, Brazil attempts to apply incorrectly a “final resolution” standard rather than the “existence and consistency with a covered agreement of measures taken to comply” standard clearly set out in the Article 21.5 of the DSU. Moreover, Brazil misreads the original panel’s report, suggesting that the original panel disregarded the claims presented to it and, instead, made findings of WTO-inconsistency against the marketing loan and counter-cyclical programs on claims that were never made, and without expressly indicating to the parties that it even was doing so. And in the context of claims regarding compliance in past periods, Brazil appears to confuse questions that are properly before an Article 21.5 compliance panel and those that are properly before an Article 22.6 arbitrator.

3. Beyond these issues, the United States has also shown that Brazil’s claims are legally and factually faulty. Brazil’s claims fall into two categories: those that deal with the **export** subsidy-related recommendations and rulings of the DSB and those that deal with the **actionable** subsidy-related DSB recommendations and rulings. In both cases, Brazil fails to make a *prima facie* case.

4. Specifically, with respect to the **export** subsidies, Brazil attempts to show that the United States has not satisfied its WTO obligations with respect to export credit guarantees under the GSM 102 program – the single one of three export credit guarantee program to have survived the drastic measures taken by the United States to implement the DSB’s recommendations and rulings. Brazil asks the Panel to find that the United States is providing export credit guarantees “at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes” within the meaning of item (j) of the Illustrative List. In so doing, however, Brazil seeks to have the Panel disregard evidence showing clearly that the GSM 102 program is being operated at a substantial profit (indeed, at a level (total net negative present value) of close to \$200 million dollars). Indeed, this was the case even *before* the United States implemented fee increases of, on average 46 percent, to respond to the original panel’s finding regarding as to

whether premia charged under the export credit guarantee programs were “geared toward ensuring adequacy to cover long-term operating costs and losses.”¹

5. Perhaps in light of the strength of the evidence regarding the net costs of the GSM 102 program, Brazil attempts to have the Panel consider that “claim” only in the alternative and to find first on the basis of the generic definition of export subsidy laid out in Articles 1 and 3.1(a) of the *SCM Agreement*. The United States has explained that Brazil’s approach is not supported by the text of the *SCM Agreement*. While Brazil has offered no legitimate response to these U.S. arguments, the United States has nonetheless also shown that Brazil does not demonstrate that the GSM 102 export credit guarantees provide any “benefit” within the meaning of Article 1 of the *SCM Agreement*. Brazil has provided no persuasive evidence to the contrary.

6. In the case of Brazil **actionable** subsidy-related claims, Brazil’s evidence is similarly lacking. Indeed, Brazil submits virtually no legitimate empirical evidence to support its claims that “the effect” of U.S. marketing loan and counter-cyclical payments is (a) “present” significant price suppression within the meaning of Article 5(c) and 6.3(c) of the *SCM Agreement*; (b) “an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted;” or (c) to “threaten” serious prejudice in the future.

7. Nor can Brazil do so. According to the studies and the economic data submitted by the United States, marketing loan payments and counter-cyclical payments are not causing any significant distortions at present; prices are rebounding and are expected to continue to do so; U.S. share of world production and exports indicates that U.S. producers are heeding and responding to market signals; and U.S. producers of upland cotton are meeting their variable and, often, their total costs of production. In short, Brazil has little to no empirical basis for its claims of serious prejudice. Indeed, Brazil’s submissions now make clear that Brazil relies heavily on Brazil’s own econometric modeling. Even a basic assessment of this model shows, however, that it is designed so as to inflate significantly any possible effects of marketing loan and counter-cyclical payments. Under these circumstances, the results of Brazil’s modeling exercise cannot properly support any findings regarding the U.S. marketing loan and counter-cyclical payments.

II. PRELIMINARY RULING REQUESTS

8. Brazil has made a number of claims that are not properly within the scope of this Article 21.5 compliance proceeding; namely: (1) claims relating to export credit guarantees in respect of exports of pig meat and poultry meat; (2) claims relating to the marketing loan and counter-cyclical payment *programs* in addition to payments made thereunder; and (3) claims regarding

¹ *Upland Cotton (Panel)*, para. 7.859

compliance in past periods relating to a measure that Brazil asserts no longer exists. These are not claims relating to the “existence or consistency with a covered agreement of measures taken to comply with the recommendations and rulings [of the DSB].” Accordingly, the United States has respectfully requested that the Panel reject these claims.² Although Brazil disagrees with the U.S. requests, it has identified no basis that would permit these claims to be reviewed in the present proceeding.

- In the case of the first of these claims, against export credit guarantees in respect of exports of pig meat and poultry meat, Brazil appears to confuse the proper standard – set out in the text of DSU Article 21.5 itself – as to when claims are within the scope of an Article 21.5 proceeding. Brazil incorrectly assumes that the standard is one of whether there has been a “final resolution” of the issue in the original proceeding.
- Further, in the case of Brazil’s claims against the marketing loan and counter-cyclical payment *programs* and payments, Brazil continues to mischaracterize the DSB’s recommendations and rulings. The United States shows below that, contrary to Brazil’s assertions, these recommendations and rulings applied to payments made in certain years under the Step 2, marketing loan, and counter-cyclical payment programs, not the programs themselves (neither alone or in addition to payments). In addition, the marketing loan and counter-cyclical payment programs are *unchanged* measures that are not a measure taken to comply with any recommendations and rulings. For these reasons, the claims that Brazil attempts to advance in respect of these measures are outside the scope of this proceeding.
- Finally, with respect to Brazil’s claims in respect of compliance in earlier periods, the United States demonstrated that Brazil had neither alleged a “disagreement” regarding the past period nor identified any textual basis for a finding about the timeliness of compliance under factual circumstances that, according to Brazil’s own admissions, no longer exist.³ Brazil has failed to rebut these arguments.

9. The United States addresses each of these issues, in turn, below.

A. BRAZIL’S CLAIMS RELATING TO EXPORT CREDIT GUARANTEES IN RESPECT OF EXPORTS OF PIG MEAT AND POULTRY MEAT ARE OUTSIDE THE SCOPE OF THIS PROCEEDING

10. The United States has shown that Brazil’s claims under Articles 10.1 and 8 of the

² U.S. First Written Submission, paras. 22-56.

³ U.S. First Written Submission, paras. 50-52.

Agreement on Agriculture and Articles 3.1(a) and 3.2 the *SCM Agreement* are outside the scope of this proceeding to the extent that they relate to GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat (hereinafter referred to as “pig meat and poultry meat GSM 102 guarantees”).⁴ The original panel rejected Brazil’s claims under Article 10.1 of the *Agreement on Agriculture* (and, thus, also its claims under Articles 3.1(a) and 3.2 of the *SCM Agreement*) in respect of those measures.⁵ While Brazil successfully appealed the panel’s application of Article 10.1 of the *Agreement on Agriculture* with respect to pig meat and poultry meat GSM 102 guarantees, this did not result in a finding that the guarantees were provided in circumvention of that (or any other) WTO-provision because the Appellate Body did not consider that there were sufficient uncontested facts to support such a finding.⁶ In other words, as Brazil expressly concedes, there have *never* been any findings of WTO inconsistency against the pig meat and poultry meat GSM 102 guarantees, and consequently there were no DSB recommendations and rulings against these measures with which the United States was obligated to comply.⁷ Thus, the claims made by Brazil against these measures are not properly the subject of a compliance proceeding under Article 21.5 of the DSU.

11. Brazil contends, however, that “Appellate Body jurisprudence” provides it with the right to “reassert” its claims under the *Agreement on Agriculture* and the *SCM Agreement* with respect to the pig meat and poultry meat GSM 102 guarantees.⁸ Brazil alleges that in *EC – Bed Linen (Article 21.5 – India)*, the Appellate Body identified “the range of possible scenarios” “in which the scope of proceedings under Article 21.5 may be limited by the scope of the original proceedings.”⁹ According to Brazil, this “range” consists of the single scenario in which “an *unappealed* finding included in a panel report is *adopted* by the DSB” and, thus, is “treated as a

⁴ U.S. First Written Submission, paras. 24-30. Under the Panel’s working procedures, parties may submit any requests for preliminary rulings “not later than in their first written submissions to the Panel.” See *Working Procedures for the Panel*, para. 11 (8 November 2006). The timing of the U.S. request for preliminary ruling (*i.e.*, in the U.S. first written submission, after the U.S. was able to confirm which claims Brazil would be pursuing) is entirely appropriate. Brazil’s professed “surprise[.]” at this timing is not credible and, in any event, does not alter the conclusion that Brazil’s claims against GSM 102 export credit guarantees in respect of exports of pig meat and poultry meat fall outside the scope of this proceeding.

⁵ *Upland Cotton (Panel)*, para. 8.1(d)(ii).

⁶ *Upland Cotton (AB)*, para. 694.

⁷ Brazil Submission Regarding U.S. Requests for Preliminary Ruling, para. 9-10 (“the Appellate Body . . . concluded that there were insufficient uncontested facts of record to enable it to complete the analysis. . . . [A]s a result, Brazil did not formally “win” this claim. . . . [T]here is no adopted finding that the [export credit guarantee programs], with respect to pig meat and poultry meat, are inconsistent with Article 10.2 of the *Agreement on Agriculture*.”). The United States notes further that there was no finding that pig meat and poultry meat GSM 102 guarantees are inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement* (indeed, the Appellate Body left undisturbed the original panel’s rejection of those claims).

⁸ Brazil Submission Regarding U.S. Requests for Preliminary Ruling, para. 7.

⁹ Brazil Submission Regarding U.S. Requests for Preliminary Ruling, para. 11.

final resolution to a dispute between the parties in respect of that claim.”¹⁰ Brazil considers that the present situation does not fit within this “range” because – unlike in the *EC – Bed Linen (Article 21.5 – India)* dispute – Brazil successfully appealed the question of the original panel’s application of Article 10.1 of the *Agreement on Agriculture*.¹¹ On this basis, Brazil considers that it has the right to reassert its claims against the pig meat and poultry meat GSM 102 guarantees in this Article 21.5 “compliance” proceeding.¹²

12. Brazil’s argument is without merit; Brazil simply misreads the Appellate Body’s report in *EC – Bed Linen (21.5 – India)* and continues to confuse two distinct issues – (a) the scope of a compliance proceeding pursuant to Article 21.5 of the DSU and (b) when a claim against a specific measure or aspect of a measure can be considered to be “finally resolved” for purposes of WTO dispute settlement.¹³ *EC – Bed Linen (21.5 – India)* dealt with both issues because the EC identified both as bases for the rejection of certain of India’s claims.¹⁴ Specifically, India’s claims were ones that it had made in the original panel proceeding against an aspect of an EC antidumping determination and that the original panel had rejected for failure to make a *prima facie* case.¹⁵ India renewed these claims in the Article 21.5 proceeding and the compliance panel rejected them.¹⁶ The EC defended the panel’s decision before the Appellate Body arguing that (a) the aspect of the antidumping determination subject to India’s claims was not a part of the “implementation measure” and, thus, was outside the scope of an Article 21.5 proceeding and (b) India, by failing to appeal the original panel’s rejection of the claim, had accepted the rejection of the claims by the original panel as a “final resolution” of the dispute between the parties.¹⁷

¹⁰ Brazil Submission Regarding U.S. Requests for Preliminary Ruling, para. 11 (emphasis in original).

¹¹ Brazil Submission Regarding U.S. Requests for Preliminary Ruling, para. 12.

¹² Brazil Submission Regarding U.S. Requests for Preliminary Ruling, paras. 12, 15.

¹³ Brazil’s arguments relating to *United States – Argentina Sunset (Panel) (21.5 – Argentina)* are unavailing. As an initial matter, the United States notes that this panel report, and the particular aspect of it cited by Brazil, is on appeal. Moreover, Brazil’s arguments again confuse the question of the scope of an Article 21.5 proceeding with the question of the “final resolution” of claims in WTO dispute settlement. Brazil argues that a compliance panel found in that dispute that the exercise of judicial economy in a proceeding does not preclude the reassertion of claims against “aspects [of an antidumping determination] which have been incorporated by the authorities in the measure taken to comply.” See Brazil Submission Regarding U.S. Requests for Preliminary Ruling, para. 12, n, 14 (citing *United States – Argentina Sunset (Panel) (21.5 – Argentina) (Panel)*, para. 7.92. According to Brazil, neither the exercise of judicial economy nor the failure to reach a finding constitute a “final resolution.” Brazil Submission Regarding U.S. Requests for Preliminary Ruling, para. 12. However, as the United States explains above, whether or not a matter has been “finally resolved” does not answer the separate question of whether particular claims are against a “measure taken to comply” such that they are properly within the scope of an Article 21.5 proceeding.

¹⁴ *EC – Bed Linen (21.5 – India) (AB)*, paras. 32-38.

¹⁵ *EC – Bed Linen (21.5 – India) (AB)*, para. 71.

¹⁶ *EC – Bed Linen (21.5 – India) (AB)*, para. 71.

¹⁷ *EC – Bed Linen (21.5 – India) (AB)*, paras. 32-35.

13. The Appellate Body agreed with the EC on both counts.¹⁸ In doing so, however, it was simply addressing the arguments presented. The Appellate Body was not indicating that the test with respect to the claims that are properly within the scope of a DSU Article 21.5 proceeding is whether a claim has been “finally resolved,” as Brazil suggests here.¹⁹ Nor was the Appellate Body indicating that it had identified “the range of possible scenarios” “in which the scope of proceedings under Article 21.5 may be limited by the scope of the original proceedings,” as Brazil has argued.²⁰ To the contrary, on the question of scope, the Appellate Body reaffirmed that “[i]f a claim challenges a measure which is not a ‘measure taken to comply,’ that claim cannot properly be raised in Article 21.5 proceedings.”²¹

14. Brazil correctly observes that the present dispute is *not* identical to *EC – Bed Linen (Article 21.5 – India)* on the question of whether or not the original panel’s rejection of Brazil’s claims against the pig meat and poultry meat constitutes a “final resolution” of the matter for purposes of WTO dispute settlement; certainly, Brazil is not precluded from challenging those measures in a new dispute. However, on the question of whether the claims are subject to review *in an Article 21.5 proceeding*, the outcome in this dispute is the same as in *EC – Bed Linen (Article 21.5 – India)*. Like the claims made by India in that dispute, Brazil’s claims here against the pig meat and poultry meat GSM 102 guarantees are not claims against a “measure taken to comply” and, as such, are outside the scope of this proceeding by operation of the express limitations in Article 21.5 of the DSU.²²

¹⁸ *EC – Bed Linen (21.5 – India) (AB)*, paras. 87-95.

¹⁹ Brazil’s suggestion that the United States argued for an approach similar to Brazil’s in *Canada – Dairy (21.5 United States and New Zealand)* is erroneous. See Brazil Submission Regarding U.S. Requests for Preliminary Ruling, para. 10, n. 10. The U.S. statement to which Brazil cites relates to the request by the United States and New Zealand for a second DSU Article 21.5 proceeding where the Appellate Body was unable to reach a decision in a first DSU Article 21.5 proceeding regarding the WTO-consistency of certain Canadian measures taken to comply because of a lack of sufficient facts. Under those circumstances, the United States and New Zealand considered that a disagreement continued to exist as to whether the Canadian measures taken to comply were consistent with Canada’s WTO obligations and that this disagreement was properly the subject of a second Article 21.5 proceeding. See Minutes of DSB Meeting of 18 December 2001, para. 55, WT/DSB/M/116 (31 January 2002). In *Canada – Dairy (21.5 United States and New Zealand)*, there was no dispute as to whether the measure subject to review was a measure taken to comply. Thus, that dispute clearly did not involve the question at issue here – whether claims can be made in an Article 21.5 compliance proceeding that are *not* claims against “measures taken to comply” with the DSB’s recommendations and rulings.

²⁰ Brazil Submission Regarding U.S. Requests for Preliminary Ruling, para. 11.

²¹ *EC – Bed Linen (21.5 – India) (AB)*, para. 78.

²² This is not only required by Article 21.5 of the DSU, but it makes good sense. By encouraging the Panel to allow the claims against the pig meat and poultry meat GSM 102 guarantees, Brazil is effectively asking the Panel to render meaningless the fact that the Appellate Body *declined* to make any finding of WTO-inconsistency with respect to the measures because it *did not* find uncontested facts showing that the measures were provided inconsistently with any U.S. WTO obligations. Brazil would have this Panel assume that the Appellate Body *had* made a finding of WTO-inconsistency with respect to the pig meat and poultry meat GSM 102 guarantees and *had* made a recommendation that the United States bring these measures into compliance with the obligations assumed to be breach (and further to assume that this recommendation was adopted by the DSB). None of these things

15. For the reasons explained above and in paragraphs 24-30 of the U.S. first written submission, the United States again respectfully requests that the Panel find that (1) the pig meat and poultry meat GSM 102 guarantees are not measures taken to comply with the recommendations and rulings of the DSB; (2) the pig meat and poultry meat GSM 102 guarantees are not measures within the scope of this proceeding; (3) Brazil's claims under Articles 10.1 and 8 of the *Agreement on Agriculture* relating to such guarantees are outside the scope of this proceeding; and (4) Brazil's claims under Articles 3.1(a) and 3.2 of the *SCM Agreement* are outside the scope of this proceeding.

B. BRAZIL'S CLAIMS ARE OUTSIDE THE SCOPE OF THIS PROCEEDING TO THE EXTENT THAT THEY RELATE *EITHER* TO THE MARKETING LOAN OR COUNTER-CYCLICAL PAYMENT PROGRAMS OR TO THOSE PROGRAMS IN ADDITION TO PAYMENTS

16. In its first written submission, the United States noted that Brazil appears to be challenging the “consistency with a covered agreement” of the marketing loan program and counter-cyclical payment program as such (*i.e.*, the “legal/regulatory provisions” providing for the U.S. marketing loan payments and counter-cyclical payments).²³ The United States explained that, if so, Brazil's claims fall outside the scope of this proceeding.²⁴ Brazil now clarifies that its claims are actually even *more* expansive than first appeared.²⁵ According to Brazil, its claims apply not only to the marketing loan and counter-cyclical payment *programs*, as such, but to the programs *in addition* to all payments authorized under the programs.²⁶

17. Brazil's claims are outside the scope of this proceeding, regardless of whether they are against the marketing loan and counter-cyclical payment programs alone or against the programs in addition to payments. First, contrary to Brazil's assertions, the original panel did *not* make a finding of WTO-inconsistency against the Step 2, marketing loan, and counter-cyclical payment *programs* or against the programs in addition to all payments thereunder. Instead, the measure found to be WTO-inconsistent was a “subsidy” comprising *payments* made under the Step 2, marketing loan, and counter-cyclical payment programs during a certain period of time.²⁷ And the only payments even subject to a *claim* of “present” serious prejudice were payments made in

happened, and Brazil has no basis for asking the Panel to pretend otherwise. Moreover, Brazil's approach would create a situation where a Member could effectively be deprived of a reasonable period of time to bring any measures found to be WTO-inconsistent into compliance with its obligations. If a measure is found to be WTO-inconsistent in an original proceeding, such an opportunity is provided. A Member may not have such an opportunity, however, where a measure (that is not a measure taken to comply) is found to be WTO-inconsistent for the first time in an Article 21.5 proceeding.

²³ U.S. First Written Submission, para. 31.

²⁴ U.S. First Written Submission, para. 31-37.

²⁵ Brazil Submission Regarding U.S. Requests for Preliminary Rulings, section 3.1.

²⁶ Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 31.

²⁷ *Upland Cotton (Panel)*, paras. 7.1395 and 8.1(g)(i).

MY 1999-2002.²⁸ Consequently, these were the measures that were the subject of the DSB's recommendations and rulings. There was no DSB recommendation with respect to the Step 2, marketing loan, and counter-cyclical payment programs – either alone or in addition to payments – with which the United States was required to comply. Accordingly, the claims that Brazil attempts to make on the basis of that mischaracterized recommendation are not properly within the scope of this compliance proceeding.

18. Second, even leaving aside Brazil's misrepresentation of the DSB's recommendations and rulings, the measures that Brazil seeks to challenge – marketing loan and counter-cyclical payment programs in addition to all payments under the programs – are *not* measures taken to comply. Indeed, these measures have not been changed to implement any DSB recommendations and rulings or for any other reason; they remain the same as they were in the original proceeding. Under Article 21.5 of the DSU, claims of consistency with a covered agreement can not be made in respect of measures that are *not* measures taken to comply and that are the same measures as in an original proceeding. For this reason too, Brazil's claims – whether against the marketing loan and counter-cyclical payment programs or the programs in addition to payments thereunder – are not properly within the scope of this proceeding.

1. Brazil Misrepresents The Original Panel's Findings and the DSB's Recommendations and Rulings

19. Contrary to Brazil's arguments, neither the original panel's finding of "present" serious prejudice nor the DSB's recommendations and rulings flowing from that finding applied to any amalgam of the marketing loan and counter-cyclical payment programs either alone or in addition to payments authorized thereunder.

a. There is no legal or factual basis for Brazil's assertion that "in the circumstances of this dispute a subsidy payment cannot be divorced from a subsidy "program"

20. Brazil argues first that "[i]n the circumstances of this dispute, a subsidy 'payment' cannot be divorced from a subsidy 'program.'"²⁹ There is, however, no factual or legal basis for this argument, and it is undermined by Brazil's own claims and arguments in this dispute.

21. First, as a matter of fact, the marketing loan and counter-cyclical payment programs (*i.e.*, the statutory/regulatory provisions authorizing marketing loan and counter-cyclical payments) are distinct from the payments that they authorize. The former comprise rules enacted by the U.S. Congress and codified in the U.S. Code regarding, *inter alia*, the conditions under which marketing loan and counter-cyclical payments can be made and to whom. The latter comprise

²⁸ *Upland Cotton (Panel)*, paras. 7.1395 and 8.1(g)(i).

²⁹ Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 34.

financial contributions provided to recipients following the established rules. The former is the program itself. The latter are measures that result from the application of the program in particular circumstances.

22. Either the statutory/regulatory provisions themselves or the measures resulting from their application (i.e. particular payments) may be challenged in WTO dispute settlement, but each is recognized and treated as a distinct measure. Brazil purports to challenge “the continued relevance of the ‘as such’ *versus* ‘as applied’ distinction in light of recent Appellate Body jurisprudence.”³⁰ However, it fails to cite to even a single Appellate Body report that suggests that, henceforth, the actual real-world difference between a statutory/regulatory provision and the measures that it authorizes (in this case, a payment) must be disregarded and the two considered a single measure for purposes of WTO dispute settlement.³¹

23. To the contrary, the Appellate Body has clarified that “as such” and “as applied” challenges are distinct. For example, in *United States – Sunset Reviews on OCTG from Argentina*, the Appellate Body explained:

In our view, “as such” challenges against a Member's measures in WTO dispute settlement proceedings are serious challenges. By definition, an “as such” claim challenges laws, regulations, or other instruments of a Member that have general and prospective application, asserting that a Member's conduct – not only in a particular instance that has occurred, but in future situations as well – will necessarily be inconsistent with that Member's WTO obligations. In essence, complaining parties bringing ‘as such’ challenges seek to prevent Members *ex ante* from engaging in certain conduct.

The implications of such challenges are obviously more far-reaching than “as applied” claims. We also expect that measures subject to ‘as such’ challenges would normally have undergone, under municipal law, thorough scrutiny through various deliberative processes to ensure consistency with the Member's international obligations, including those found in the covered agreements, and that the enactment of such a measure would implicitly reflect the conclusion of that Member that the measure is not inconsistent with those obligations. The presumption that WTO Members act in good faith in the implementation of their WTO commitments is particularly apt in the context of measures challenged “as such.”³²

³⁰ Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 31, n. 41.

³¹ Indeed, Brazil appears to confuse two separate issues – (a) whether a statutory/regulatory provision is a measure distinct from the thing that it authorizes; and (b) the elements that need to be proven to find that a statutory or regulatory provision is WTO-inconsistent, as such (specifically the fact that the mandatory-discretionary principle applies in this latter context).

³² *United States – Argentina OCTG Sunset Reviews (AB)*, paras. 172-173.

24. Brazil’s suggestion that “recent Appellate Body jurisprudence” has called into question the “continued relevance” of the distinction between two different measures – one, a statutory/regulatory provision and, the other, a payment – is thus without basis.

25. Equally without basis is Brazil’s argument that “the particular nature of an adverse effects claim under Articles 5 and 6 of the *SCM Agreement*” requires the conflation of the statutory/regulatory provisions authorizing marketing loan and counter-cyclical payments and the payments themselves.³³ This argument appears to be based on Brazil’s assertion that “[t]he focus of the provisions in Part III of the *SCM Agreement* is . . . on ‘effects’ – not the particular form or some portion of ‘the subsidy’ alleged to cause the adverse effects.”³⁴ This is simply a *non sequitur*; Brazil does not explain why “the focus on effects” in Part III of the *SCM Agreement* would require that the statutory and regulatory provisions authorizing payments be conflated with the payments themselves and considered as a single “subsidy” for purposes of an assessment under those provisions.

26. In any event, the Appellate Body has clarified that the “measure” identified as being subject to WTO claims cannot “vary depending on the substance of the legal provision invoked by a complainant and the interpretation that a panel might give to that provision.”³⁵ Thus, in *EC – Customs*, the Appellate Body rejected a panel’s finding that the “manner of administration” of a provision should be considered the “measure at issue” under Article 6.2 of the DSU where the claim was of a breach of Article X:3(a) of the GATT 1994.³⁶ The panel reasoned that “a Member breaching Article X:3(a) of the GATT 1994 would be required ‘to alter the manner in which the relevant laws, regulations, decisions and/or rulings are being administered in order to abide by that recommendation’” and that, therefore, “manner of administration” was the appropriate measure. In rejecting the panel’s reasoning, the Appellate body explained that “measures” and “claims” are “conceptually different and they should not be confused.”³⁷ Brazil’s argument here – that the “measure” for purposes of a claim of serious prejudice under Article 5(c) and 6.3(c) must be determined by reference to the “focus on effects” in those provisions – suffers from the same fatal flaw in logic and should be rejected.

27. Moreover, Brazil own claims and arguments in the original proceeding undermine Brazil’s new argument that the “focus on effects” in Part III of the *SCM Agreement* means that

³³ Brazil Submission Regarding U.S. Requests for Preliminary Rulings, paras. 33-34.

³⁴ Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 34.

³⁵ *EC – Customs (AB)*, para. 132.

³⁶ *EC – Customs (AB)*, para. 132. DSU Article 6.2 provides, in relevant part, that “[t]he request for the establishment of a panel shall . . . identify the specific measures at issue.” Article X:3(a) of the GATT 1994 provides that “[e]ach contracting party shall administer in a uniform, impartial and reasonable manner all its laws, regulations, decisions and rulings of the kind described in paragraph 1 of this Article.”

³⁷ *EC – Customs (AB)*, para. 132.

“a subsidy ‘payment’ cannot be divorced from a subsidy ‘program.’”³⁸ As discussed in greater detail below, in the original proceeding, Brazil made claims of *threat* of serious prejudice³⁹ against payments allegedly “mandated” to be made in MY 2003-2007.⁴⁰ But it also made separate claims of *threat* of serious prejudice against the legal regime providing for these payments.⁴¹ In fact, Brazil not only made separate *claims* against these different measures but it expressly acknowledged that the claims were comprised of distinct elements because of the different measures at issue.⁴²

28. Brazil argued that payments could have adverse effects even when the programs that authorized them were no longer in existence⁴³ and that programs could have adverse effects even when no payments were being made under the programs.⁴⁴ In other words, Brazil argued that the effects of the programs and the payments could well be distinct. Brazil’s new argument that the “focus on effects” in Articles 5 and 6 of the *SCM Agreement* requires conflation of programs and

³⁸ Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 34. The United States regrets that it has had to wait to receive Brazil’s *rebuttal* submission even to learn the measures that Brazil is purporting to challenge. Brazil did *not* explain in its first written submission its newly-asserted view that “[i]n the circumstances of this dispute, a subsidy ‘payment’ cannot be divorced from a subsidy ‘program’” and that it would henceforth attempt to make claims against an amalgam of the two types of measures.

³⁹ The claims were under Articles 5(c) and 6.3(c) of the *SCM Agreement*, Articles 5(c) and 6(d) of the *SCM Agreement*, and Article XVI:1 of the GATT 1994.

⁴⁰ *Upland Cotton (Panel)*, para. 3.1(vii).

⁴¹ *Upland Cotton (Panel)*, para. 3.1(viii). These claims too were under Articles 5(c) and 6.3(c) of the *SCM Agreement*, Articles 5(c) and 6(d) of the *SCM Agreement*, and Article XVI:1 of the GATT 1994.

⁴² To take just one example, Brazil explained how a showing of the mandatory nature of the statutory/regulatory provisions was a “required element” for its *per se* claims but not for the “threat” of serious prejudice claims “that do not involve claims regarding the ‘per se’ validity of the statutes”:

The mandatory nature of the U.S. subsidies is relevant to (a) Brazil’s “per se” claims as well as (b) Brazil’s threat of serious prejudice claims that do not involve claims regarding its “per se” validity of the statutes. The evidence of mandatory (or “normative”) measures is a required element for Brazil’s “per se” claims. And a threat of serious prejudice under Article 6.3 and 5(c) will be more likely to exist if the subsidies are mandatory, i.e., that the subsidies must be paid to eligible producers, exporters, and users.

Brazil’s Answers to Additional Questions Following Second Panel Meeting, para. 18 (20 January 2004). Brazil’s explanation shows not only that Brazil separately challenged the “per se” validity of the statutes and the payments authorized to be made under the statutes – despite its argument now that no distinction can be drawn between them “in the circumstances of this dispute” – but that it considered the claims to entail distinct factual showings.

⁴³ See *Upland Cotton (Panel)*, paras. 7.105, 7.107-7.122. Brazil argued that, even though, the legislation providing for PFC and MLA payments had expired, it “pursues claims . . . in respect of the subsidies and domestic support provided under the expired programmes and authorizing legislation, in other words, *the payments themselves*” because, according to Brazil, these payments continued to cause adverse effects to its interests. *Upland Cotton (Panel)*, para. 7.108 (emphasis added).

⁴⁴ For example, Brazil argued that “the very existence of the mandatory marketing loan, Step 2 and counter-cyclical payment program alone impacts farmers’ planting decisions” even when no payments were being made under them. Brazil’s Answers to Additional Questions Following Second Panel Meeting, para. 20 (20 January 2004)

the payments made thereunder is contradicted by its own previous claims and arguments and should be rejected by the Panel.

b. Brazil did not challenge, the original panel did not find, and the DSB did not make any recommendation or ruling against the marketing loan and counter-cyclical payment programs or the programs in addition to payments

29. As part of its effort to expand the scope of its claims in this Article 21.5 compliance proceeding, Brazil misrepresents the measures that were the subject of its “present” serious prejudice claim under Article 5(c) and 6.3(c) of the *SCM Agreement* (the only claim with respect to which the original panel made an affirmative finding). To clarify, the United States sets out in detail below the claims that Brazil made in the original proceeding and the resolution of each by the original panel. As shown in the summary below, Brazil did not challenge,⁴⁵ the original panel did not find, and the DSB did not make, any recommendation or ruling against the programs, as such, either alone or in addition to payments under the programs. Rather, as the original panel explained, Brazil’s claim under Article 5(c) and 6.3(c) applied with respect to “subsidies provided during MY 1999-2002.”⁴⁶

(i) Summary of Brazil’s claims and findings of the original panel

30. In the section of the original panel report entitled “Parties’ Requests for Findings and Recommendations,” the panel set out the claims presented by Brazil. With respect to Brazil’s claim of “present” serious prejudice under Articles 5(c) and 6.3(d) of the *SCM Agreement*, the panel explained that:

Brazil requests that the Panel make the following findings . . . concerning present serious prejudice to the interests of Brazil: the subsidies *provided* during MY 1999-2002 caused and continue to cause serious prejudice to the interests of Brazil by suppressing upland cotton prices in the U.S., world, and Brazilian

⁴⁵ Brazil suggests in certain parts of its rebuttal submission that it *did* in fact make claims of “present” serious prejudice against both marketing loan and counter-cyclical payment programs *and* payments. *See e.g.*, Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 57. Nonetheless, it contradicts its own arguments in the same submission. For example, Brazil argues that “at several points in the original panel proceedings, Brazil asked the panel not to exercise judicial economy in considering Brazil’s threat of serious prejudice claims. Specifically, Brazil noted that a ruling on its threat of serious prejudice claim was necessary to ensure that United States would have a substantive future implementation obligation.” Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 69. Brazil does not explain why, if it had made *present* serious prejudice claims against the marketing loan and counter-cyclical payment programs, as such, it nonetheless urged the panel not to exercise judicial economy against the “threat” claims because a ruling on those claims was “necessary to ensure that United States would have a substantive future implementation obligation.” Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 69.

⁴⁶ *Upland Cotton (Panel)*, para. 3.1(vi).

markets for upland cotton in violation of Articles 5(c) and 6.3(c) of the *SCM Agreement*.⁴⁷

31. The original panel noted Brazil's two other "present" serious prejudice claims against the same measures⁴⁸ – also against subsidies "provided" during certain past time periods – and then walked through three claims of "threat of serious prejudice" against "U.S. subsidies" allegedly "mandated" to be provided in future years.⁴⁹ Finally, the panel laid out three claims "concerning selected provisions of the FSRI Act of 2002 and the ARP Act of 2000,"⁵⁰ which the panel clarified were also claims of "threat" of serious prejudice under Articles 5(c), 6.3(c), and 6.3(d) of the *SCM Agreement*, and Articles XVI of the GATT 1994.⁵¹

32. The original panel did *not* identify a "present" serious prejudice claim under Article 5(c) and 6.3(c) of the *SCM Agreement* as one of the claims "concerning selected provisions of the FSRI Act of 2002 and the ARP Act of 2000."⁵² Nor did the original panel identify "selected provisions of the FSRI Act of 2002 and the ARP Act of 2000" as part of the measures subject to Brazil's claims of "present" serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*.⁵³ Thus, Brazil's argument that it made "present" serious prejudice claims against the marketing loan and counter-cyclical payment *programs* in addition to payments authorized thereunder finds no support there.

33. To the contrary, the original panel identified only "the subsidies provided during MY 1999-2002" as the measures subject to Brazil's claim of "present" serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*.⁵⁴ The original panel then identified the

⁴⁷ *Upland Cotton (Panel)*, para. 3.1(vi) (emphasis added).

⁴⁸ These were claims under Articles 5(c) and 6(d) of the *SCM Agreement* against "U.S. subsidies" provided in MY 1999-2001 and under Article XVI of the GATT 1994 against "U.S. subsidies" provided in MY 1999-2002. *Upland Cotton (Panel)*, para. 3.1(vi).

⁴⁹ These were claims under Articles 5(c) and 6(c) of the *SCM Agreement* against "U.S. subsidies" allegedly "mandated" to be provided in MY 2003-2007, claims under Articles 5(c) and 6(d) of the *SCM Agreement* against "U.S. subsidies" allegedly "mandated" to be provided in MY 1999-2001, and claims under Article XVI of the GATT 1994 against "U.S. subsidies" allegedly "mandated" to be provided in MY 2003-2007. *Upland Cotton (Panel)*, para. 3.1(vii).

⁵⁰ *Upland Cotton (Panel)*, para. 3.1(viii)

⁵¹ *Upland Cotton (Panel)*, para. 7.1507. Brazil confirms in its response to the U.S. preliminary ruling requests that its "'per se' claim before the original panel was raised as a claim of 'threat of serious prejudice.'" See Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 70, n. 94.

⁵² *Upland Cotton (Panel)*, para. 3.1(viii)

⁵³ *Upland Cotton (Panel)*, para. 3.1(vi).

⁵⁴ *Upland Cotton (Panel)*, para. 3.1(vi). See also *Upland Cotton (Panel)*, para. 7.1108 ("Brazil claims that United States subsidies provided during MY 1999-2002 have caused, cause and continue to cause "serious prejudice" to Brazil's interests. . . .") and para. 7.1112 ("Brazil alleges that all of the challenged measures constitute "subsidies". According to Brazil, most of them – user marketing (Step 2) payments to domestic users and exporters;

“challenged measures” that were alleged to be the “subsidies” for purposes of that claim;⁵⁵ these were the “user marketing (Step 2) *payments* to domestic users and exporters; marketing loan programme *payments*; PFC *payments*; MLA *payments*; DP *payments*; CCP *payments*; crop insurance *payments*; and cottonseed *payments*.”⁵⁶ The original panel found that these constituted “subsidies” within the meaning of Article 1 of the *SCM Agreement* because they were “financial contributions” (mostly in the form of “grants”) conferring a “benefit.”⁵⁷ The original panel did not consider whether the statutory/regulatory provisions authorizing these payments were also “subsidies.”

34. The original panel then found that only certain of the identified “subsidies” – namely, Step 2 payments, marketing loan payments, and counter-cyclical/market loss assistance payments provided in MY 1999-2002 – caused serious prejudice to the interests of Brazil under Articles 5(c) and 6.3(c):

[i]n conclusion, in light of all of these considerations, we find 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 Agreement*.

35. As shown in the table below, the original panel did not make any further finding of WTO inconsistency with respect to Brazil’s claims. Rather, as the United States explained in its first written submission, the original panel rejected Brazil’s claims of “present” serious prejudice and “threat” of the serious prejudice under Articles 5(c) and 6(d) of the *SCM Agreement* for failure to make a *prima facie* case and declined to address all of Brazil’s other claims (except, of course, the “present” serious prejudice claim under Articles 5(c) and 6.3(c) of the *SCM Agreement*).⁵⁹

| Measure Challenged | Claim Made | Resolution by Original Panel | Paragraph in Panel Report |
|--------------------|------------|------------------------------|---------------------------|
|--------------------|------------|------------------------------|---------------------------|

marketing loan programme payments; production flexibility contract payments; market loss assistance payments; direct payments; counter-cyclical payments; crop insurance subsidies¹²⁴⁸; and cottonseed payments – provide “financial contributions” in the form of “grants” to participating United States producers, processors, users or exporters of upland cotton within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*.”)

⁵⁵ *Upland Cotton (Panel)*, para. 7.1112-7.1120.

⁵⁶ *Upland Cotton (Panel)*, para. 7.1120.

⁵⁷ *Upland Cotton (Panel)*, paras. 7.1112-7.1120.

⁵⁸ *Upland Cotton (Panel)*, paras. 7.1416 (emphasis added).

⁵⁹ U.S. First Written Submission, para. 36. As shown, Brazil’s assertion that “the original panel did not reject Brazil’s claims that the marketing loan and counter-cyclical payment programs, or the mandatory and price-contingent payments made thereunder, cause serious prejudice or a threat thereof” is, in Brazil’s words, “flatly wrong.” Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 51.

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

36. Upon appeal, the Appellate Body upheld the original panel’s finding “that the effect of marketing loan program payments, Step 2 payments, market loss assistance payments, and counter-cyclical payments is significant price suppression within the meaning of Article 6.3(c) of the SCM Agreement.”⁶⁰ Brazil did not appeal the panel’s decisions to reject or decline to address its claims regarding “U.S. subsidies” allegedly “mandated” to be provided in MY 2003-2007 or the *per se* claims with respect to the programs. Moreover, its arguments to the Appellate Body reflected the understanding that the original panel’s “present” serious prejudice finding

⁶⁰ *Upland Cotton (AB)*, para. 496.

applied only with respect to subsidies provided in MY 1999-2002.⁶¹

37. On 21 March 2005, the DSB adopted the Appellate Body report and the original panel report, as modified by the Appellate Body report.⁶² This included adoption of the single actionable-subsidy related 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 meaning of Articles 6.3(c) and 5(c) of the SCM Agreement.”⁶³

(ii) Brazil fails to show that the original panel ignored the claims presented and found the marketing loan and counter-cyclical payment programs to be WTO-inconsistent as such without even addressing the parties arguments in that regard

38. As shown above, the original panel understood Brazil’s claim of “present” serious prejudice under Articles 5(c) and 6.3(c) to apply with respect to “subsidies provided during MY 1999-2002.”⁶⁴ The original panel identified certain payments – including Step 2, marketing loan, and counter-cyclical/market loss payments – as the “subsidies” within the meaning of Article 1 of the SCM Agreement.⁶⁵ And, consistent with the claim and arguments presented by Brazil, the original panel found that the effect of a package comprising Step 2, marketing loan, and counter-cyclical/market loss assistance programs provided in MY 1999-2002 caused serious prejudice to the interests of Brazil in the same period within the meaning of Articles 5(c) and 6.3(c) of the *SCM Agreement*.

39. Brazil asks the Panel to ignore these facts. It asks the Panel to agree, instead, that the original panel disregarded the very matter that it expressly *recognized* Brazil as having

⁶¹ For example, Brazil argued vociferously against the U.S. position that, under the *SCM Agreement*, the benefit of the subsidies provided in MY 1999-2002 would need to be allocated to the year in which they were provided. Brazil argued that, if the U.S. argument were credited, “Brazil will have no remedy under Article 7.8 of the SCM Agreement for its serious prejudice, since it is allegedly legally impossible for the MY 2002 price-contingent recurring subsidies to have any adverse effects after 31 August 2003 (the close of MY 2002).” *Upland Cotton (AB)*, para. 529. It is difficult to see how Brazil could claim to have “no remedy” if, as Brazil attempts to argue now, the original panel had actually made a “serious prejudice” finding not only against the Step 2, marketing loan, and counter-cyclical payments made in MY 1999-2002 but also the programs themselves and all payments (including future payments) allegedly “mandated” to be made under the programs. Indeed, Brazil’s argument only makes sense if – as is actually the case – the original panel’s serious prejudice finding applied in respect of payments made in MY 1999-2002.

⁶² *United States – Subsidies on Upland Cotton*, Action by the Dispute Settlement Body, WT/DS267/20.

⁶³ *Upland Cotton (Panel)*, para. 7.1416.

⁶⁴ *Upland Cotton (Panel)*, para. 3.1(vi).

⁶⁵ *Upland Cotton (Panel)*, para. 7.1120.

presented,⁶⁶ and chose to mix and match the claims and measures before it as it saw fit. Under Brazil's theory, the original panel did so without so much as an explanation or any identification of the legal basis for such action, and in complete disregard of the fact that similar action has been found impermissible in other disputes.⁶⁷ Indeed, Brazil would have the Panel believe that the original panel made findings of WTO-inconsistency against certain programs, as such, and against payments allegedly mandated to be made in certain future years without even addressing the extensive arguments that the parties made in respect of those claims, and without making any of the factual findings that *Brazil* conceded would be necessary to support an affirmative finding of WTO-inconsistency.⁶⁸ Brazil offers no reason why the original panel's report should be read in a way that suggests that the panel not only inappropriately made Brazil's case for it, but made a case other than Brazil's case for it.⁶⁹

40. In fact, contrary to Brazil's arguments, it is clear that where the original panel intended to refer to programs, as such, it knew precisely how to do so. The prohibited subsidy-related conclusions and recommendations regarding the Step 2 program, for example, expressly refer to "section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters of upland cotton"⁷⁰ and "section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users of upland cotton."⁷¹ The absence of any such express reference to any legal/regulatory provisions in paragraphs 8.3(d) and 8.1(g)(i) of the original panel report confirms that the actionable subsidy-related conclusion and recommendation laid out therein do *not* apply to any programs as such (either alone or in part of any invented amalgam of programs and payments).

41. Notably, the Appellate Body has clarified that complaining parties have an obligation under DSU Article 6.2 "to be especially diligent in setting out 'as such' claims in their panel

⁶⁶ *Upland Cotton (Panel)*, para. 3.1(vi).

⁶⁷ See e.g., *Chile – Price Bands (AB)*, para. 173 (finding that, by making a finding on a matter that was not before it, the Panel acted *ultra petita* and inconsistently with Article 11 of the DSU.) *Chile – Price Bands (AB)*, para. 173.

⁶⁸ For example, in the case of its claims against the challenged programs, *per se*, Brazil asked the Panel "to find that the mandatory provisions of the 2002 FSRI Act and the 2000 ARP Act together with their implementing regulations, as listed above, *cannot be applied in a WTO consistent manner*." Brazil's 9 September 2003 Further Submission, para. 435-436. Explaining what this would mean in the context of this dispute, Brazil argued "[f]irst, the Panel needs to evaluate whether the U.S. subsidies will *necessarily threaten* to cause serious prejudice at price levels below the trigger prices of the U.S. subsidies. Second, the Panel needs to consider whether the U.S. subsidies threaten to cause serious prejudice *even at price levels at which only crop insurance subsidies and direct payments are made*." Brazil's 9 September 2003 Further Submission, para. 426 (emphasis added). The original panel did not conduct the requested evaluation and did not make the requested findings.

⁶⁹ See, e.g., *Japan – Measures Affecting Agricultural Products (AB)*, para. 129.

⁷⁰ See *Upland Cotton (Panel)*, paras. 8.3(b) and 8.1(e).

⁷¹ See *Upland Cotton (Panel)*, paras. 8.3(c) and 8.1(f).

requests as clearly as possible” so as to “leave responding parties in little doubt that, notwithstanding their own considered views on the WTO-consistency of their measures, another Member intends to challenge those measures, as such, in WTO dispute settlement proceedings.”⁷² It is hardly surprising, then, that the original panel would be at least as diligent in explaining where a finding of WTO-inconsistency pertains to a measure “as such” (or *per se*).

42. Moreover, where the original panel wanted to refer to programs, as such, and payments *together*, it expressly stated it was doing so. For example, in Section VII:D of the Panel Report, dealing with the evaluation of domestic support measures under Article 13 of the *Agreement on Agriculture*, the original panel expressly stated that, “[i]n this Section of our report, the Panel will consider the current programmes ‘as applied’ and ‘as such’ together. Therefore, references to marketing loan programme, user marketing (step 2), direct, counter-cyclical and crop insurance ‘payments’ include the legislative and regulatory provisions authorizing those payments unless otherwise indicated.”⁷³ No similar statement can be found in Section VII:G, which is the section including the original panel’s analysis of the effects of the subsidies alleged to be causing serious prejudice and, in fact, the paragraph clearly distinguishes payments from provisions providing for those payments in paragraph 7.1107 (listing “measures at issue” before addressing Brazil’s claims of “present” serious prejudice). Nor is there any similar statement made in connection with the recommendation in paragraph 8.3(d) of the panel report (or paragraph 8.1(g)(i), which contains the conclusion on actionable subsidies to which the recommendation relates).

43. For all the reasons above, it is abundantly clear that the original panel did *not* make any finding under Article 5(c) and 6.3(c) of the *SCM Agreement* against the marketing loan and counter-cyclical payment programs, as such, whether alone or in addition to payments.

c. Brazil misrepresents the original panel’s “present” significant price suppression findings and the DSB’s recommendations and rulings based on those findings

44. Notwithstanding the original panel report, Brazil argues that the original panel *did* make findings of WTO-inconsistency against the marketing loan and counter-cyclical payment program as such. In so doing, Brazil relies on selectively cited language from the panel report taken out of its proper context. The United States turns to those arguments next and demonstrates that they are without basis.

45. First, Brazil points to the original panel’s listing of the “measures at issue” at the start of the discussion of Brazil’s claims of “present” serious prejudice, arguing that the “qualification” of payments as, *inter alia*, “Step 2,” “marketing loan programme,” and “counter-cyclical”

⁷² *United States - Sunset Measures on OCTG from Argentina (AB)*, para. 173.

⁷³ *Upland Cotton (Panel)*, para. 7.337(ix), n. 466.

payments is somehow evidence that the original panel’s finding about the payments were actually made in respect of some amalgam of programs and payments.⁷⁴ This argument makes little sense. It seems apparent that the original panel was simply identifying the particular payments using their names; not purporting to expand any findings to the programs as such.

46. Brazil also attempts to make much of the fact that the original panel lists “legislative and regulatory provisions currently providing for the payment of,” *inter alia*, Step 2, marketing loan, and counter-cyclical payment programs among the “measures at issue.”⁷⁵ However, this does not support Brazil’s view that the original panel’s findings apply to programs, as such, in addition to payments authorized under them. Rather, this listing is consistent with the original panel’s (correct) view that payments constitute legislative and regulatory measures “as applied” and that a challenge to a payment is an “as applied” challenge to the measure that authorizes the payment.⁷⁶ This would explain, in fact, why the panel includes, at the same time, a footnote referencing in addition (“see also”) “Brazil’s *per se* actionable subsidy claims in Section VII:1.”⁷⁷ Indeed, this listing is important because it shows that the original panel clearly drew a distinction between payments, on the one hand, and the provisions authorizing them, on the other; thereby undermining Brazil arguments that “[i]n the circumstances of this dispute, a subsidy ‘payment’ cannot be divorced from a subsidy ‘program.’”⁷⁸

47. Second, Brazil seizes on two statements made by the original panel as it was declining to address Brazil’s “threat” of serious prejudice claims against payments allegedly “mandated” to be paid in MY 2003-2007. These were the original panel’s statements that (a) “[o]ur findings of ‘present’ serious prejudice . . . pertain to . . . measures in force and subsidies paid in MY 2002;” and (b) “[b]ecause the Panel’s ‘present’ serious prejudice finding deal with the FSRI Act of 2002 and subsidies granted thereunder in MY 2002, the United States is obliged to take action concerning its present statutory and regulatory framework as a result of our ‘present’ serious prejudice finding.”⁷⁹ Brazil’s reliance on this language is, however, misplaced. The panel states that its “present” serious prejudice findings “deal with” the statute; it does not state that it found the statutory provisions to be WTO-inconsistent, as such, as Brazil suggests. Indeed, here again,

⁷⁴ Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 55.

⁷⁵ Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 55.

⁷⁶ The original panel’s view of “payments” as programs “as applied” is evident, for example, from its consideration of the U.S. preliminary objection in the original proceeding that the legislative and regulatory provisions authorizing production flexibility contract and market loss assistance payments could not come within the panel’s terms of reference given that those measures had expired before the request for consultations. The original panel noted that Brazil was not challenging those measures *per se*. *Upland Cotton (Panel)*, para. 7.111. Nonetheless, the Panel stated that “to the extent that the payments constituted programmes ‘as applied,’ Brazil is challenging expired measures and the Panel will therefore consider the preliminary objection further.” *Upland Cotton (Panel)*, para. 7.111.

⁷⁷ *Upland Cotton (Panel)*, para. 7.1107(ix).

⁷⁸ Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 34.

⁷⁹ Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 63.

the panel's statement can be understood as reflecting its view that payments under a program constitute programs "as applied" and, thus, a finding against payments is a finding against programs "as applied."

48. Moreover, regarding the original panel's statement that the United States would be "obliged to take action concerning" the statutory/regulatory provisions as a result of the "present" serious prejudice finding, the United States notes, first, that this is not a recommendation⁸⁰ and Brazil concedes as much.⁸¹ Rather, this appears to be a statement of the original panel's views as to what would be a likely response of the United States to the recommendation that the original panel *did* make to remove the adverse effects of, or withdraw, the "subsidy" that the original panel had identified. And the United States did indeed take action to repeal the Step 2 program. While the original panel may have considered that the adverse effects of the "subsidy" it was examining would be eliminated through "action concerning" the statutory provisions authorizing the payments, this does not change the fact that the "subsidy" it was examining was a package of payments made in MY 1999-2002 under the Step 2, marketing loan, and counter-cyclical payment programs, and not the programs, as such, or the programs in addition to payments thereunder.

49. Third, Brazil attempts to attach significance to the fact that the original panel's conclusion in paragraph 8.1(g)(i) does not indicate that the subsidies at issue are ones that are made during any particular time period.⁸² Brazil suggests that this too is evidence that the original panel's conclusion applied to the newly-invented amalgam of payments and programs, rather than the package of Step 2, marketing loan, and counter-cyclical/market loss assistance payments made in MY 1999-2002. The United States disagrees. Indeed, the far more logical reason seems to be that (a) the panel had already explained earlier in its report what the "subsidies" were (certain payments)⁸³ and that Brazil's claims of serious prejudice only applied to "subsidies provided during MY 1999-2002;"⁸⁴ and (b) the only "subsidies" that were even capable of causing "present" serious prejudice were the ones provided in MY 1999-2002 and not the ones allegedly "mandated" to be provided in MY 2003-2007. The latter not only were *not* the subject of Brazil's present serious prejudice claims but also were not yet even in existence at that time. Thus, the original panel may reasonably have considered it unnecessary to specify that

⁸⁰ The original panel's recommendations simply provide, in relevant part, that "upon adoption of this report, the United States is under an obligation to 'take appropriate steps to remove the adverse effects or ... withdraw the subsidy'" subject to the conclusion in paragraph 8.1(g)(i). Paragraph 8.1(g)(i) provides that "the effect of the mandatory price-contingent United States subsidy measures – marketing loan programme *payments*, user marketing (Step 2) *payments*, MLA *payments* and CCP *payments* – is significant price suppression in the same world market within the meaning of Article 6.3(c) of the SCM Agreement constituting serious prejudice to the interests of Brazil within the meaning of Article 5(c) of the *SCM Agreement*." *Upland Cotton (Panel)*, para. 8.1(g)(i).

⁸¹ Brazil First Written Submission, para. 32.

⁸² Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 68.

⁸³ *Upland Cotton (Panel)*, para. 7.1120.

⁸⁴ *Upland Cotton (Panel)*, para. 7.1108.

the particular payments to which the finding of “present” serious prejudice applied were the payments that had actually been made in MY 1999-2002.⁸⁵

50. Fourth, Brazil takes great pains to show a “link” between the Step 2, marketing loan, and counter-cyclical payment programs and the payments made thereunder, arguing that because of this link “[t]he original panel did not, and could not, make the artificial distinction between ‘payments’ and the ‘statutory programs mandating such payments,’ which the United States now alleges are completely disconnected.”⁸⁶ Brazil misrepresents the U.S. argument; the United States has never “alleged” that the Step 2, marketing loan, and counter-cyclical payment programs are “completely disconnected” from the payments that they authorize. Indeed, such an assertion would be somewhat absurd given that, by definition, the latter results from the application of the former; there will always be a “link” between a measure, as such, and the measure that results from its application. But this does not change the fact that the two are distinct measures.

51. Thus, for example, in *Brazil – Aircraft (21.5 II – Canada)*, there was necessarily a “link” between Brazil’s subsidy program (the PROEX III program), which Canada challenged as such, and the interest rate equalization payments to Brazilian exporters authorized under the program, which Canada challenged as applied.⁸⁷ However, the Article 21.5 panel had no difficulty in considering the two to be distinct measures. Indeed, while the Article 21.5 panel found that Brazil’s PROEX III payments could “be expected to allow purchasers of Brazilian regional aircraft to obtain export credits on terms more favourable than those available to them in the commercial market”⁸⁸ and, in fact, the entire “logic of PROEX III would be undermined if Brazil were to limit the provision of PROEX III interest rate equalisation to cases where no benefit was conferred,”⁸⁹ it did *not* find against the PROEX III program as such.

52. Rather, applying the mandatory-discretionary principle – which Brazil now seeks to have this Panel disregard in its assessment of the U.S. measures – the Article 21.5 panel dismissed Canada’s “as such” claims because it “concluded that Brazil is not required by the PROEX III scheme to provide, in respect of the export of regional aircraft, a subsidy within the meaning of Article 1.1 of the SCM Agreement which is contingent upon exportation in the sense of Article 3.1(a).”⁹⁰ Certainly, Brazil was not heard to complain in that context that the panel was drawing

⁸⁵ Indeed, the conclusion of the panel’s report necessarily is based on and reiterates the panel’s findings as set out previously in the report. *See Upland Cotton (Panel)*, para. 7.1416. The conclusion could not alter that previous finding since the panel then would not have set out the basic rationale behind its findings as required DSU Article 12.7.

⁸⁶ Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 64.

⁸⁷ *Brazil – Aircraft (21.5 II – Canada)*, para. 2.1.

⁸⁸ *Brazil – Aircraft (21.5 II – Canada)*, para. 5.32.

⁸⁹ *Brazil – Aircraft (21.5 II – Canada)*, para. 5.51.

⁹⁰ *Brazil – Aircraft (21.5 II – Canada)*, para. 5.55.

an “artificial distinction” between the PROEX III programs and the payments authorized thereunder. And there is no basis for Brazil to complain so here.⁹¹

2. The Marketing Loan and Counter-Cyclical Payment Programs and Payments Are Not Measures Taken to Comply With the DSB’s Recommendations and Rulings

53. For the reasons above, it is clear that, contrary to Brazil’s assertions, the original panel did *not* make a finding of WTO-inconsistency against any amalgam of the Step 2, marketing loan, and counter-cyclical payment *programs*, as such, and all payments thereunder. Therefore, Brazil’s assertion that it is challenging measures taken to comply with such a recommendation is incorrect.

54. Further, Brazil claims are outside the scope of this proceeding in any event because the measure that Brazil purports to challenge – the invented amalgam of “the marketing loan and counter-cyclical payment programs plus all payments under the programs” – is *not* a measure taken to comply with any DSB recommendations and rulings. The Appellate Body has explained before that “[i]n our view, the phrase ‘measures taken to comply’ refers to measures which have been, or which should be, *adopted by a Member to bring about compliance with the recommendations and rulings of the DSB.*”⁹² Neither the marketing loan program, nor the counter-cyclical payment program, nor any marketing loan payments or counter-cyclical payments, nor some combination of these measures was “adopted by [the United States] to bring about compliance with the recommendations and rulings of the DSB.” In fact, these measures were in existence and were even at issue in the original proceeding. And, as Brazil acknowledges, they have not been changed since that proceeding to implement any DSB recommendations and rulings or for any other reason.⁹³

55. Brazil argues at length that the United States understood *the elimination of the Step 2 program* to be a measure taken to comply with the DSB’s recommendations and rulings in this dispute. But this misses the point. The United States has never disputed⁹⁴ that termination of the

⁹¹ The United States notes, in this regard, that if Brazil’s claims were within the scope of this proceeding – and they are clearly not – they would be subject to the mandatory-discretionary doctrine and would fail on those grounds as well because Brazil has not shown that the programs themselves (i.e., the statutory/regulatory provisions authorizing payments) *mandate* any breach of Articles 5 of the *SCM Agreement*. See U.S. First Written Submission, paras. 196-202.

⁹² *Canada – Aircraft (AB) (21.5 – Brazil)*, para. 36.

⁹³ Brazil Submission Regarding U.S. Requests for Preliminary Rulings, para. 35.

⁹⁴ The United States does, however, object to the *serious* misrepresentations that Brazil makes in this respect, especially with regard to certain reports issued by the Congressional Research Service (“CRS”), an independent research arm of the U.S. Congress. As Brazil has now made these misrepresentations *twice* in this proceeding, the United States responds to clarify the record. See also Brazil First Written Submission, para. 38 and n.26. Brazil asserts that a “recent report by the Congressional Research Service states that the remedy under Article

program is a measure taken to comply with certain of the DSB’s recommendations and rulings.⁹⁵ What the United States contests is Brazil’s attempt to renew its claims of WTO-inconsistency against measures *other* than the termination of the Step 2 program. Attempting to show that the United States considers termination of the Step 2 program to be a measure taken to comply with the DSB’s recommendations and rulings does not answer that question.

56. Moreover, Brazil’s attempts to link the two issues are without merit. Brazil argues that elimination of the Step 2 program simultaneously “created” the invented measure that Brazil seeks to challenge here comprised of “the marketing loan and counter-cyclical payment programs plus all payments under the programs.”⁹⁶ In other words, according to Brazil, the elimination of the Step 2 program somehow transformed the other measures – which had been in existence since the original proceeding and were not “taken to comply” with any DSB recommendations and rulings – into a “measure taken to comply.” Brazil argues that this result is mandated by the fact that the original panel considered the effects of the measures subject to Brazil’s “present” serious prejudice claims collectively, rather than individually. This argument is not logically sound.

57. First, DSU Article 21.5 permits a compliance panel to consider the WTO-consistency of a measure that is “in principle . . . a new and different measure which was not before the original

7.8 requires ‘eliminating the subsidy program, reducing the subsidy amounts, reducing the linkage between the subsidy and the adverse effects (e.g., decoupling, ...).’ Brazil Rebuttal Submission, para. 24, n. 30. This is *not* what the CRS report “states.” To the contrary, here is the full language from the CRS report:

With respect to actionable subsidies, the remedy is to remove the subsidy’s adverse effects or withdraw the subsidy (SCM Article 7.8). *The subsidizing party is given some leeway in deciding how to remove the adverse effect. Options could include eliminating the subsidy program, reducing the subsidy amounts, reducing the linkage between the subsidy and the adverse effects (e.g., decoupling), or making some sort of mutually acceptable compensatory payment.*

See “Potential Challenges to U.S. Farm Subsidies in the WTO: A Brief Overview,” Congressional Research Service Report for Congress, 25 October 2006, p. 6 (Exhibit BRA-559).

Similarly, Brazil asserts that CRS has “concluded” that “additional permanent modifications to U.S. farm programs may still be needed to fully comply with the WTO ruling on ‘actionable subsidies.’” Brazil Rebuttal Submission, para. 24. In fact, in the discussion cited by Brazil, CRS was explaining the status of this dispute, noting that Brazil was continuing to challenge U.S. compliance and that, as such (i.e., if Brazil were successful) further changes could be required. This is not a “conclusion” of the CRS about U.S. compliance; it is an observation about possible litigation outcomes. It is regrettable that Brazil has chosen to make these kinds of blatant misrepresentations in an effort to support its arguments in this proceeding.

⁹⁵ To the contrary, the United States has expressly acknowledged the original panel’s finding that section 1207(a) of the FSRI Act of 2002 providing for Step 2 payments to exporters and domestic users of U.S. upland cotton was inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement* and its recommendation that the United States withdraw that measure. *Upland Cotton (Panel)*, para. 8.1(e)(iii), 8.1(f), 8.3(b), and 8.3(c). The U.S. termination of the Step 2 program satisfy that implementation obligation. Moreover, as the *application* of the Step 2 program together with the marketing loan and counter-cyclical payment programs in MY 1999-2002 was found to have caused serious prejudice in the same period, the United States considers that termination of the Step 2 program is also relevant to that separate finding of the original panel.

⁹⁶ Brazil Rebuttal Submission, para. 26.

panel” but that was adopted to bring an original measure into compliance with recommendations and rulings in respect of that original measure.⁹⁷ These claims are permissible, despite the expedited nature of Article 21.5 compliance proceedings, because they could *not* have been made in respect of the same measure in the original proceeding (as that measure did not exist).⁹⁸ This rationale does not apply in the case of Brazil’s claims in this proceeding against the marketing loan or counter-cyclical payment programs, marketing loan or counter-cyclical payments, or some combination of these measures. Those measures could have been challenged in the original proceeding and, indeed, some of them *were* challenged by Brazil:

| PAYMENTS MADE IN MY 1999-2002 | PAYMENTS IN MY 2003-2007 | DOMESTIC SUPPORT PROGRAMS |
|-----------------------------------------|------------------------------|------------------------------|
| serious prejudice – Article 5(c)/6.3(c) | threat – Article 5(c)/6.3(c) | threat – Article 5(c)/6.3(c) |
| serious prejudice – Article 5(c)/6.3(d) | threat – Article 5(c)/6.3(d) | threat – Article 5(c)/6.3(d) |
| serious prejudice – Article XVI | threat – Article XVI | threat – Article XVI |

58. Of those claims, the claims of “present” serious prejudice against the payments made in MY 1999-2002 under Articles 5(c) and 6.3(d) were rejected for failure to make a *prima facie* case.⁹⁹ Moreover, the original panel declined to address Brazil’s claims of “threat” of serious prejudice under Articles 5(c) and 6.3(c) against payments allegedly “mandated” to be made in MY 2003-2007 and, separately, the challenged programs, as such.¹⁰⁰

59. Second, Brazil’s argument leads to absurd results. Specifically, under Brazil’s theory, taking action with respect to one of the measures subject to the original “present” serious prejudice finding transforms the other measures into “measures taken to comply” and thus renders them subject to any new or renewed claims of WTO-inconsistency. However, taking *no action* means that they are not so transformed and thus are not subject to any new or renewed claims of WTO-inconsistency. In other words, a Member would be in a more vulnerable position with respect to those measures by attempting to comply with DSB recommendations and rulings than doing nothing. This would not seem to be the kind of result for which DSU Article 21.5 of the DSU (a measure focusing on *compliance*) aims.

60. Third, there is no basis for Brazil’s suggestion that there is something unusual about the

⁹⁷ *Canada – Aircraft (AB) (21.5 – Brazil)*, para. 41.

⁹⁸ *EC – Bed Linen (AB) (21.5 – India)*, para. 88.

⁹⁹ *Upland Cotton (Panel)*, paras. 7.1465, 7.1504, 8.1(g)(ii). No claims of “present” serious prejudice under those provisions could be made in respect of payments mandated to be made in MY 2003-2007. However, Brazil did make claims of “threat” of serious prejudice under Articles 5(c) and 6.3(d) in respect of those measures, and they were also rejected for failure to make a *prima facie* case.

¹⁰⁰ *Upland Cotton (Panel)*, para. 7.1511.

nature of adverse effects claims under Articles 5 and 6 of the *SCM Agreement* that changes the analysis of the measures that are “measures taken to comply.” Indeed, Brazil seems to echo the same reasoning asserted by India – and rejected by the Appellate Body – in *EC – Bed Linen (21.5 – India)*. In that dispute, India attempted to renew its claims against an unchanged aspect of antidumping redetermination (a assessment of “other [causal] factors”).¹⁰¹ Like the marketing loan and counter-cyclical payments in MY 1999-2002, the EC’s “other factors” analysis was part of a larger measure subject to findings of WTO-inconsistency but was not itself found to be WTO-inconsistent.¹⁰² In addition, also like the measures at issue here, the EC’s “other factors” analysis was not changed to implement any DSB recommendations and rulings. Despite this, India argued that it should be able to renew its claims regarding the “other factors” analysis because the antidumping redetermination was a “whole new measure” that was “not capable of being divided into separate elements.”¹⁰³

61. The Appellate Body disagreed, however, explaining that “we do not see why that part of the redetermination that merely incorporates elements of the original determination on ‘other factors’ would constitute an inseparable element of a measure taken to comply with the DSB ruling in the original dispute. Indeed, the investigating authorities were able to treat this element separately.”¹⁰⁴ Here, there can be no question that the marketing loan program, the counter-cyclical payment program, and payments under those programs are separable. The fact that their effects were considered cumulatively in determining the existence of “present” serious prejudice does nothing to change that fact.

3. Conclusion

62. As shown above, Brazil incorrectly argues that the DSB recommended that the United States bring some amalgam of the Step 2, marketing loan, and counter-cyclical payment programs, as such, as well as all payments thereunder into compliance. Brazil’s claims that are premised on there being such recommendations and rulings are, thus, without basis and not properly within the scope of this proceeding. Moreover, even leaving aside this fundamental flaw, it is clear that the newly-invented amalgam of “the marketing loan and counter-cyclical payment programs, as such, plus all payments thereunder” are *not* measures taken to comply with any DSB recommendations and rulings. Indeed, as Brazil concedes, they are *unchanged* measures that were at issue in the original proceeding. Thus, even under Brazil’s incorrect view of the DSB’s recommendations and rulings, it would have no basis to make new or renewed claims of WTO-inconsistency with respect to newly-invented amalgam of “the marketing loan and counter-cyclical payment programs, as such, plus all payments thereunder”.

¹⁰¹ *EC – Bed Linen (AB) (21.5 – India)*, para. 80.

¹⁰² *EC – Bed Linen (AB) (21.5 – India)*, para. 80.

¹⁰³ *EC – Bed Linen (AB) (21.5 – India)*, para. 82.

¹⁰⁴ *EC – Bed Linen (AB) (21.5 – India)*, para. 86.

63. For these reasons and the reasons set out in the U.S. first written submission,¹⁰⁵ the United States respectfully requests the Panel to find that (1) the newly-invented amalgam of the marketing loan and counter-cyclical payment programs plus all payments under the programs are not measures to which the recommendations and rulings of the DSB were addressed; (2) the newly-invented amalgam of the marketing loan and counter-cyclical payment programs plus all payments under the programs are not measures within the scope of this proceeding; and (3) Brazil’s claims relating to the newly-invented amalgam of the marketing loan and counter-cyclical payment programs plus all payments under the programs under Articles 5 and 6 of the SCM Agreement are not within the scope of this proceeding.

C. BRAZIL’S CLAIMS REGARDING COMPLIANCE IN PAST PERIODS ARE OUTSIDE THE SCOPE OF THIS PROCEEDING

64. In its first written submission, the United States requested that the Panel reject Brazil’s claim that “measures taken to comply” with the adverse effects-related recommendations and rulings of the DSB did not exist in a past period (from September 22, 2005 to July 31, 2006); such a claim is not recognized under DSU Article 21.5.¹⁰⁶ Specifically, recalling that the scope of DSU Article 21.5 proceedings is limited to resolving “disagreements over the existence and consistency with a covered agreement of measures taken to comply with the recommendations and rulings [of the DSB],” the United States demonstrated that Brazil had neither alleged a “disagreement” regarding the past period nor identified any textual basis for a finding about the timeliness of compliance under factual circumstances that, according to Brazil’s own admissions, no longer exist.¹⁰⁷ Brazil has failed to rebut these arguments.

65. Brazil does not explain how the Panel can review a claim regarding the “existence” of a measure taken to comply if in fact, as Brazil alleges, that there is no “disagreement” in that regard.¹⁰⁸ Instead, Brazil attempts to twist the U.S. argument into an “apparent U.S. admission” which Brazil purports to “welcome” and with respect to which Brazil demands a finding.¹⁰⁹ Brazil misses the point. As the party invoking the Article 21.5 procedures in the present dispute, it is up to Brazil to show that its claims are properly reviewable in this context (*i.e.*, that the claims relate to a point of “disagreement as to the existence or consistency with a covered agreement of measures taken to comply the recommendations and rulings [of the DSB]”). The fact that Brazil has not even made *allegations* consistent with that standard, alone, is a basis for rejecting Brazil’s claim.

¹⁰⁵ U.S. First Written Submission, paras. 31-44.

¹⁰⁶ U.S. First Written Submission, paras. 49-56.

¹⁰⁷ U.S. First Written Submission, paras. 50-52.

¹⁰⁸ As the United States explained in its first written submission, Brazil is not contesting that a “measure taken to comply” exists now and argues that it is undisputed that such a measure *did not* exist in the period identified by Brazil. U.S. First Written Submission, para. 50.

¹⁰⁹ Brazil Submission Regarding U.S. Requests for Preliminary Ruling, para. 78.

66. In addition, Brazil has yet to identify any legitimate textual basis for its request that the Panel make findings on this type of claim regarding compliance within the six-month period set out in Article 7.9 of the *SCM Agreement* rather than as of the date of panel establishment pursuant to Article 21.5 of the DSU. Instead, Brazil continues to conflate the two provisions. Specifically, citing the text of Article 7.9 of the *SCM Agreement*, Brazil asserts that its “right” to challenge the existence or WTO-consistency of U.S. measures taken to comply “vested” on the expiry of the 6-month period set out in that provision.

67. However, Article 7.9 of the *SCM Agreement* says nothing about the “vesting” of “rights” to challenge measures pursuant to Article 21.5 of the DSU; it simply provides that if a Member “has not taken appropriate steps to remove the adverse effects of the subsidy or withdraw the subsidy within six months from the date when the DSB adopts the panel report or the Appellate Body Report” the complaining Member can seek authorization *to take countermeasures* “commensurate with the degree and nature of the adverse effects determined to exist.”¹¹⁰

68. Moreover, the question here is not whether Brazil *could have* challenged the existence or WTO-consistency of U.S. measures taken to comply upon expiry of the six-month period set out in Article 7.9 of the *SCM Agreement*. The fact is that Brazil chose not to do so; instead, it chose to wait until the repeal of the Step 2 program went into effect (presumably to gain the opportunity to challenge that repeal). Thus, the question is whether Brazil can have it both ways (*i.e.*, whether it can challenge the “existence” and “consistency” of measures taken to comply both under the facts that exist currently and under factual circumstances that, under Brazil’s own admission, no longer exist). Brazil has not identified any textual basis for such an exercise. Nor can it. Indeed, under similar circumstances, prior Article 21.5 panels have properly reviewed the “existence” or “consistency with a covered agreement of measures taken to comply as of the date that the matter was referred to it; not as of the date of the end of any implementation period.”¹¹¹

- For example, the panel in *United States – Shrimp (21.5 – Malaysia)* considered: “that it should take into account all the relevant facts occurring until the date the matter was referred to it. By applying this

¹¹⁰ Article 7.10 of the *SCM Agreement*, to which Brazil also cites, confirms that the focus is on the complaining Member’s ability to request and take countermeasures, not the “vesting” of any alleged “right” to challenge measures taken to comply in a DSU Article 21.5 proceeding.

¹¹¹ See *United States – Shrimp (Panel) (21.5 – Malaysia)*, para. 5.12 (“The Panel takes the view that it should take into account all the relevant facts occurring until the date the matter was referred to it. By applying this approach, an Article 21.5 panel can reach a decision that favours a prompt settlement of the dispute. Indeed, it avoids situations where implementing measures allowing for compliance with the DSB recommendations and rulings would be disregarded simply because they occur after the end of the reasonable period of time.”); *EC – Bed Linen (Panel) (21.5 – India)*, para. 6.28 (“[i]t appears India considers that we must make two decisions on the existence or consistency of measures taken to comply – one as of the end of the reasonable period of time, and one as of the date of establishment of the Panel. We do not consider that it would be either necessary or appropriate, as a matter of judicial economy, to first examine whether compliance had occurred as of the end of the reasonable period of time, and second consider compliance as of the later date.”).

approach, an Article 21.5 panel can reach a decision that favours a prompt settlement of the dispute. Indeed, it avoids situations where implementing measures allowing for compliance with the DSB recommendations and rulings would be disregarded simply because they occur after the end of the reasonable period of time.¹¹²

- And the panel in *EC – Bed Linen (21.5 – India) agreed*: “It appears India considers that we must make two decisions on the existence or consistency of measures taken to comply – one as of the end of the reasonable period of time, and one as of the date of establishment of the Panel. We do not consider that it would be either necessary or appropriate, as a matter of judicial economy, to first examine whether compliance had occurred as of the end of the reasonable period of time, and second consider compliance as of the later date.”¹¹³

69. Brazil alleges that “the assessment [of] whether any proposed countermeasures are commensurate” is “tied to the date on which the implementation period expires,” and argues that this is another reason the Panel should address the question of compliance as of that date.¹¹⁴ In so doing, however, Brazil confuses the mandate of an arbitrator under Article 22.6 of the DSU with that of a compliance panel under DSU Article 21.5. The question of whether countermeasures are “commensurate” within the meaning of Article 7.9 of the *SCM Agreement*, and the methodologies and approaches that are to be used to answer this question, are *exclusively* within the ambit of an arbitrator appointed pursuant to DSU Article 22.6.¹¹⁵ Moreover, nothing in DSU Article 21.5, or any other provision of the DSU or *SCM Agreement*, indicates that the scope of claims that may be raised in Article 21.5 proceedings are to be determined by reference to how an arbitrator (assuming one has been requested) might or might not perform its task.

70. Indeed, as is apparent from Brazil’s arguments here, such an approach could require an Article 21.5 panel to trespass impermissibly on matters that are within the exclusive province of the arbitrator, including on such important questions as the date on which to assess whether countermeasures “are” commensurate with the degree and nature of the adverse effects determined “to exist” within the meaning of Article 7.9 of the *SCM Agreement*. Those questions are not before this Panel and Brazil has no basis to ask this Panel to assume certain answers to

¹¹² *United States – Shrimp (Panel) (21.5 – Malaysia)*, para. 5.12.

¹¹³ *EC – Bed Linen (Panel) (21.5 – India)*, para. 6.28.

¹¹⁴ Brazil Submission Regarding U.S. Requests for Preliminary Ruling, para. 85.

¹¹⁵ This is clear from Article 7.10 of the *SCM Agreement*, which provides that “[i]n the event that a party to the dispute requests arbitration under paragraph 6 of Article 22 of the DSU, the arbitrator shall determine whether countermeasures are commensurate with the degree and nature of the adverse effects determined to exist.” Emphasis added.

those questions in determining which of Brazil's claims fall outside the scope of this proceeding.¹¹⁶

71. For the reasons above and discussed in the U.S. first written submission, the United States respectfully renews its request that the Panel find that (1) there is no disagreement between the parties as to the existence of measures taken to comply with the DSB's actionable subsidy-related recommendations and rulings and (2) Brazil's claim that there were no U.S. measures taken to comply between 22 September 2005 and 31 July 2006 is not within the scope of this proceeding.¹¹⁷

III. BRAZIL'S EXPORT SUBSIDY-RELATED CLAIMS

72. In the following section, the United States addresses the arguments raised by Brazil regarding the GSM-102 export credit guarantee programs and demonstrates that, contrary to Brazil's arguments, these guarantees do not constitute an export subsidy within the meaning of item (j) of the Illustrative List of Export Subsidies because the United States charges premium rates that are more than adequate to cover the long-term operating costs and losses of the program.

73. Although Brazil continues to pursue its "claim" under item (j) in the "alternative," it provides no textual basis for doing so. Indeed, Brazil fails to address the fundamental problem identified by the United States with Brazil's approach; namely, that it would lead to the fatally flawed result that a measure could be found to fall *outside* the definition of an export subsidy under Articles 1 and 3 of the *SCM Agreement* but then nonetheless be found *to be* an export subsidy under item (j) of the Illustrative List. In other words, under Brazil's interpretation, the items in the Illustrative List would *not* illustrate what is an export subsidy but rather would identify measures in *addition* to the measures that are defined in Articles 1 and 3 as export subsidies. Brazil's approach does not comport with the text of the *SCM Agreement* or Brazil's own arguments in other disputes¹¹⁸ that, in the case of measures identified in the Illustrative List,

¹¹⁶ Brazil also cites to certain arguments by Australia as to the alleged "voiding of rights under Article 22 of the DSU." Brazil Submission Regarding U.S. Requests for Preliminary Ruling, para. 86. Brazil has not explained the relevance of these arguments. First, Brazil does not allege or even identify any "rights under Article 22 of the DSU" are allegedly voided by the U.S. preliminary ruling request. Therefore, Brazil's assertion that Australia provides a "useful contribution" as to the assessment of the U.S. preliminary ruling request is without merit. In any event, as the United States has discussed above, the question of alleged "rights" under Article 22 is properly addressed to a arbitrator appointed under Article 22.6 of the DSU, should the dispute get to that point; it is not properly addressed this Panel.

¹¹⁷ Brazil First Written Submission, para. 38.

¹¹⁸ *Brazil – Aircraft (AB)*, para. 14 (Brazil argued in that dispute that "[u]nder the express terms of item (k), government payment in support of export credit constitutes a prohibited export subsidy only in so far as they are used to secure a material advantage in the field of export credit terms. It follows, a contrario, that they do not constitute prohibited export subsidies if they are not used to secure a material advantage in the field of export credit terms.")

it is the specific provisions of the Illustrative List – and not the general subsidy provisions in Articles 1.1 and 3.1(a) – that govern when the measures may be considered export subsidies.

74. Nonetheless, the United States also demonstrates below that GSM 102 export credit guarantees do not confer a “benefit” within the meaning of Article 1.1(b) of the *SCM Agreement*. This simply further confirms the fact that item (j) correctly illustrates that GSM 102 export credit guarantees are not export subsidies.

**A. THE UNITED STATES IS NOT PROVIDING EXPORT CREDIT GUARANTEES IN
CONTRAVENTION OF ARTICLES 10.1 AND 8 OF THE *AGREEMENT ON AGRICULTURE***

75. The United States demonstrates below, first, that the budget data of the United States Government shows that the export credit guarantee programs, consistently over the last 14 years, have charged premia adequate to cover long-term operating costs and losses. This conclusion comes from data and a budget methodology *advocated by Brazil* in the original proceeding and on which the original panel principally relied. Alternative accounting methodologies that Brazil now advances either do not in fact substantiate Brazil’s assertions and, in fact, contradict them.

76. Second, the United States, contrary to Brazil’s assertions, and as set forth in budget data, has received substantial recoveries following initial claims under the programs. Such recoveries, in conjunction with substantially increased fees and the elimination of high-risk country exposure, demonstrate that the GSM-102 program is structured and designed to cover long-term operating costs and losses. Brazil greatly overstates the amount of rescheduled debt under SCGP and, in any event, as rescheduled debt is a receivable following a default, it is irrelevant to Brazil’s incorrect assertion that the United States has failed to “withdraw the subsidy.”

77. Third, Brazil wrongly asserts that the Commodity Credit Corporation can *never* issue export credit guarantees without conferring an export subsidy. Brazil focuses entirely on CCC’s status as a government entity without regard to the nature of its *product*. Brazil’s approach is utterly unsupported – indeed is contradicted – by the text of the *SCM Agreement*.

78. Fourth, Brazil misplaces its emphasis on the initial subsidy estimates in the U.S. budget. They are not derived specifically from the actual experience of the CCC programs nor does CCC provide the principal factors used in the calculation of the original subsidy rates in the U.S. budget. These are prepared by the U.S. Office of Management and Budget on a government-wide basis and are applied to virtually all U.S. agencies providing international credits, based on assumptions regarding risk and recovery rates involving the highest-risk countries. CCC, however, does not take any risk with respect to such highest risk countries.

79. Fifth, Brazil has failed to demonstrate that the export credit guarantee program confers a

benefit. Brazil appears to abandon its own theory under Article 14(c) of the *SCM Agreement*, dismissing the express language of that Article, which presumes a government guarantee does *not* confer a benefit, absent a showing that Brazil not only fails to make but does not even attempt. Brazil focuses on a “severable benefit” theory, nowhere mentioned in the text, which ignores the entire cost side of relevant transactions. Brazil’s approach is contrary to the Appellate Body’s own interpretation of the relationship between Articles 1.1(b) and 14(c) of the *SCM Agreement*.

80. And, sixth, despite Brazil’s failure to meet its burden under Article 14(c) to show that a benefit is conferred, the United States uses real-world examples to demonstrate that sources of financing and guarantees comparable to GSM-102 guarantees are available in the marketplace. Brazil again wrongly attempts to dismiss such *products*, not on the basis of their terms, but because of the *status* of the entities providing them. Like its arguments concerning CCC, Brazil’s argument that these entities could *never* provide a commercial product is unsupported by any WTO text. The United States nevertheless further demonstrates that these entities design their products to be robustly profitable.

1. Certain Claims of Brazil are Outside the Scope of the *Agreement on Agriculture*

81. Before turning to Brazil’s argument, the United States notes, as a preliminary matter, that contrary to the assertions of Brazil,¹¹⁹ the United States has addressed the evidence and arguments offered by Brazil to demonstrate that the United States has not applied the GSM-102 export credit guarantee program to circumvent its export subsidy commitments, within the meaning of Article 10.1 of the *Agreement on Agriculture*. The United States has demonstrated that the export credit guarantee programs of the Commodity Credit Corporation (CCC), as substantially revised in 2005, do not constitute export subsidies and therefore cannot be applied in circumvention of its export subsidy commitments.

82. The United States would also note that “Brazil’s claims of inconsistency with Articles 10.1 and 8 of the *Agreement on Agriculture*, as well as Articles 3.1(a) and 3.2 of the *SCM Agreement*, are product-specific” and that “Brazil does not assert that the GSM 102 program itself circumvents the United States’ export subsidy commitments.”¹²⁰

83. Brazil’s claims with respect to unscheduled products include lyocell, lysine, and wood products.¹²¹ These products are not within the product coverage of Annex I of the *Agreement on*

¹¹⁹ Rebuttal Submission of Brazil, paras. 19, 360

¹²⁰ Rebuttal Submission of Brazil, para. 378

¹²¹ First Written Submission of Brazil, para. 450, fn. 622.

Agriculture and are therefore outside the proper scope of Brazil's claims.¹²²

2. The Export Credit Guarantee Program is Profitable

84. In its first written submission the United States demonstrated that the CCC export credit guarantee programs, including the GSM-102 program, generated a significant profit over the last 14 fiscal years, even before implementation of the revised risk-based fee structure on 1 July 2005.¹²³ Consequently, even before (1) elimination of the GSM-103 program; (2) cessation of the Supplier Credit Guarantee Program; (3) removal of the highest risk countries from program eligibility and (4) an average fee increase of 46 percent, premia were more than adequate to cover the long-term operating costs and losses of the programs. The United States explained that under the "net present value" accounting methodology applicable throughout the federal government of the United States, "a negative present value means that the program generates a 'profit' (excluding administrative costs) to the United States government."¹²⁴

85. The United States demonstrated further that the current United States budget data now reflects that for the cohorts 1992-2005, the applicable total net negative present value amount is \$166,549,780.¹²⁵

86. In its rebuttal submission, Brazil accuses the United States of making these numbers up: "the calculations in paragraph 87 of the U.S. Submission were specifically created by the United States for purposes of this litigation."¹²⁶ This is simply untrue. Each and every number used in the calculations is cited to the corresponding budget document from which it is extracted. The calculations are simply used to demonstrate the significance of these figures for purposes of showing profitability.

87. Brazil nowhere challenges that a negative present value amount reflects profitability under the Federal Credit Reform Act budget accounting methodology.¹²⁷ Instead, Brazil asks the Panel simply to ignore the budget numbers and look instead at the financial statements of the Commodity Credit Corporation for fiscal year 2006. In particular, Brazil argues that the term "credit guarantee liability" therein "results in a new cumulative loss figure of \$220 million for

¹²² Lysine is a chemical within Chapter 29 of the Harmonized Schedule. Wood products are within Chapter 44. Lyocell is a cellulosic fiber within Chapter 55.

¹²³ U.S. First Written Submission, paras. 8-9 and 81-99

¹²⁴ U.S. First Written Submission, para. 83; *Upland Cotton (Panel)*, para. 7.842; OMB Circular A-11, section 185.2, pp. 185.3 and 185.4 (Exhibit BRA-116)

¹²⁵ U.S. First Written Submission, paras. 87-91

¹²⁶ Rebuttal Submission of Brazil, para. 484.

¹²⁷ Brazil concurs that the negative subsidy amounts in the Federal Credit Supplement reflect overall profitability of the programs. Statement of Brazil, First Panel Meeting, para. 126 (22 July 2003); *See also*, Brazil's Comments on U.S. Rebuttal Submission, paras. 56, 67 (27 August 2003)

those post-1991 ECGs.” Brazil further claims that, as a result, “management’s view” and “CCC’s own unvarnished assessment of the performance of the program” are congruent with Brazil’s assertion that this figure represents a loss.¹²⁸ These assertions are incorrect.¹²⁹

88. The original Panel viewed these figures in a manner expressly contrary to what Brazil advances now and advanced in the earlier proceeding.¹³⁰

“The CCC defines the term ‘credit guarantee liability’ as the estimated cash outflows of the guarantees on a net present value basis. ‘Liability’ is defined as ‘. . . a probable future outflow or other sacrifice of resources as a result of past transactions or events. We observe that these amounts are not actual losses.’”¹³¹

89. Having extolled the virtues of the “Federal Credit Reform Act cost formula” as “an ideal basis on which to determine whether the CCC’s export credit loan guarantee programs are offered at premium rates that are inadequate to cover the long-term operating costs and losses of the programs, within the meaning of item (j) of the Illustrative List of Export Subsidies,”¹³² Brazil now seeks to abandon the inconvenient truth of its results.

90. In lieu of this data, Brazil seeks to introduce its own constructed “cash-basis accounting methodology” to assert that “the ECG programs have incurred net losses over the period FY 1993-2005.”¹³³ Brazil misleads the compliance Panel, however, when it asserts that such “cash-basis accounting methodology [was] adopted by the original panel.”¹³⁴ The original Panel did not “adopt” this approach nor did the “original panel net program receipts against program disbursements on a fiscal year basis,” as Brazil asserts.

¹²⁸ Rebuttal Submission of Brazil, para. 484

¹²⁹ The Statements of Federal Financial Accounting Concepts and Standards of the Financial Accounting Standards Advisory Board set forth a consolidated glossary of terms applicable to Generally Accepted Accounting Principles for federal entities. That glossary defines “liability” as: “For Federal accounting purposes, a probable future outflow or other sacrifice of resources as a result of past transactions or events.” Loss, on the other hand, is: “Any expense or irrecoverable cost, often referred to as a form of nonrecurring charge, an expenditure from which no present or future benefit may be expected.” U.S. Answers to Panel’s Question 227 Following Second Panel Meeting (22 December 2003) and Statement of Federal Financial Accounting Concepts and Standards (May 2002), Appendix E, pages 1140-1141 (Exhibit US-130)

¹³⁰ Brazil previously attempted to assert that the “credit guarantee liability” figure signifies that CCC “lost money”. See, Comment of Brazil to Panel Question 81(g), para. 178 (11 August 2003); 22 August 2003 Rebuttal Submission of Brazil, para. 109.

¹³¹ *Upland Cotton (Panel)*, para. 7.855 (italics added)

¹³² Statement of Brazil, First Panel Meeting, para. 129 (22 July 2003); Rebuttal Submission of Brazil, para. 112 (22 August 2003)

¹³³ Rebuttal Submission of Brazil, para. 485

¹³⁴ Rebuttal Submission of Brazil, para. 485.

91. The original panel was careful to note only that Brazil “placed on the record” its own constructed “cost” formula.¹³⁵ The original panel then compared Brazil’s formula with alternative cash basis data the United States placed before the original panel.¹³⁶ The original panel then simply noted that “a major difference between the *parties’ approaches* relates to the treatment of rescheduled debt.”¹³⁷ At no time did the original panel adopt Brazil’s approach as its own. Indeed, it is clear that the paramount fact on which the panel relied in reaching its conclusion was the result of U.S. budget figures: “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.”¹³⁸

92. Brazil’s assertion that the original panel adopted Brazil’s cash-basis accounting methodology¹³⁹ is completely disingenuous, because Brazil never proposed that the original panel adopt such approach. To the contrary, “Brazil emphasizes that it does not intend for this revised constructed formula to replace the formula used by the U.S. government itself to track the costs of the CCC guarantee programs pursuant to the U.S. Federal Credit Reform Act.”¹⁴⁰ Brazil now appears to advocate the opposite.

93. Moreover, Brazil’s advocacy of a cash-basis approach is contrary to its own stated views on the validity of such an approach in this dispute. “The FCRA formula, as has been noted and elaborated by the Office of Management and Budget, the General Accounting Office, the Federal Accounting Standards Advisory Board, and the Congressional Budget Office, records the full cost of a loan guarantee as an outlay at the time it is disbursed. For this reason, it is a well-established and accepted method used by the U.S. Government to determine with accuracy the cost of loan guarantees. (The purpose of the FCRA is, in fact, to ‘measure more accurately the costs of Federal credit programs.’) Prior to passage of the FCRA, loan guarantees were recorded on a cash basis, which distorted their costs.”¹⁴¹ Brazil cannot explain why it is now contradicting its previous position on the primacy of the methodology applied in the U.S. budget.

94. Brazil previously asserted that “the entire purpose of federal credit reform and the FCRA is to “measure more accurately the costs of Federal credit programs.” Brazil expressly criticized the United States for “effectively argu[ing] for a return to the cash-basis accounting that it

¹³⁵ *Upland Cotton (Panel)*, para. 7.844

¹³⁶ *Upland Cotton (Panel)*, para. 7.846

¹³⁷ *Upland Cotton (Panel)*, para. 7.847 (italics added)

¹³⁸ *Upland Cotton (Panel)*, para. 7.854

¹³⁹ Rebuttal Submission of Brazil, para. 485

¹⁴⁰ Brazil’s Answers to Questions Posed by the Panel Following the First Substantive Meeting of the Panel, para. 164 (Question 77) (11 August 2003) (emphasis in original).

¹⁴¹ Statement of Brazil - First Panel Meeting (22 July 2003), para. 128.

rejected with the FCRA.”¹⁴² Brazil’s own arguments before the original panel undermine its current fallacious assertion that the programs suffered a “net loss of over \$689 million” over the period FY 1993-2005.¹⁴³

95. In addition to these conceptual inconsistencies, Brazil commits a glaring factual omission in its allegations concerning program receipts on a fiscal year basis. It includes no recoveries during the listed fiscal years in respect of guarantees issued before 1992. For fiscal years 1993-2005, corresponding to the years listed in Exhibit BRA-613, such recoveries total over \$5.6 billion (\$5,638,618,000). Exhibit US-68 sets forth pages from the U.S budget for fiscal years 1993-2005 (as displayed in the annual U.S. budgets for fiscal years 1995-2007) showing recoveries in the “liquidating account” budget line 88.40 for repayments of principal and interest, just like the “recovered principal and interest” budget line 88.40 that Brazil sets forth from the ledger for the programs’ “financing account.”

96. Brazil accurately states that its figures from the “financing account” in Bra-613 reflect “cash flows to and from the Government resulting from loan guarantees committed in 1992 and beyond.”¹⁴⁴ With two relatively minor exceptions, Brazil accurately sets forth in that exhibit the revenue figures in respect of those guarantees issued in 1992 and beyond.¹⁴⁵

97. However, Brazil does not include any recoveries attributable to guarantees issued before 1992 but received during fiscal years 1993-2005. The compliance panel will note, as explained in the original proceeding, that as part of the change from a cash-basis accounting methodology to a present value accounting methodology under the Federal Credit Reform Act, activity in respect of any guarantees issued before fiscal year 1992 are treated separately under the “liquidating account.”¹⁴⁶

¹⁴² 22 August 2003 Rebuttal Submission of Brazil, para. 112

¹⁴³ Rebuttal Submission of Brazil (11 January 2007), para. 486.

¹⁴⁴ Rebuttal Submission of Brazil (11 January 2007), para. 485, fn. 703

¹⁴⁵ The two exceptions occur in the 2005 fiscal year. Brazil seems to have inadvertently overlooked \$60 million in additional revenue in line 88.25 (“interest on uninvested funds”). See Exhibit BRA-544, p. 117. Second, Brazil has understandably simply reproduced an obvious printing error in the U.S. budget for the same fiscal year setting forth fees of \$508 million and recoveries of zero. Premia for FY 2005 were just above \$21 million, consistent with the order of magnitude for premia in the other fiscal years in Exhibit BRA-613 (See Summary of 2005 Export Credit Guarantee Program Activity for GSM-102 as of close of business September 30, 2005, p. 10 (Exhibit US-69)). The balance of \$487 million for FY 2005 should have been printed in the recovery line (88.40) of the financing account. Irrespective of this printing error the total revenue for the financing account for FY 2005 remains the same.

¹⁴⁶ 2 USC Section 661a(8) provides: “The term ‘liquidating account’ means the budget account that includes all cash flows to and from the Government resulting from direct loan obligations or loan guarantee commitments made prior to October 1, 1991. Exhibits BRA-117 and US-70.

98. Actual cash recoveries¹⁴⁷ in respect of guarantees issued before FY1992 are set forth in the liquidating account line 88.40. Reproduced below is a table showing the recovered principal and interest in Brazil's Exhibit BRA-613 for the financing account (i.e., in respect of guarantees issued in 1992 and beyond) and the corresponding figures for the liquidating account (i.e., in respect of guarantees issued before 1992).

| Fiscal year | Recovered principal and interest (88.40) Financing Account (Bra-613) | Recovered principal and interest (88.40) Liquidating account ¹⁴⁸ |
|-------------|----------------------------------------------------------------------|-----------------------------------------------------------------------------|
| 1993 | 12,793,000 | 302,632,000 |
| 1994 | 458,954,000 | 270,986,000 |
| 1995 | 62,000,000 | 349,000,000 |
| 1996 | 68,000,000 | 441,000,000 |
| 1997 | 104,000,000 | 360,000,000 |
| 1998 | 81,000,000 | 283,000,000 |
| 1999 | 58,000,000 | 234,000,000 |
| 2000 | 100,000,000 | 214,000,000 |
| 2001 | 149,000,000 | 412,000,000 |
| 2002 | 155,000,000 | 498,000,000 |
| 2003 | 187,000,000 | 440,000,000 |
| 2004 | 219,000,000 | 407,000,000 |
| 2005 | 487,000,000 ¹⁴⁹ | 1,427,000,000 |

¹⁴⁷ The United States hastens to note that none of this data employs the cash basis approach to rescheduling accounting that the United States presented to the original panel discussed in para. 7.846 of the original panel report. Rather, this data is completely consistent with the "cash-basis" approach Brazil advocates here and in Table 3 of the original panel report (para. 7.845). "[T]he left-hand column of that chart records revenue collected on a fiscal year (not a cohort-specific) basis[.]" Brazil's Comments on U.S. Rebuttal Submission (27 August 2003), para. 58.

¹⁴⁸ The figure for FY 1993 appears in Exhibit BRA-614. Brazil has neglected to reproduce the liquidating account figures for the other fiscal years. They are set forth in Exhibit US-68.

¹⁴⁹ This figure is presented in lieu of the 0 figure in Bra-613, because of the obvious printing error. This depiction does not change the total revenue but more accurately depicts the revenue attributable to recoveries, instead of premia.

| | | |
|---------------|------------------------|------------------------|
| Total: | \$2,141,747,000 | \$5,638,618,000 |
|---------------|------------------------|------------------------|

Total recoveries for the export credit guarantee programs for fiscal years 1993-2005 therefore approach \$7.8 billion (\$7,780,365,000). Adding back amounts paid out of the liquidating account over the same period of \$2,232,861,000¹⁵⁰ still yields a net favorable result of nearly \$5.6 billion.

99. In addition, the President’s Budget of the United States Government for fiscal year 2008 is, by coincidence, released today (5 February 2007). These newly issued budget figures reflect principal and interest collections (line 88.40) in the financing account (post-1991 ECGs) of \$523 million and principal and interest collections (line 88.40) in the liquidating account of \$980 million.¹⁵¹

100. These figures belie Brazil’s assertion that “CCC recovery rates are very low.”¹⁵² Brazil appears to rely entirely on a 1994 publication for this assertion,¹⁵³ which publication obviously could not have considered the very large recoveries achieved since that time and reflected in the U.S. budget.

3. The GSM-102 Program is Structured and Designed to Cover Long-Term Operating Costs and Losses

¹⁵⁰ Claims Paid by CCC Export Credit Liquidating Account (FY 1993- 2006) (Line 01.01, Capital Investment: Direct Loans: Guarantee Claims) (Exhibit US-68)

| Fiscal Year | Claims Paid (\$ Thousands) |
|-------------|----------------------------|
| 1993 | 793,391 |
| 1994 | 748,470 |
| 1995 | 620,000 |
| 1996 | 44,000 |
| 1997 | 21,000 |
| 1998 | 6,000 |
| 1999 | 0 |
| 2000 | 0 |
| 2001 | 0 |
| 2002 | 0 |
| 2003 | 0 |
| 2004 | 0 |
| 2005 | 0 |
| 2006 | 0 |

Total: 2,232,861

¹⁵¹ Budget of the United States Government for Fiscal Year 2008, Appendix regarding Department of Agriculture, pp.52, 53 (Exhibit US-71).

¹⁵² Rebuttal Submission of Brazil, para. 423.

¹⁵³ Rebuttal Submission of Brazil, para. 423, fn. 615

a. Risk controls and accounting treatment complement recoveries

101. The size of the cash recoveries in conjunction with the substantial modifications to the export credit guarantee programs similarly belie Brazil's continuing assertion that "the GSM 102 program is not structured or designed to meet long-term operating costs and losses."¹⁵⁴

102. Contrary to Brazil's assertions, the profitability of the programs are neither "against the odds"¹⁵⁵ nor "avoiding losses by good fortune."¹⁵⁶ As the United States has pointed out, the budget data reflects profitability of the program for 14 fiscal years, even before adoption of the most recent changes in 2005.

103. Brazil preposterously argues that "under the United States view of item (j), an ECG program could charge *no fees* [italics in original] whatsoever, and be excluded from item (j) if the program was lucky enough not to suffer defaults in a given period."¹⁵⁷ The United States has never argued any such thing. It has always charged fees and now charges fees based on both risk and tenor. It also has altogether excluded numerous previously eligible countries from eligibility from the programs.¹⁵⁸

104. Brazil next alleges, essentially, that because CCC is part of the United States government and can borrow from the U.S. Treasury it "is not subject to the disciplines of the market" and that its mere *status* as a United States government agency is a "structural factor" precluding any possibility of structuring an export credit guarantee program to meet long-term operating costs and losses.¹⁵⁹ In effect, irrespective of its fee structure, loss experience, and any other commercial factor that a government agency may employ in the design of an export credit guarantee program, Brazil argues that solely because it can borrow from the government, such agency's program could *never* satisfy the item (j) test. The WTO Agreements set forth no such absolute rule, and the original panel certainly ascribed no such significance to it, despite Brazil's representations.¹⁶⁰ Indeed, Brazil's approach would render item (j) inutile since no government export credit

¹⁵⁴ Rebuttal Submission of Brazil, Section 3.6.3

¹⁵⁵ Rebuttal Submission of Brazil, para. 489

¹⁵⁶ Rebuttal Submission of Brazil, para. 490.

¹⁵⁷ Rebuttal Submission of Brazil, para. 490.

¹⁵⁸ The United States cannot reconcile Brazil's assertion that "on July 1, 2005 no GSM 102 or SCGP ECGs were outstanding for 13 of the 19 countries removed from eligibility." Rebuttal Submission of Brazil, para. 17. Only 10 of the 22 countries removed from eligibility did not have such outstanding amounts: Azerbaijan, Bosnia, Burkina Faso, Cameroon, Gambia, Kenya, Mali, Niger, Tanzania, and Vietnam.

¹⁵⁹ Rebuttal Submission of Brazil, paras. 491-493.

¹⁶⁰ Indeed, item(j) of the Illustrative List of Export Subsidies contemplates that "governments (or special institutions controlled by governments)" *may* provide export credit guarantee programs, subject to the requirement that premium rates be adequate to cover the long-term operating costs and losses of the program. Interest expense is merely an operating cost to be included in such calculation, and the source of such borrowing is irrelevant.

guarantee program could ever not be an export subsidy. Accordingly, Brazil’s approach would run counter to customary rules of treaty interpretation.

105. Brazil notes that “CCC continues to incur interest on Treasury borrowings,”¹⁶¹ but Brazil ignores the fact that CCC also has funds on deposit in the Treasury, on which the Treasury pays interest to CCC. As would be the case for any commercial actor, interest expense and interest income are duly accounted for in the U.S. budget and are fully reflected in the program costs and revenues.¹⁶² Even Brazil’s Exhibit BRA-613 depicts figures for both interest expense and interest revenue taken from the U.S. budget. Actual interest expense and revenue figures are set forth in lines 00.02 and 88.25, respectively of the financing account provisions of each budget. To illustrate, a table setting forth these figures for programming years 1992-2002 are set forth in Exhibit US-72.¹⁶³

106. Brazil next emphasizes that the U.S. Congress has not yet repealed the statutorily-imposed one-percent fee cap imposed on the GSM 102 program.¹⁶⁴ Brazil notes during a fee review in 2003, before the establishment of the risk-based fee structure, that a move to a risk-based system could entail fees in excess of one percent. The operating assumption at the time, of course, was that all of the then-eligible countries would remain eligible under the hypothetical new regime. Instead, in light of the fact that the fee cap has not yet been repealed, CCC eliminated from eligibility 22 countries with respect to which participation in the program might require fees in excess of the statutory maximum.

107. Brazil also dismisses the fact that CCC sets strict limits on its exposure to individual bank obligors. Brazil argues that the only way to achieve “prudent fiscal management” is to do it in the exact manner Brazil dictates, requiring not only the tight exposure limits that CCC employs, but also different fees for these banks. First, no WTO rule governs how a government program shall ensure that its premia are adequate to cover long-term operating costs and losses. Second, Brazil reveals its lack of understanding of the program when it indicates that under the GSM-102 program “every bank within a country pays the same fee.”¹⁶⁵ As the compliance panel undoubtedly understands, the U.S. exporter pays the fee, not the importer’s bank.

b. Initial subsidy estimates in the U.S. budget are not derived from the actual experience of the CCC programs

108. Irrespective of the overwhelming negative subsidy amounts and their undisputed

¹⁶¹ Rebuttal Submission of Brazil, para. 494

¹⁶² See Exhibit BRA-116, Section 185.2, p. 185-4.

¹⁶³ Exhibit US-72 simply reproduces the table in U.S. Answer to Panel Question 224 (22 December 2003), para. 111

¹⁶⁴ Rebuttal Submission of Brazil, para. 495

¹⁶⁵ Rebuttal Submission of Brazil, para. 496.

significance under the U.S. budget, Brazil next alleges that CCC predicts every year, including for FY 2006 and 2007, that it will incur loss.¹⁶⁶ CCC makes no such prediction. Brazil simply misunderstands the nature and meaning of the original subsidy estimate set forth in the budget for any particular year.

109. Brazil alleges that “CCC’s actual historical experience is a primary factor in setting the initial annual projections of long-term results.”¹⁶⁷ This is not correct.

110. Brazil assumes (1) the specific experience of the CCC programs in particular are the historical experience used in the calculation of the original subsidy rates and (2) CCC itself provides the principal factors used in the calculation of the original subsidy rates. Both of these assumptions are false.

111. “The Office of Management and Budget (OMB) has overall responsibility for coordinating cost estimates under credit reform and plays a unique role in determining the subsidy costs of [] federal agencies that offer international credit - it provides these agencies with expected loss rates, a key component of their subsidy costs.”¹⁶⁸

112. OMB currently determines expected loss rates for CCC for purposes of original subsidy estimates, irrespective of the specific experience of CCC in its particular programs. Unlike with domestic credit agencies of the U.S. government, “for U.S. international credits, OMB provides the expected loss rates, which are composed of default and recovery assumptions.”¹⁶⁹ This is because OMB uses a generic approach that does not differentiate among the various agencies or based on specific programs, unless OMB has completed a review of a particular entity.

113. Following enactment of the Federal Credit Reform Act in 1990, the Interagency Country Risk Assessment System (ICRAS) - a working group of executive branch agencies engaged in international credit activities - was formed to provide uniformity to the process for evaluating country risk and estimating the program costs. OMB is responsible for determining the expected loss rates associated with each ICRAS risk rating and maturity level.¹⁷⁰

114. All but one of the U.S. agencies providing international credit, including CCC, are required to use the same expected loss rates for each ICRAS risk rating and maturity in preparing

¹⁶⁶ Rebuttal Submission of Brazil, para. 501-503

¹⁶⁷ Rebuttal Submission of Brazil, para. 505.

¹⁶⁸ United States Government Accountability Office Report to Congressional Committees (GAO-04-531) September 2004: Export Import Bank - OMB’s Method for Estimating Bank’s Loss Rates Involves Challenges and Lacks Transparency (Exhibit US-73), p. 2.

¹⁶⁹ GAO Report, p. 7 (Exhibit US-73)

¹⁷⁰ GAO Report, p. 76 (Exhibit US-73)

subsidy cost estimates.¹⁷¹ OMB provides these rates annually to be used in preparing budget submissions. OMB also provides the discount rates that are used to calculate subsidy estimates.¹⁷²

115. OMB's generic approach to estimate such expected loss rates is based not on CCC's specific experience at all but on "rating agency corporate default data and interest rate spreads to estimate default probabilities" and "assumptions about recoveries after default to estimate expected loss rates."¹⁷³

116. This one-size-fits-all approach to calculating original subsidy rates largely explains the continuing presence of an original subsidy estimate for CCC export credit guarantee programs in fiscal years 2006 and 2007, notwithstanding the particular experience of profitability of the programs reflected in the budget data.

117. Starting with fiscal year 2003, OMB changed its method for determining expected loss rates because emerging finance literature indicated its former approach might overstate losses to the government.¹⁷⁴

118. OMB's methodology, however, continues to make certain assumptions that are not consistent with CCC's experience nor with its program. Assumptions regarding recovery rates are a significant component in OMB's calculation of the expected loss rates for all international credit programs, including the GSM-102 program. OMB uses "the market price of credits with the lowest ICRAS rating (category 11) [as] the predominant basis for recovery rates." OMB's use of the market price of the "lowest-rated credits is based on the assumption that this value represents the most the U.S. government would recover in the event of default."¹⁷⁵ "OMB publishes two risk ratings for each country - a sovereign rating and a nonsovereign, or private, rating. Each sovereign borrower or guarantor is rated on an 11-category scale, ranging from A through F- (or their numerical counterparts, categories 1-11)."¹⁷⁶

119. For CCC, however, no country below ICRAS rating of [[]] is eligible for the program at all. Consequently, OMB's imposed assumption about recovery rates as part of the calculation of expected loss rates is much more conservative than would be warranted with respect to the CCC

¹⁷¹ Following the publication of the GAO Report, starting with the FY 2007 budget for the Export-Import Bank of the United States, OMB applies loss factors specific to Ex-Im more reflective of the bank's actual recovery experience. These include an assumption of a significantly higher estimated recovery rate than applied generally to other international credit agencies. OMB has not yet undertaken a comparable review of CCC's particular experience, and the CCC budget continues to apply the OMB generic approach.

¹⁷² GAO Report, p. 10, including fn. 19. (Exhibit US-73)

¹⁷³ GAO Report, p. 16 (Exhibit US-73)

¹⁷⁴ GAO Report, p. 1 (Exhibit US-73)

¹⁷⁵ GAO Report, p. 35. (Exhibit US-73)

¹⁷⁶ GAO Report, p. 77 (Exhibit US-73)

programs. Recall that the OMB methodology applies across all international credit agencies in the U.S. Government. These include, among others, the Agency for International Development and the Department of Defense,¹⁷⁷ which may indeed extend credit to much less creditworthy countries.

120. “The assumed recovery rate is a key driver of the expected loss rates. OMB assumed an across-the-board recovery rate of 17 percent for the fiscal year 2003 budget - that is, the government was expected to lose \$830 and recover \$170 for every \$1,000 in defaulted credits. It assumed lower recovery rates of 12 percent for the fiscal year 2004 budget and 9 percent for the fiscal year 2005 budget.”¹⁷⁸ Such recovery rates are grossly lower than CCC’s particular experience. OMB used corporate default data to predict U.S. international credit agencies’ defaults, after comparing data on historical defaults from one U.S. government agency. “OMB did not compare other ICRAS agencies’ defaults with the corporate data.”¹⁷⁹

121. As the “predictive value” of the OMB methodology is “not yet established,”¹⁸⁰ GAO recommended to OMB to ask “U.S. international credit agencies for their most complete, reliable data on default and repayment histories, so that the validity of the data on which the methodology is based can be assessed over time.”¹⁸¹

122. To date OMB has not incorporated any data specific to CCC experience in the calculations of expected loss rates that it requires CCC to employ in the preparation of its budget at the beginning of each fiscal year.

123. The rigidity and generic nature of the OMB methodology, particularly in respect of recovery assumptions and ICRAS grades generates a “subsidy rate” that CCC and every other U.S. government international credit agency must apply.

124. CCC, again like other agencies, then introduces certain assumptions about the level of programming for a particular cohort. For CCC, what is the level of guarantees it anticipates issuing in a given year? This is the “historically overly-optimistic projection of the use of the program” to which the United States has previously referred and which Brazil erroneously derides as “patently false.”¹⁸² The United States in fact provided data to the Panel specifically demonstrating the disparity between projected guarantee registrations and actual registrations.¹⁸³

¹⁷⁷ GAO Report, fn. 11 (Exhibit US-73)

¹⁷⁸ GAO Report, p. 19-20 (Exhibit US-73)

¹⁷⁹ GAO Report, p. 33 (Exhibit US-73)

¹⁸⁰ GAO Report, p. 4 (Exhibit US-73)

¹⁸¹ GAO Report, p. 5 (Exhibit US-73)

¹⁸² Rebuttal Submission of Brazil, para. 506-7

¹⁸³ Exhibit US-7; U.S. First Written Submission, para. 104

125. This aspect of specific program experience goes into the calculation of the original subsidy estimate as the amount to be multiplied by the OMB-dictated subsidy rate. *Revised* estimates are indeed based on the amount of guarantees actually issued, rather than the amount originally projected to be issued. But the estimate figure continues to require the multiplication of the actual amount of guarantees by the Government-wide subsidy rate imposed by the OMB model.

126. The fact remains that under the Federal Credit Reform Act accounting methodology, a negative subsidy net of reestimate reflects profitability, and the CCC export credit guarantee programs have achieved that for fourteen fiscal years. The compliance Panel will further note that in the Federal Credit Supplement released today (5 February 2007), the net lifetime reestimate for all cohorts¹⁸⁴ of both GSM-102 and GSM-103 from 1992-2006, is negative.¹⁸⁵

c. Premia are only one factor in the structure and design of the program

127. Average fee increases of 46 percent and elimination of the highest risk countries, when added to profitability of the programs even before such changes demonstrate that the GSM-102 program is structured and designed to cover long-term operating costs and losses. Brazil appears to focus largely on the issue of whether or not overall premia has “resulted in a significant increase in revenue for the program”¹⁸⁶ and that SCGP “constituted a marginal part of the CCC ECG portfolio.”¹⁸⁷

128. Such comparisons ignore the elimination of the comparative risk. Although GSM-102 fee premia declined in FY2006 to \$12.3 million in FY 2006 from \$21.5 million in FY 2004, this represents a 22 percent increase in fees per billion dollars of registrations. GSM 102 registrations declined precipitously from \$2.9 billion to \$1.36 billion.¹⁸⁸ Registrations now only occurs in respect of less risky countries. Furthermore, budget data also reflect that the SCGP presented a significantly greater risk exposure to CCC than GSM-102. In direct contrast to GSM-102, net lifetime reestimates for SCGP have increased, largely based on loss experience just preceding cessation of the program.¹⁸⁹

¹⁸⁴ The table does not reflect cohorts 1994 and 1995, which were closed during fiscal year 2004, and are no longer subject to the reestimation process. However, the final subsidy estimate, net of reestimates, for these cohorts (all programs) was negative. *See*, U.S. First Written Submission, para. 89, fn. 147.

¹⁸⁵ 2008 U.S. Budget, Federal Credit Supplement, Table 8 - Loan Guarantees: Subsidy Reestimates p. 45 (Exhibit US-74)

¹⁸⁶ Rebuttal Submission of Brazil, para. 14.

¹⁸⁷ Rebuttal Submission of Brazil, para. 15.

¹⁸⁸ *See*, Exhibits US-60 and US-61.

¹⁸⁹ *See* Exhibit US-5 and Exhibit US-74 (2008 U.S. Budget, Federal Credit Supplement: Table 8 - Loan Guarantees: Subsidy Reestimates

4. Rescheduling Debt is Irrelevant to Brazil's Incorrect Assertion that the United States Has Failed to "Withdraw the Subsidy"

129. Brazil apparently misunderstands the statement of the United States in its first submission that "CCC has no further contingent liability under SCGP, as no guarantees were issued after September 30, 2005, the period to ship has expired, and the period of coverage was only 180 days. In other words, there are no export credit guarantees 'still outstanding' under the SCGP program."¹⁹⁰ Brazil asserts that "the United States' position rests on the assumption that the maximum program tenors cannot be exceeded."¹⁹¹ The United States makes no such assertion. What the United States simply intended to convey was that any and all claims payable by the United States under a supplier credit guarantee have been received and paid. The United States is not exposed to any further potential liability under SCGP.

130. Brazil focuses on rescheduled debt under the other export credit guarantee programs and makes an extrapolation of outstanding rescheduled debt under the SCGP.¹⁹² The existence or non-existence of rescheduled debt, however, has nothing to do with potential liability under SCGP (i.e., whether the U.S. will honor any further claims under the program). Any already rescheduled debt is a *receivable*, pursuant to which CCC would receive money, not pay. The United States simply does not understand the relevance of rescheduled debt to withdrawal of the subsidy.

131. Brazil inexplicably further suggests that "the United States may not, subsequent to July 1, 2005, reschedule or restructure debt covered by a CCC ECG issued prior to July 1, 2005, because rescheduling is either a means of avoiding default and the need for the United States to make a 'payment' on the CCC obligation, or a means of collecting default for which a 'payment' was made (potentially with interest deferment or reduction, which can itself be characterized as a 'payment')." ¹⁹³

132. CCC does not, however, reschedule debt prior to default. In GSM-102 the original debt is owed from a foreign bank to the holder of the CCC guarantee, and in SCGP the original debt is owed from the importer to the holder of the guarantee. In both cases, no obligation is owed to CCC until it pays a claim and is subrogated to the position of the original obligee. CCC cannot

¹⁹⁰ U.S. First Written Submission, para. 143

¹⁹¹ Rebuttal Submission of Brazil, para. 388.

¹⁹² Brazil's extrapolation implies a vastly exaggerated amount for rescheduled SCGP. Although the United States continues to believe the amount of SCGP reschedulings is irrelevant, in the interest of factual clarity the amounts and cohorts of rescheduled SCGP are as follows:

FY 2002: \$2,240,907

FY 2003: 2,835,000

FY 2004: 62,100,053

¹⁹³ Rebuttal Submission of Brazil, para. 398

reschedule anything until the occurrence of default on the underlying obligation.

133. Brazil illogically then indicates that the United States can never reschedule debt once the obligor has defaulted. Rescheduling, however, as is commonly recognized throughout the commercial lending sector, *enhances* the likelihood of recovery in a situation where the obligor has already defaulted. It makes no sense for Brazil to assert on the one hand that the United States must strive to recover its long-term operating costs and losses and on the other hand assert that the United States is *prohibited* from engaging in a practice that achieves precisely that.

5. The Export Credit Guarantee Program Does Not Confer a Benefit

a. *Brazil has failed to undertake the proper analysis under Article 14(c) of the SCM Agreement*

134. The United States has demonstrated that export credit guarantees under the GSM-102 program are not export subsidies within the meaning of the test for such determination under item (j) of the Illustrative List of Export Subsidies because the program is designed and structured to charge premia adequate to cover its long-term operating costs and losses. In addition, on the basis of Brazil's own avowed approach, the United States has also demonstrated that the program does not confer a benefit.

135. Brazil asserted that its "first approach to determine whether a 'benefit' is conferred by a guarantee draws on context from Article 14(c) of the *SCM Agreement*."¹⁹⁴

136. Article 14(c) provides:

[A] loan guarantee by a government shall *not* be considered as conferring a benefit *unless* there is a difference between the amount that the firm receiving the guarantee pays on *a loan* guaranteed by the government and the amount that the firm *would pay on a comparable commercial loan* absent the government guarantee. In this case the benefit shall be the difference between these two amounts adjusted for any differences in fees.¹⁹⁵

137. The United States pointed out that Article 14(c) presumes that benefit does *not* exist in the absence of a particularized showing that the overall cost, including fees, of *a loan* guaranteed by the government is less than that the firm receiving the guarantee would pay on a *comparable commercial loan*. The United States noted that Brazil has made no attempt to provide such specific information on individual loan costs and fees or to identify comparable commercial loans

¹⁹⁴ First Written Submission of Brazil, para. 372

¹⁹⁵ Emphasis added.

and their terms.¹⁹⁶ Brazil does not refute this in its Rebuttal Submission.

138. Instead, Brazil appears to acknowledge that depending on various factors that “the type of [[]] loan cited by the United States or a loan underlying a GSM 102 ECG could be more costly than the other, depending on the relative likelihoods of default”¹⁹⁷ and then appears to abandon its own theory under Article 14(c), dismissing its express language, and noting that “Brazil is undertaking to assess a severable ‘benefit’ to the U.S. exporter.”¹⁹⁸

139. Such a theory of “severable ‘benefit’” is directly contrary to the entire point of Article 14(c). Indeed, a loan guarantee by a government may provide a benefit. Such benefit may fall upon one or more of the participants in the transaction. In arguing that the GSM-102 program confers such benefits, Brazil itself suggests several potential recipients of such alleged benefit: “the U.S. exporter, the U.S. bank; the foreign bank; and the foreign purchaser/borrower.”¹⁹⁹ Any potential benefit of a government guarantee could be distributed in whole or in part among one or more of such parties.

140. What Brazil fails to acknowledge is that costs are also distributed among the parties. A fundamental premise of Brazil’s “severable benefit” theory is that “the U.S. exporter does not bear the costs or risks of securing or extending financing to the foreign bank or the foreign purchaser/borrower. Thus, the benefit to the U.S. exporter can be measured through an assessment of how GSM 102 fees line up against the fees for similar instruments.”²⁰⁰

141. Brazil’s premise, however, is not correct. In every GSM-102 transaction, numerous fees and costs are incurred in addition to the guarantee fee itself, and the two banks involved pass the direct costs on to their customers (the exporter and importer, respectively). The importer and exporter share in some fashion the bank costs of opening the documentary letter of credit, as well as the letter of credit negotiating fees, and, if the letter of credit is confirmed, the confirmation fee.

142. Most importantly, however, the financial institution that takes assignment of the guarantee and the underlying credit of the foreign obligor bank deeply *discounts* the amount it pays the exporter. Through its fees and the discount pricing mechanism the U.S. assignee bank spreads cost and risk onto the exporter, who has already alone paid the full premium for the CCC guarantee. It is therefore not accurate to assert that “the exporter in a GSM 102 situation is not

¹⁹⁶ U.S. First Written Submission, para. 133

¹⁹⁷ Rebuttal Submission of Brazil, para. 430

¹⁹⁸ Rebuttal Submission of Brazil, para. 370

¹⁹⁹ Rebuttal Submission of Brazil, para. 370

²⁰⁰ Rebuttal Submission of Brazil, para. 370. In addition, the GSM 102 program does not *require* the exporter to assign the guarantee at all. On admittedly rare occasion, the exporter retains the guarantee and directly extends credit to the foreign obligor bank.

directly affected by the ‘total cost of funds’ involved in the transaction.”²⁰¹

143. Because costs and potential benefits can both be shared in various ways among all participants in a loan transaction covered by a government guarantee, Article 14(c) focuses on the overall costs of the loan, including the guarantee fees, rather than one “severable” component of the entire transaction.

144. As the Appellate Body has stated:

“Although the opening words of Article 14 state that the guidelines it establishes apply ‘[f]or the purposes of Part V’ of the *SCM Agreement*, which relates to ‘countervailing measures’, our view is that Article 14, nonetheless constitutes relevant context for the interpretation of ‘benefit’ in Article 1.1(b). The guidelines set forth in Article 14 apply to the calculation of the ‘benefit to the recipient conferred pursuant to paragraph 1 of Article 1’. [emphasis by the Appellate Body itself] This explicit textual reference to Article 1.1 in Article 14 indicates to us that ‘benefit’ is used in the same sense in Article 14 as it is in Article 1.1”²⁰²

b. Sources of financing and guarantees comparable to GSM-102 guarantees are available in the marketplace

145. Unlike Brazil, the United States has provided specific information to demonstrate that sources of financing and guarantees comparable to GSM-102 guarantees are available in the marketplace.

146. The United States has provided evidence supplied directly from a [[

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147. Brazil contends that the examples provided directly by a private sector participant “do not undermine evidence showing that the GSM-102 program is designed to make commercial credit available where it otherwise would not be.”²⁰⁴ In support of this point, Brazil offers its Exhibit BRA-588, which on its face indicates that it was prepared in 2004, before all of the revisions to the program now at issue.

²⁰¹ Rebuttal Submission of Brazil, para. 406

²⁰² *Canada - Measures Affecting the Export of Civilian Aircraft* (Appellate Body Report), WT/DS70/AB/R, adopted 20 August 1999, para. 155

²⁰³ U.S. First Written Submission, paras. 119-130 and Exhibit US-22

²⁰⁴ Rebuttal Submission of Brazil, para. 418.

148. Brazil further observes that Exhibit US-22 “offers no information about the credit ratings of the banks involved in these alleged transactions[.]. Nor does the statement offer any information about the seniority of the creditors.”²⁰⁵ Although the information supplied expressly indicates that all of the private sector examples were unsecured transactions, Brazil observes that “the transactions discussed by the United States involve syndicated loans, which are generally classified as senior debt (but can be either secured or unsecured). In the event of default, senior creditors will lose less than subordinated creditors and, therefore, can command a lower spread.”²⁰⁶

149. []

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150. []

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151. Brazil’s principal allegation to critique these real-world examples in the marketplace is that “the patterns of credit risk to which the lender is exposed are very different in these cases.”²⁰⁸ Brazil is factually correct that in a bullet loan the credit risk lasts only as long as the loan is

²⁰⁵ Rebuttal Submission of Brazil, para. 422.

²⁰⁶ Rebuttal Submission of Brazil, para. 422.

²⁰⁷ Fitch Ratings Definitions (Exhibit US-75)

²⁰⁸ Rebuttal Submission of Brazil, para. 429.

outstanding. In a GSM-102 transaction that extends for the maximum authorized 3 year term,²⁰⁹ Brazil is correct that “the principal is paid in equal installments over three years; so the entire principal is at risk over year 1; two-thirds of the principal remains at risk between years 1 and 2; and fully one-third of the principal amount is at risk in year 3.”²¹⁰

152. In its misplaced assertion of lack of comparability between these private sector examples and the GSM-102 transactions, however, Brazil inappropriately divorces the temporal differences in principal risk exposure with the pricing of the loans. Unlike the GSM-102 transaction, as Brazil recognizes, in a two-year bullet loan the principal is fully at risk for the entirety of two years.²¹¹ Similarly, in a five-year bullet loan, the principal is payable in a “bullet” at the end of the term, and the principal is fully at risk for five years.

153. As the United States explained in its first submission, loans are priced to take account of these temporal differences in principal risk exposure. The “average life” of a loan is the average number of years that principal is outstanding. The cost of a loan to a borrower - or the value of the loan to a lender - is reflected in the annualized cost or value.²¹² Loans with different “patterns of credit risk” become directly comparable using this “average life” calculation, the validity of which Brazil has not challenged.²¹³

154. The United States also provided numerous examples of commercial products offered by the International Finance Corporation (“IFC”), Inter-American Development Bank (“IDB”), and the European Bank for Reconstruction and Development (“EBRD”) that are directly comparable in providing a guarantee “(a) against default by a foreign bank on (b) a letter of credit issued by it to (c) finance a specific commercial transaction.”²¹⁴ Many of these products cover credits of up to 3 years and in amounts up to 100 percent of the individual transactions.

155. Brazil simply asserts that by definition anything that the IDB, IFC, and EBRD does in the market cannot be commercial and cannot be considered in respect of products available in the

²⁰⁹ Many GSM-102 guarantees are in fact for less than 3 years.

²¹⁰ Rebuttal Submission of Brazil, para. 429.

²¹¹ Rebuttal Submission of Brazil, para. 429.

²¹² U.S. First Written Submission, paras. 123-4.

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²¹⁴ U.S. First Written Submission, para. 111.

marketplace.²¹⁵

156. Brazil first emphasizes that each of these entities purportedly enjoys “immunities traditionally conferred on such official entities, including immunity from regulation, suit, seizure of assets and taxation.”²¹⁶ Whether or not an *entity* enjoys such immunities, however, or has an overarching purpose of fostering economic and social development, has nothing to do with the commercial nature of its *products*. This is not unlike Brazil’s argument that because CCC is part of the United States government and can borrow from the U.S. Treasury it “is not subject to the disciplines of the market” and that its mere *status* as a United States government agency is a “structural factor” precluding any possibility of structuring an export credit guarantee program to meet long-term operating costs and losses.²¹⁷

157. Similarly, it asserts that although “EBRD pledges to use ‘sound banking principles’ in its activities, it is not a private sector actor motivated by profit.”²¹⁸ In one sentence, Brazil sweepingly excludes all not-for-profit *entities*, simply because of their status, from eligibility for inclusion as commercial actors potentially offering commercial *products*, relevant for establishing market benchmarks. Brazil’s argument goes too far.

158. Contrary to Brazil’s assertions, in any event, “the EBRD has budgeted for a robust profit in 2006.”²¹⁹ And the EBRD is in fact robustly profitable. Its net profit for the year to date as of September 30, 2006 is 923 million euros.²²⁰ Its net profit for 2005 was over 1.5 *billion* euros, and it has been profitable in each of the last five years.²²¹

159. The compliance Panel will recall that the EBRD offers the Trade Facilitation Programme (TFP) to over 100 issuing banks in 28 countries in central and Eastern Europe.²²² Through this program, “the EBRD provides [unconditional] guarantees to international confirming banks. In so doing, it takes the political and commercial payment risk of transactions undertaken by issuing

²¹⁵ “The IDB, IFC, and EBRD are not commercial banks offering market products. The IDB, IFC and EBRD are public financial institutions whose product offerings are [] distorted by government intervention.” Rebuttal Submission of Brazil, paras. 373, 438

²¹⁶ Rebuttal Submission of Brazil, paras. 439, 441, and 442

²¹⁷ Rebuttal Submission of Brazil, paras. 491-493.

²¹⁸ Rebuttal Submission of Brazil, para. 441.

²¹⁹ European Bank for Reconstruction and Development, Annual Report 2005, Financial Report (Exhibit US-76), p. 9 (Outlook for 2006)

²²⁰ European Bank for Reconstruction and Development, Interim Financial Report at September 30, 2006 (unaudited), (Exhibit US-77), p.2 <http://www.ebrd.com/about/basics/interim.pdf>

²²¹ European Bank for Reconstruction and Development, Annual Report 2005, Financial Report (Exhibit US-74), p. 2, 3 <http://www.ebrd.com/pubs/general/6710.pdf>

²²² See EBRD sector factsheet: Trade Facilitation Programme (Exhibit US-17) available at <http://www.ebrd.com/pubs/factsh/themes/trade.pdf>.

banks in the countries where the EBRD operates.” It provides “guarantees of up to 100 percent of the face value of the underlying trade finance instruments.” The guarantees may be used to secure payment of letters of credit from the issuing bank.²²³ The EBRD extends its guarantees in respect of agricultural export transactions where CCC is unwilling to take on risk.²²⁴

160. Recent evidence confirms that the TFP is market-based. On December 4, 2006, the EBRD announced that “a group of international insurance underwriters agreed for the first time to back [TFP] for the [Commonwealth of Independent States].”²²⁵ These commercial underwriters have agreed to underwrite 183 million euros of TFP guarantees, enabling “the EBRD to double its exposure for selected issuing banks in Azerbaijan, Georgia, Moldova, Russia, Tajikistan and Ukraine.”

161. In addition, despite Brazil’s characterizations to the contrary, the IFC is also a highly profitable, private sector actor, whose guarantee pricing reflects market conditions.

162. “IFC has been consistently profitable since its inception in 1956, and recorded operating income for FY06 of \$1,409 million, as compared with \$1,953 million for the year ended June 30, 2005 (FY05), and \$982 million for the year ended June 30, 2004 (FY04). The \$1,953 million of operating income in FY05 was a record high for the [IFC].”²²⁶ In FY06, its interest income and financial fees from loans, which include guarantees under its Global Trade Finance Program²²⁷, totaled \$807 million.²²⁸ Its return on average net worth in FY 2006 was 13.7%, its median return for the last five years.²²⁹

163. IFC loan pricing “reflects such factors as market conditions and country and project risks; variable rate loans are generally tied to the 6-month LIBOR index in the relevant currency.”²³⁰ IFC mobilizes private sector finance “through the sale of participations in its loans, known as the B-loan program.[]. Over 150 commercial banks and nonbank financial institutions currently

²²³ See “About the [EBRD] trade facilitation programme” <http://www.ebrd.com/apply/trade/about/index.htm> (Exhibit US-18).

²²⁴ EBRD Trade Facilitation Programme brochure. Case Study 1: a guarantee of a Moldova bank on a wheat import transaction. <http://www.ebrd.com/pubs/finance/tfp.pdf> (Exhibit US-19).

²²⁵ EBRD Press Release: “Leading insurance underwriters back EBRD trade programme.” (Exhibit US-78). <http://www.ebrd.com/new/pressrel/2006/170Dec04.htm>

²²⁶ IFC 2006 Annual Report, Management’s Discussion and Analysis (Exhibit US-79, p. 3. http://www.ifc.org/ifcext/annualreport.nsf/Content/AR2006_English

²²⁷ IFC 2006 Annual Report, Management’s Discussion and Analysis (Exhibit US-79), p. 24.

²²⁸ IFC 2006 Annual Report, Management’s Discussion and Analysis (Exhibit US-79), p. 4. “IFC does not recognize income on loans where collectability is in doubt or payments of interest or principal are past due more than 60 days unless management anticipates that collection of interest is expected in the near future.” p. 17.

²²⁹ IFC 2006 Annual Report, Management’s Discussion and Analysis (Exhibit US-79), p. 4.

²³⁰ IFC 2006 Annual Report, Management’s Discussion and Analysis (Exhibit US-79), p. 9.

participate in IFC's B-loan program.[]. *IFC charges fees to the borrower at prevailing market rates to cover the cost of the syndication of the B-loan.* Since it began its loan syndication program, IFC has placed participations totaling \$26 billion."²³¹

164. The syndication of loans is a further indication of the market nature of IFC's lending practices. "Whenever it participates a loan, IFC will always make a loan for its own account (an A-loan), thereby sharing risk alongside its loan participants.." "IFC finances only a portion, usually not more than 25% of the cost of any project."²³² Indeed, IFC "mobiliz[es] funds from other lenders and investors through cofinancings, syndications, underwritings, and guarantees."²³³

165. "Guarantees and client risk management facilities committed but not utilized at June 30, 2006, were \$0.8 billion (\$0.8 billion at June 30, 2005)."²³⁴ IFC "offers partial credit guarantees to clients covering, on a risk-sharing basis, client obligations on bonds and/or loans. [IFC's] guarantee is available for debt instruments and trade obligations of clients and covers commercial as well as noncommercial risks. IFC will provide local currency guarantees, but when a guarantee is called, the client will generally be obligated to reimburse [IFC] in US dollar terms. *Guarantee fees are consistent with IFC's loan pricing policies.* During FY06, [IFC] signed \$0.6 billion of guarantees and \$0.2 billion in FY05."²³⁵ IFC "operates under the assumption that the guarantee portfolio is exposed to the same idiosyncratic and systematic risks as IFC's loan portfolio and the inherent, probable losses in the guarantee portfolio need to be covered by an allowance for loss."²³⁶ "IFC recorded a small provision for losses on loans and guarantees of \$15 million in FY06, including \$5 million in respect of guarantees."²³⁷

166. It is also important to note that the IFC, "unlike other multilateral development banks (MDBs) [], lends to private sector companies in high-risk economies *without* the benefit of a

²³¹ IFC 2006 Annual Report, Management's Discussion and Analysis (Exhibit US-79), p. 10 (emphasis added). Similarly, the Inter-American Development Bank indicates that its "loans and guarantees may be made directly to private businesses without government guarantees on the basis of *market-based pricing*, typically for infrastructure - energy, transportation, sanitation or communications - and capital market development projects *and for export financing*." Inter-American Development Bank: "About the IDB - Eligibility for Lending: Private Sector Lending." (Exhibit US-80) http://www.iadb.org/aboutus/II/op_eligibility.cfm?language=English

²³² IFC 2006 Annual Report, Management's Discussion and Analysis (Exhibit US-79), p. 10

²³³ Standard & Poor's Report on the International Finance Corporation (17 November 2005) (Exhibit US-81), p. 1

²³⁴ IFC 2006 Annual Report, Management's Discussion and Analysis (Exhibit US-79), p. 6.

²³⁵ IFC 2006 Annual Report, Management's Discussion and Analysis (Exhibit US-79), p. 10 (emphasis added)

²³⁶ IFC 2006 Annual Report, Management's Discussion and Analysis (Exhibit US-79), p. 17

²³⁷ IFC 2006 Annual Report, Management's Discussion and Analysis (Exhibit US-79), p. 26.

sovereign guarantee.” It also lacks callable capital, unlike many other MDBs.²³⁸

167. As the independent financial analyst Moody’s has indicated: “Instead of borrowing from the [International Bank for Reconstruction and Development], which it could do as a member of the World Bank Group and did in the past, the IFC raises funds in the international debt markets. *This has the benefit of reinforcing the private sector character of the IFC by exposing the [IFC] to the financial discipline needed to raise money in the international market at the lowest possible cost.*”²³⁹

168. Although it is a highly profitable private sector actor charging market rates for its loans and guarantees, the IFC also manages its liquidity in a fiscally conservative manner: “[IFC] manages its liquidity with profitability as a secondary consideration to the preservation of its capital earnings.”²⁴⁰ “Nonetheless, IFC’s income is important because in the absence of capital increase (which is not anticipated), its income will be the source of any significant increases in its risk-bearing capacity.”²⁴¹

169. Despite the highly commercial and profitable nature of IFC’s loan and guarantee products, the United States notes again that the IFC Global Trade Finance Program, quite analogous to the CCC GSM-102 export credit guarantee program,²⁴² is available in at least 14 markets in which the CCC does not accept foreign-bank risk.²⁴³ The IFC program “offers confirming banks partial or full guarantees to cover *payment risk on banks* in the emerging markets. *These guarantees are transaction-specific* and apply to: letters of credit; trade-related promissory notes and bills of exchange; bid and performance bonds; advance payment guarantees.”²⁴⁴ This facility also provides tenors of up to three years.²⁴⁵

²³⁸ Moody’s Analysis of the International Finance Corporation (October 2005) (Exhibit US-82), p. 1. (emphasis in original). *See also*, Standard & Poor’s report on the International Finance Corporation (17 November 2005) (Exhibit US-81), pp. 2, 10, 12.

²³⁹ Moody’s Analysis of the International Finance Corporation (October 2005) (Exhibit US-82), p. 4. (emphasis added). Brazil’s criticism of the use by the United States of IFC’s own phrase “private sector arm” is therefore misplaced. *See* Rebuttal Submission of Brazil, para. 440 and U.S. First Written Submission, para. 115.

²⁴⁰ Moody’s Analysis of the International Finance Corporation (October 2005) (Exhibit US-82), p. 4.

²⁴¹ Standard & Poor’s report on the International Finance Corporation (17 November 2005) (Exhibit US-81), p. 13. It is also noteworthy that IFC maintains a capital adequacy ration “more than 3x the equivalent ratio of highly rated commercial banks.” *Id.*, p. 13.

²⁴² U.S. First Written Submission, para. 114.

²⁴³ U.S. First Written Submission, para. 116, fn. 189. Exhibit US-16.

²⁴⁴ Exhibit US-13. In the U.S. First Written Submission (para. 114, fn. 185), this language was inadvertently attributed to Exhibit US-11.

²⁴⁵ *See* International Finance Corporation description of Global Trade Finance Program <http://www.ifc.org/ifcext/gfm.nsf/Content/TradeFinance> (Exhibit US-12) and Global Trade Finance Program “What We Offer” <http://www.ifc.org/ifcext/gfm.nsf/Content/TF-WhatWeOffer>. (Exhibit US-13).

170. Brazil has not only failed to establish that GSM-102 guarantees confer a benefit as set out in Article 14(c) of the *SCM Agreement*, but it has also failed to rebut the evidence the United States has put forward demonstrating affirmatively that comparable commercial loans (absent a U.S. guarantee) are available in the marketplace at a cost lower than that of a loan guaranteed by CCC. Brazil has therefore failed to demonstrate that the GSM-102 program confers a benefit.

IV. BRAZIL'S ACTIONABLE SUBSIDY-RELATED CLAIMS

A. INTRODUCTION

171. Brazil has claimed that “the U.S. measure taken to comply (i.e., the repeal of the Step 2 program) leaves a new ‘basket of measures’ [i.e., the marketing loan and counter-cyclical payment programs and payments thereunder] that still causes serious prejudice to the interests of Brazil, within the meaning of Articles 5(c) and Article 6.3 of the *SCM Agreement*.”²⁴⁶ Brazil makes two main claims in this regarding. First, Brazil claims a breach of Articles 5(c) and 6.3(c) of the *SCM Agreement*, arguing that “the effect” of the marketing loan payments and counter-cyclical payments is present “significant price suppression.” Second, Brazil claims a breach of Articles 5(c) and 6.3(d) of the *SCM Agreement*, alleging that “the effect” of payments under the same two programs is “an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted.”²⁴⁷ In both cases, one important premise of Brazil’s argument is that the termination of the Step 2 program has had little or no effect on U.S. planting, production, exports, or world market prices. It is on this basis that Brazil argues that termination of the Step 2 program by the United States is insufficient to “remove the adverse effects [of] . . . or withdraw” the subsidy found to be causing serious prejudice.²⁴⁸

172. For the reasons discussed above, these claims are clearly not within the scope of this proceeding. But wholly apart from that, Brazil could not prevail on these claims because it has not yet made a *prima facie* case of breach. Brazil has provided virtually no valid empirical evidence to prove the effects that it alleges. Rather, as discussed below, Brazil’s claims appear to depend critically on the flawed results of an econometric modeling exercise it has performed for purposes of this proceeding. As the United States shows, neither this modeling exercise, nor any of the scant evidence Brazil cites, satisfies the burden that Brazil bears in this dispute.

173. This is true also of a third, “contingent” claim of threat of serious prejudice that Brazil makes under Articles 5(c) and 6.3(c) of the *SCM Agreement*. One important factor to consider in assessing Brazil’s claims of “threat” of serious prejudice is the fact that both the marketing loan

²⁴⁶ Brazil First Written Submission, para. 54.

²⁴⁷ See Brazil Rebuttal Submission, paras. 346-358.

²⁴⁸ See e.g., Brazil First Written Submission, para. 47.

and counter-cyclical payment programs are scheduled to expire in October of this year (2007). That fact alone, significantly undermines the arguments that Brazil makes here regarding any “threat” that future payments under the program will cause serious prejudice within the meaning of Articles 5(c) and 6 of the *SCM Agreement*.

174. The United States addresses each of these claims in turn below.

B. BRAZIL’S ARGUMENTS ABOUT THE “RELATIVELY MODEST” EFFECTS OF THE ELIMINATION OF THE STEP 2 PROGRAM CONTINUE TO BE UNSUBSTANTIATED AND INCONSISTENT WITH ITS EARLIER POSITIONS

175. Brazil argues in this proceeding that termination of the Step 2 program by the United States is insufficient to “remove the adverse effects [of] . . . or withdraw” the subsidy found to be causing serious prejudice.²⁴⁹ Towards this end, Brazil makes a series of arguments designed to minimize any effects of terminating the Step 2 program; specifically, that: (a) the effects of terminating the Step 2 program would be offset by a resulting *increase* in counter-cyclical payments,²⁵⁰ (b) due to the fact that outlays under the Step 2 program have been smaller than those under the marketing loan and counter-cyclical payment programs, the effects of its termination are “relatively modest;” (c) “the elimination of the Step 2 program will likely have *no impact* on the level of U.S. production or exports” and “*little positive impact* on the world price for cotton in the long term;”²⁵¹ and (d) the empirical evidence of historically low U.S. exports following termination of the Step 2 program is not evidence of any effect of termination on U.S. exports.

176. As the United States explained in its first written submission, however, these arguments are both unsubstantiated and undermined by Brazil’s own arguments before the original panel on which the original panel relied in making prohibited and actionable subsidy findings against the Step 2 program and payments, respectively.²⁵² As discussed below, Brazil fails even to address – let alone rebut – many of the U.S. arguments. And where Brazil does attempt to address the U.S. arguments, it continues to rely on internally-inconsistent arguments and evidence that do not square with the positions taken by Brazil and the evidence submitted by Brazil in the original proceeding.

1. Brazil Misrepresents the U.S. Arguments Regarding the “Cause” of the Serious Prejudice Found to Exist By the Original Panel

²⁴⁹ See e.g., Brazil First Written Submission, para. 47.

²⁵⁰ Brazil First Written Submission, paras. 1997-208.

²⁵¹ Brazil First Written Submission, para. 206 (quoting Brazil First Written Submission, Annex II, paras. 41-43).

²⁵² U.S. First Written Submission, paras. 157-195.

177. Brazil attempts, first, to attribute to the United States – and then attack – arguments that the United States has not made. Specifically, Brazil asserts that the United States “appears to argue” that:

the Step 2 program and the mandatory payments made thereunder – but not the marketing loan or counter-cyclical program and the mandatory payments thereunder – was the sole cause of the serious prejudice found by the original panel and Appellate Body to exist during the period MY 1999-2002, as well as the sole cause of any serious prejudice that resulted from these three subsidies under the FSRI Act of 2002 during the period MY 2003-2005.²⁵³

178. Brazil’s assertion is devoid of any citation, support, or explanation,²⁵⁴ which is not surprising, given that the United States has not made any such argument. To the contrary, even in the *very first sentence* in Section VI of the U.S. first written submission discussing Brazil’s actionable subsidy-related claims, the United States explains that “the panel’s finding of ‘present’ serious prejudice in the original proceeding applied to *a package of payments* made under the Step 2, marketing loan, and counter-cyclical payment programs in [MY] 1999-2002.”²⁵⁵ And U.S. arguments throughout this proceeding have been premised on precisely this understanding of the original panel’s findings.

179. Brazil’s assertions not only mischaracterize the U.S. arguments but their apparent premise is deeply flawed. Specifically, Brazil seems to assume that elimination of any of the measures subject to the original panel’s finding of serious prejudice could only remove the adverse effects found to exist if that measure *alone* were the cause of the serious prejudice. This is simply incorrect. It is worth recalling, in this regard, that Brazil resisted any assessment regarding whether payments made under the Step 2, marketing loan, and counter-cyclical payment programs in MY 1999-2002, individually, caused serious prejudice in that period. Instead, Brazil insisted that the original panel assess only the “collective effects” of the payments made in MY 1999-2002 under all three programs.²⁵⁶ As a result, there is no finding that any payments under any *one* or *two* of the programs could have caused serious prejudice; all that is known is that payments made in MY 1999-2002 under all *three* programs *together* were the cause of serious prejudice in those years.

²⁵³ Brazil Rebuttal Submission, para.50. *See also* Brazil Rebuttal Submission, para. 67 (“In asserting that only Step 2 subsidies caused any adverse effects in MY 2005, the United States. . . .”)

²⁵⁴ Save a generic reference to Section VI.A of the U.S. submission, responding to Brazil’s arguments about the effects of terminating the Step 2 program.

²⁵⁵ U.S. First Written Submission, para. 146 (emphasis added). Further, there has never been a finding of present serious prejudice with respect to *any* U.S. domestic support program or payment made in the period MY 2003-2005 and, contrary to Brazil’s assertions, the United States has *never* suggested otherwise.

²⁵⁶ *See e.g.*, Brazil Further Submission, para. 147 (“it is the collective effects of the subsidies that are relevant for assessing the significance of the price suppression and the serious prejudice to the interests of Brazil.”)

180. In light of this, there is no basis for Brazil to argue that the United States has suggested – or that Panel should consider – that a salient question in this proceeding is whether Step 2 *alone* causes any significant price suppression. Instead, the United States has argued that Brazil bears the burden of proving its claims. In the present proceeding, Brazil has argued that the effects of the termination of the Step 2 program are “relatively modest” and “will likely have *no impact* on the level of U.S. production or exports” and “*little positive impact* on the world price for cotton in the long term;”²⁵⁷ But Brazil has provided virtually no empirical evidence to prove this. The United States turns to that issue next.

2. Brazil Appears to Acknowledge That Termination of the Step 2 Program Is Unlikely to Result In A Present Or Substantial Increase In Counter-cyclical Payments But Does Result In *Reduced* Marketing Loan Payments

181. In its first written submission, Brazil had argued that terminating the Step 2 program “*lower[s]* U.S. domestic price levels” and thereby “trigger[s] *larger* price-contingent counter-cyclical payments. In other words, repealing the Step 2 program may *enhance* the adverse effects caused by counter-cyclical payments.”²⁵⁸ Brazil fails to rebut the arguments, however, showing that there is no “present” *increase* in counter-cyclical payments as a result of elimination of the Step 2 program but that there is, in fact, a resulting *decline* in marketing loan payments. Moreover, even in future years (*i.e.*, before expiration of the provisions authorizing counter-cyclical payments at the end of MY 2007), any possible increase in counter-cyclical payments is likely to be small and offset by declines in marketing loan payments.

a. “Present” Serious Prejudice

182. The United States has explained that there is unlikely to be any increase in counter-cyclical payments as a result of elimination of the Step 2 program in the period that is relevant for Brazil’s claims of “present” serious prejudice (*i.e.*, MY 2006).²⁵⁹ Brazil does not – and, indeed, cannot – contest this fact in its rebuttal submission.²⁶⁰ Further, Brazil now concedes that termination of the Step 2 program is likely to *reduce* marketing loan payments.²⁶¹ It is, therefore, undisputed that, for purposes of assessing Brazil’s claims of “present” serious prejudice, the effects of eliminating the Step 2 program are *not* likely to be offset by any increase in counter-cyclical payments, as Brazil had originally suggested, and, in fact, any positive *are* likely to be

²⁵⁷ Brazil First Written Submission, para. 206 (quoting Brazil First Written Submission, Annex II, paras. 41-43).

²⁵⁸ Brazil First Written Submission, para. 197.

²⁵⁹ U.S. First Written Submission, para. 160-170.

²⁶⁰ Brazil Rebuttal Submission, paras. 57-65.

²⁶¹ Brazil Rebuttal Submission, para. 58 (“Brazil and the United States agree that the repeal of the Step 2 subsidy will have *some* impact on the amount of marketing loan payments, and they agree on the direction of the impact.”) However, surprisingly, Brazil neglected to make any mention of this in its first written submission.

amplified because of the resulting reduction in payments under the marketing loan program.

183. While Brazil concedes that marketing loan payments are likely to decline as a result of terminating the Step 2 program, however, it attempts to argue that the amount of the decline is “relatively insignificant.”²⁶² Brazil’s assertion is based on a series of flawed comparisons. According to a study by the Food and Agricultural Policy Research Institute (“FAPRI”), elimination of the Step 2 program results in an average increase of 0.4 cent/lb in the “adjusted world price” (“AWP) in MY 2006-2010 and a *decline* of the same amount in the marketing loan payment.²⁶³ Brazil attempts to minimize this decline – which is a projection regarding future years based on the market conditions projected to exist in those years – by comparing it to payments that were made in *past* years (MY 2004 and 2005) under entirely different market conditions (not accounting, for present purposes, for the fact that the marketing loan and counter-cyclical payment programs are currently scheduled to expire in MY 2007).²⁶⁴ This is not a meaningful comparison. Rather, to put the projected decline in marketing loans in perspective, the more appropriate comparison is to projected marketing loan payments in MY 2006-2010.

| | MY2006 (cents/lb) | MY2007 (cents/lb) | MY2008 (cents/lb) | MY2009 (cents/lb) | MY2010 (cents/lb) | Average MY2006-10 |
|---------------------------------------------------------------------------------------------------------------|----------------------|----------------------|----------------------|----------------------|----------------------|----------------------|
| Projected adjusted world price ²⁶⁵ (A) | 48.30 | 51.40 | 52.80 | 53.70 | 53.40 | 51.90 |
| Projected marketing loan payment (52 cents - (A)) | 3.70 | 0.60 | 0.00 | 0.00 | 0.00 | 0.86 |
| Projected AWP increase and decline in marketing loan payment resulting from Step 2 elimination ²⁶⁶ | 0.41 | 0.50 | 0.38 | 0.31 | 0.34 | 0.39 |
| Percentage decline in marketing loan payment due to Step 2 elimination | 10% | 45% | – | – | – | 33% |

184. As shown above, Brazil has no basis to assert that “the repeal of the Step 2 subsidy will not cause any meaningful reduction in marketing loan payments” and that the “effects from this second subsidy will . . . remain strong in the absence of the Step 2 subsidy.”²⁶⁷ Clearly, elimination of the Step 2 program does result in substantial declines in marketing loan payments, including in the present marketing year and even more so (almost by half) in MY 2007. Moreover, *marketing loan payments* are not even projected to be made past MY 2007; any effects they may have can, therefore, hardly be expected to “remain strong in the absence of the Step 2

²⁶² Brazil Rebuttal Submission, para. 59.

²⁶³ As marketing loan payments are equal to the difference between the marketing loan rate (US\$0.52) and the AWP, the effect of a *rise* in world market prices that raises the A-Index price – and thus raises the AWP – will be a corresponding *decline* in the amount of marketing loan payments.

²⁶⁴ Brazil Rebuttal Submission, para. 59.

²⁶⁵ FAPRI July 2006 Baseline Update for U.S. Agricultural Markets, at 6 (Exhibit BRA-479)

²⁶⁶ FAPRI, “Impacts of Commodity and Conservation Reserve Program Provisions in House and Senate Reconciliation Bills,” FAPRI-UMC Report #15-05, December 2005 (Exhibit BRA-484).

²⁶⁷ Brazil Rebuttal Submission, para. 65 (emphasis removed).

subsidy.”²⁶⁸

185. Brazil attempts to make a similarly flawed comparison with the Congressional Budget Office’s (“CBO’s”) projection that elimination of the Step 2 program will result in a reduction in government outlays of US\$17 million over the 2006-2015 (fiscal year) period.²⁶⁹ Purporting to “put this figure in perspective” Brazil asserts that the outlays under the marketing loan program in the period MY 1996-2005 were US\$10.2 billion. However, again, this is a misleading comparison. As is evident from the price and payment projections shown above, marketing loan payments *themselves* are projected to be small and then eliminated altogether as of MY 2008. Accordingly, it is hardly surprising that the projected *reduction* in marketing loan payments as a result of the elimination of the Step 2 program is also projected to be small.

186. Finally, Brazil purports to compare the likely *increase* in counter-cyclical payments resulting from eliminating of the Step 2 program (\$484 million over the 10-year period from MY 2006-2015) to the likely *decline* in payments under the marketing loan program, asserting that the former is “28 times greater than CBO’s estimated reduction in marketing loan payments over the same period (\$17 million).”²⁷⁰ Once again, this comparison says little given that the reason for the comparatively small reduction in marketing loan payments is the fact that the latter are projected to cease altogether as of MY 2008. In other words, there *can* be no reduction to marketing loan payments during most of the 10-year period; they will already be zero.

b. “Threat” of Serious Prejudice

187. Turning to that question of future effects, and Brazil’s “threat” claims, the United States recalls, again, that elimination of the Step 2 program results in substantial declines in marketing loan payments in the current marketing year (10 percent) and MY 2007 (almost 45 percent). Further, marketing loan payments are not even projected to be made in years past MY 2007. This is so not only because of market conditions (i.e., a projected increase in the AWP over the US\$0.52 marketing loan payment threshold) but because the provisions authorizing marketing loan payments only do so through that year.²⁷¹

188. In the case of counter-cyclical payments, the United States explained in its first written submission that any possible future increase resulting from the elimination of the Step 2 program

²⁶⁸ Brazil Rebuttal Submission, para. 65.

²⁶⁹ Congressional Budget Office Cost Estimate: Agricultural Reconciliation Act of 2005, CBO, 20 October 2005, accessed October 2006 at <http://www.cbo.gov/ftpdocs/68xx/doc6830/HseAgRecon.pdf>. (Exhibit BRA-482).

²⁷⁰ Brazil Rebuttal Submission, para. 61.

²⁷¹ See Section 1201(a) of the FSRI Act of 2002 (“For each of the 2002 through 2007 crops of each loan commodity, the Secretary shall make available to producers on a farm nonrecourse marketing assistance loans for loan commodities produced on the farm.”) (Exhibit BRA-29).

would likely be small and far less than the price effect of the elimination of the Step 2 program.²⁷² Indeed, in the next few marketing years, any such increase is likely to be offset entirely by a concurrent decline in marketing loan payments.²⁷³ Brazil does not contest these points. Nor can Brazil contest that the fact that the provisions of the FSRI Act authorizing counter-cyclical payments will expire after MY 2007 (*i.e.*, under the terms of the legislation, there will in fact be *no* further counter-cyclical payments as of MY 2008).²⁷⁴

c. Conclusion

189. Regardless of whether one considers Brazil’s “present” or “threat” of serious prejudice claims, there is no merit to Brazil’s suggestion that an increase in counter-cyclical payments will offset any positive impacts of terminating the Step 2 program. To the contrary, terminating the Step 2 program *does* result in a decline in marketing loan payments. This decline is not insubstantial in those few future marketing years in which marketing loan payments are even expected to be made.

3. Brazil’s Fails To Show That The Relative Size of Outlays Under the Step 2 Program Dictates a “Relatively Modest” Effect of Terminating the Program

190. Third, Brazil continues to argue that the termination of the Step 2 program has allegedly “relatively modest” *effects* because of the relatively smaller *size* of outlays under the Step 2, marketing loan, and counter-cyclical payment programs.²⁷⁵ Brazil has yet to explain, however, why the relative *size* of outlays under the Step 2, marketing loan, and counter-cyclical payment programs is the determinative consideration in assessing their *effects*. Indeed, as the United States noted in its first written submission, Brazil’s new insistence on the “significance”²⁷⁶ of the relative size of the outlays under the Step 2 program contrasts with its repeated arguments, before the Appellate Body, that the size of payments does *not* dictate their effects²⁷⁷ and that it is the latter, not the former, with which Articles 5 and 6 of the *SCM Agreement* are concerned.²⁷⁸

²⁷² U.S. First Written Submission, para. 168.

²⁷³ U.S. First Written Submission, para. 169.

²⁷⁴ See Section 1201(a) of the FSRI Act of 2002 (Exhibit BRA-29).

²⁷⁵ Brazil Rebuttal Submission, para. 54. See also Brazil Rebuttal Submission, para. 67 (“it is significant that payments under the Step 2 program represent the smallest of the three mandatory price-contingent subsidies that the original panel found to cause adverse effects”).

²⁷⁶ See Brazil Rebuttal Submission, para. 67.

²⁷⁷ Brazil Appellee Submission, para. 493 (“[E]ven billions of dollars in particular types of subsidies provided to upland cotton producers (such as PFC, DP and crop insurance subsidies) may not be sufficient to cause a particular type of serious prejudice.”)

²⁷⁸ Brazil Appellee Submission, para. 458 (“[a] serious prejudice analysis by a WTO panel calls ‘for a qualitative and, to some extent, quantitative analysis of the existence and nature of the subsidy and the serious prejudice caused.’ Its focus is on the ‘effects’ of the subsidies, not their magnitude, amount or value.”) As the United States noted before, Brazil had argued against even *quantifying* the challenged payments in the original

191. Brazil's new focus on the relative size of outlays under the Step 2 program is especially curious given the *disproportionate* effects that Brazil attempted to attribute to the Step 2 program in the original proceeding. While Step 2 payments were smaller than counter-cyclical payment (or market loss assistance payments) and marketing loan payments even in the period examined in the original proceeding (MY 1999-2002) – on average “only 13.7 percent of the magnitude of the three price-contingent subsidies,” according to Brazil²⁷⁹ – Brazil did *not* argue to the original panel the payments had only “relatively modest” effects. To the contrary, of the five subsidies against which Brazil made claims of significant price suppression, next to marketing loan payments, Step 2 payments were claimed to have had the greatest effect on prices.²⁸⁰ This was consistent, in fact, with the fact that Brazil challenged the Step 2 program, *per se*, as a *prohibited* export subsidy as well (i.e., a subsidy considered so distortive that there is no requirement to show trade effects in order for a finding of WTO-inconsistency).²⁸¹

192. Moreover, Brazil predicted that Step 2 payments would have even larger relative impacts in MY 2003-2007.²⁸² For MY 2006, for example, Brazil predicted that Step 2 payments would have a larger impact on world prices than *either* counter-cyclical payment or marketing loan payments. And Brazil argued that, in MY 2007, Step 2 payments would account for almost *half* of the alleged price impact.²⁸³

193. Brazil argues now, however, that “in view of the fact that the trade- and production-distorting marketing loan and counter-cyclical subsidies represented more than *80 percent of the value of price-contingent payments* during MY 2002-2005, it is also appropriate to describe the *relative* effects of the Step 2 subsidy as ‘modest’ by comparison.”²⁸⁴ In fact, Brazil's own arguments to the Appellate Body and the original panel demonstrate, however, precisely why it is *not* “appropriate” to do so.

4. Brazil's Arguments About the Effect of Terminating the Step 2 Program on Production and Exports Are Misleading and Inconsistent with the Evidence and Arguments Submitted By Brazil in the Original Proceeding

194. Perhaps one of the most remarkable aspects of Brazil's arguments in this proceeding has been its effort to undermine the evidence and arguments that it submitted – and on which the original panel and Appellate Body relied – in making prohibited and actionable subsidy finding

proceeding. *Upland Cotton (AB)*, para. 98. Rather, notwithstanding the different sizes of the payments, Brazil argued that it was appropriate to characterize each of them generically as “very large.”

²⁷⁹ Brazil First Written Submission, para. 112.

²⁸⁰ See e.g., *Upland Cotton (Panel)*, para. 7.1205, n. 1327.

²⁸¹ *Upland Cotton (Panel)*, para. 3.1(ii).

²⁸² Brazil First Written Submission, Annex I, p. 36.

²⁸³ Brazil First Written Submission, Annex I, p. 36.

²⁸⁴ Brazil Rebuttal Submission, para. 54.

against the Step 2 program and payments, respectively, in the original proceeding. As the United States noted in its first written submission, Brazil had argued in the original proceeding, *inter alia*, that:

- “Step 2 export payments directly stimulate U.S. exports and permit U.S. exporters to export high-cost U.S. upland cotton with the effect of suppressing A-Index prices.”²⁸⁵
- “[T]he express aim of the U.S. Step 2 program is to enhance the competitiveness of U.S. upland cotton. Numerous market reports confirm the actual effects of the program in enhancing U.S. upland cotton exports and discouraging imports of upland cotton into the United States. . . .”²⁸⁶
- “Had significant volumes of U.S. upland cotton not received Step 2 export payments, U.S. exports and, thus, the amount of U.S. upland cotton competing with Brazilian cottons would have been lower.”²⁸⁷
- “Professor Sumner’s Step 2 analysis is . . . completely consistent with the overwhelming evidence that Step 2 export and domestic subsidies have significant production, export, and world price effects.”²⁸⁸
- “[I]t is difficult to imagine how a subsidy could be *more* of an export subsidy than the Step 2 export provisions. . . . [The program] plays an important role in stimulating and maintaining the present record high U.S. upland cotton world export market share. . . .”²⁸⁹
- “[As a result of the Step 2 program] U.S. cotton can always be offered at a price that is lower than the offers of most producers in the world.”
- That the Step 2 program was one of only three factors – the other two being the relative size of U.S. production and exports and the transparency of the U.S. market – that allegedly “enable[d] the United States to act as the ‘driver’ of world prices.”²⁹⁰

²⁸⁵ Brazil Further Submission, para. 17.

²⁸⁶ Brazil Appellee Submission, para. 771.

²⁸⁷ Answers of Brazil to Questions from the Panel After 2nd Meeting, para. 132 (22 December 2003).

²⁸⁸ Brazil’s Comments on U.S. Model Critique, para. 9 (20 January 2004).

²⁸⁹ Brazil’s Rebuttal Submission to the Panel Regarding the “Peace Clause” and Non-Peace Clause Related Claims,” para. 128 (22 August 2003) (emphasis in original).

²⁹⁰ Brazil First Written Submission, Annex II, para. 31. For purposes of comparison, the United States submitted Mr. MacDonald’s earlier statement together with his new statement in Exhibit US-29.

195. Now that the United States has terminated the Step 2 program to implement the DSB's recommendations and rulings on the basis of these arguments, however, Brazil asserts that the termination of the program has had "no impact on the level of U.S. production or exports" and "little positive impact on the world price for cotton in the long term."²⁹¹ How can this be? Brazil's attempts to answer this fundamental question fail both as a matter of logic and credibility.

a. *Brazil's Attempts to Emphasize Effects On Producers' Revenue Are Misleading And Contrary to Its Arguments Before the Original Panel*

196. First, Brazil attempts to emphasize the effects on *producers* of U.S. cotton. So, for example, Brazil repeatedly refers to the allegedly "modest revenue-enhancing effects" of the Step 2 program.²⁹² It asserts that because "Step 2 payments were not made to producers of U.S. upland cotton, but rather to U.S. domestic users and exporters of upland cotton" "any *production* effects from the Step 2 subsidy are, therefore, indirectly channeled through the effects of the Step 2 subsidy in increasing the domestic U.S. price for upland cotton."²⁹³ Similarly, Brazil argues that "analysts at the U.S. government, independent research institutions, and even in the U.S. cotton industry" allegedly conclude that "removal of the Step 2 subsidy has only a negligible impact on the *overall level of subsidy revenue received by U.S. upland cotton producers*."²⁹⁴

197. As the United States has explained,²⁹⁵ however, according to Brazil's earlier arguments, impacts on revenue, are only one way in which, in Brazil's view, Step 2 payments could have affected world market prices. Brazil previously argued:

The United States . . . asserts that "world prices are relatively unaffected" by the *production effects* of the Step 2 program. Again, the United States is wrong. The United States completely ignores the effects on world prices from the *export-enhancing nature* of the Step 2 program, which it does not dispute.²⁹⁶

198. Brazil fails to explain why, in light of its arguments before the original panel, the impact on producers' *revenue* is the determinative question now. Indeed, it is useful to recall that the ultimate question under Articles 5 and 6 of the *SCM Agreement* is not whether "the effect" of a

²⁹¹ Brazil First Written Submission, para. 206 (quoting Brazil First Written Submission, Annex II, paras. 41-43).

²⁹² Brazil Rebuttal Submission, para. 66-75.

²⁹³ Brazil Rebuttal Submission, para. 68 (emphasis added).

²⁹⁴ Brazil Rebuttal Submission, para. 52.

²⁹⁵ U.S. First Written Submission, para. 184.

²⁹⁶ Brazil Appellee Submission, paras. 743-44.

measure is an increase in *revenue*;²⁹⁷ it is whether “the effect” of the challenged measures is *significant price suppression* of the *world market price* for upland cotton.²⁹⁸ Any impact on producers’ revenue is only relevant inasmuch as Brazil has alleged that the payments to producers may result, ultimately, in impacts on world market prices (*i.e.*, by stimulating production, which in turn could lead to additional exports, leading to additional supply and, thus, some possible effect world market price).

199. Brazil has represented to the original panel that, unlike marketing loan and counter-cyclical payments, Step 2 payments affected world market prices for cotton by directly impacting export demand (and, thus, exports).²⁹⁹ Thus, it is unclear why Brazil now asserts that the relative impact of that program on producers’ revenue (*i.e.*, that “upland cotton producers’ revenue . . . is far more dependent on marketing loan and counter-cyclical payments than it is on Step 2 payments”) supports its arguments that the termination of the Step 2 program has “no impact on the level of U.S. . . . exports” and “little positive impact on the world price for cotton in the long term.”³⁰⁰ Indeed, the United States recalls in this regard, Brazil’s explanation to the Appellate Body that “Professor Sumner’s analysis concluded that removing solely the Step 2 program has relatively small effects on U.S. production . . . , but large effects on the world market price.”³⁰¹ Brazil has failed to explain why, for purposes of this proceeding, the Panel should now consider instead that “relatively small effects on U.S. production” result in “little positive impact on the world price for cotton.”³⁰²

b. Brazil’s Efforts To Show Minimal Impacts on Exports Are Contradicted By Its Arguments In the Original Panel Proceeding

200. Second, Brazil submits market reports and resubmits the testimony of its market expert

²⁹⁷ In fact, there is no WTO obligation not to provide income support to agricultural producers. To the contrary, the WTO Agreement on Agriculture expressly recognizes certain kinds of income support to agricultural producers as being fundamentally *minimally* trade distorting.

²⁹⁸ This is the question with respect to Brazil’s claim under Articles 5(c) and 6.3(c) of the *SCM Agreement*. Brazil also claims, separately, under Articles 5(c) and 6.3(d) of the *SCM Agreement* that “the effect” of certain U.S. measures is “an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted.”

²⁹⁹ Brazil First Written Submission, para. 206 (quoting Brazil First Written Submission, Annex II, paras. 41-43).

³⁰⁰ Brazil First Written Submission, para. 206 (quoting Brazil First Written Submission, Annex II, paras. 41-43).

³⁰¹ Brazil Appellee Submission, para. 742 (citing Brazil Further Submission, Annex I, paras. 57-58, 66-72 and Table I.5f).

³⁰² Brazil First Written Submission, para. 206 (quoting Brazil First Written Submission, Annex II, paras. 41-43).

purporting to show that “repeal of the Step 2 program has not affected U.S. exports.”³⁰³ For example, Brazil now argues on the basis of a November 17, 2006 market report, that increased exports *when the Step 2 program went into effect* was the result of “the world market supply demand picture and the specific needs of China” rather than the effects of the Step 2 program.³⁰⁴ Brazil attempts to show on the basis of the same report the *decline* in exports following the *termination* of the Step 2 program is also the cause of “the market demand situation” and not the termination of the program.³⁰⁵

201. While the United States appreciates Brazil’s confirmation, once again, about the determinative effect of “the specific needs of China” on U.S. exports – an issue to which the United States will return in Section IV.C.6 below – the United States observes that, once again, Brazil takes positions directly contradictory to those it took before the original panel. Specifically, the United States recalls that Brazil alleged in the original report that “[n]umerous market reports confirm the actual effects of the [Step 2] program in enhancing U.S. upland cotton exports.”³⁰⁶ Brazil cited, as evidence of these “actual” export-enhancing effects, the following “market reports”:

USDA reported sales of 2001-02 U.S. cotton reached an impressive 301,100 bales for the week ended August 16, more than double the previous week’s export sales figure....Traders said the week’s sizeable sales and shipment figures were due to the large Step 2 export subsidy payment which was 8.00 cents per pound.³⁰⁷

Meanwhile, export shipments rose to 173,900 bales during the week ended May 17 as merchants focused on shipping previously sold cotton in anticipation of a further decline in the Step 2 payment rate.³⁰⁸

In other news, export shipments of U.S. cotton for the week ended April 4 were the

³⁰³ U.S. First Written Submission, para. 77.

³⁰⁴ Brazil Rebuttal Submission, para. 77 (citing Cotton Market Weekly, O.A. Cleveland, 17 November 2006, p. 1 (Exhibit BRA-561)).

³⁰⁵ Brazil Rebuttal Submission, para. 77 (citing Cotton Market Weekly, O.A. Cleveland, 17 November 2006, p. 1 (Exhibit BRA-561)) (“[O]ne should also remember that exports ‘skyrocketed’ when Step 2 went into effect more than a decade ago. . . . Yet, the world supply demand picture, and the specific needs of China had more to do with the improvement in exports immediately after Step 2 went in effect. We again have the world supply demand situation that is dictating the low level of exports at present, not the loss of Step 2.”)

³⁰⁶ Brazil Appellee Submission, para. 738.

³⁰⁷ Brazil Further Submission, para. 287 (citing Cotton Market Weekly: Plains Cotton Cooperative Association, 23 August 2001, p. 1 (Exhibit BRA-251)).

³⁰⁸ Brazil Further Submission, para. 287 (citing Cotton Market Weekly: Plains Cotton Cooperative Association, 24 May 2001, p. 1 (Exhibit BRA-251)).

largest of the season facilitated by the return of the Step 2 certificate.³⁰⁹

The Step 2 Certificate has been in operation for 25 consecutive weeks, extending from April 4 through the current week... Thus, U.S. exports were aided for almost the entire 2001/02 season, except for that single 15-week period.³¹⁰

Further, with the Step 2 payment certificate increasing, shipments will continue to grow and the USDA export target of 10.8 million bales, or even greater, is well within reach. In fact, the Step 2 payment is now near seven cents, and likely to move above seven cents at some point. Thus, export shipments should continue very strong.³¹¹

Due to the expiration of Step 2 export subsidy funds, forward sales of U.S. cotton have been disappointingly slow. According to one observer, forward sales will continue to be lacking unless an export subsidy is reinstated or U.S. cotton prices fall to compete with world cotton.³¹²

USDA programs, especially Step 2 will continue to aid exports. Step 2 pays merchants and exporters for using higher priced U.S. cotton thus making it more attractive.³¹³

202. Brazil provides no credible basis to reconcile its “new” market reports with those that it submitted to the original panel upon which the original panel relied in making findings against the Step 2 program and payments. Instead, Brazil appears to attempt to downplay its attribution of an “export-enhancing” effect to the Step 2 program, Brazil argues now that it primarily attributed a “competitive” effect to the Step 2 program but that it attributed production and export effects primarily to payments under the marketing loan and counter-cyclical payment programs.³¹⁴ According to Brazil, termination of the Step 2 program served to eliminate this “competitive” effect but did not have any meaningful production or export effect.³¹⁵ Brazil attempts to justify, on this basis, its assertions in this proceeding that termination of the Step 2 program has “no impact on the level of U.S. production or exports” and “little positive impact on the world price

³⁰⁹ Brazil Further Submission, para. 287 (citing Cotton Market Weekly: Plains Cotton Cooperative Association, 11 April 2002, p. 1 (Exhibit BRA-251)).

³¹⁰ Brazil Further Submission, para. 287 (citing Cotton Trade Review: The Seam, Volume 1, Issue 35 dated 16 September 2002, p. 1 and 4 (Exhibit BRA-251)).

³¹¹ Brazil Further Submission, para. 287 (citing Cotton Experts, 25 April 2003 (Exhibit BRA-251)).

³¹² Brazil Further Submission, para. 287 (citing The Commentator, Spring 1999, p. 1-2 (Exhibit BRA-251)).

³¹³ Brazil Further Submission, para. 287 (citing The Commentator, Summer 2001, p. 1 (Exhibit BRA-251)).

³¹⁴ Brazil Rebuttal Submission, para. 84.

³¹⁵ Brazil Rebuttal Submission, para. 87.

for cotton in the long term.”³¹⁶

203. This attempted justification strains logic. Indeed, in the original proceeding, Brazil explained that the “competitive” effect itself served to increase demand for U.S. exports (and, hence, U.S. exports themselves). Moreover, Brazil’s explanation is contradicted by the fact that Brazil itself argued that elimination of the Step 2 program would have between an 8 to 15 percent impact on the level of U.S. exports in MY 1999-2007 and, as discussed above, a larger impact on world prices than *either* counter-cyclical payment or marketing loan payments in the current marketing year.³¹⁷

204. In short, Brazil fails to provide any credible evidence proving its assertions that termination of the Step 2 program has “no impact on the level of U.S. production or exports” and “little positive impact on the world price for cotton in the long term.”³¹⁸ Indeed, as the United States explained in its first written submission, data since the termination of the Step 2 program is *inconsistent* with these assertions. The United States turns to that data next and demonstrates that Brazil’s attempts to explain away this data fail.

5. The Data Available for MY 2006, Since Termination of the Step 2 Program, Continues To Show Substantial Declines In U.S. Exports

205. In its first written submission, the United States noted that data for U.S. exports in MY 2006 showed that, following termination of the Step 2 program, exports and export commitments were substantially below historical levels (including in comparison to year-before levels, and the previous five-year average)³¹⁹ and that U.S. share of world exports was projected to fall.³²⁰ The United States explained that, to the extent that it is possible to draw conclusions from this partial-year data, the data do not appear to support Brazil’s conclusion that elimination of the Step 2 program has “no impact on the level of U.S. production or exports.”³²¹

206. Brazil attempts to dismiss this data, arguing that “[m]arket reports indicate that the world demand and supply situation” – in particular, “the specific needs of China”³²² – “is the primary reason for the decline in U.S. exports.”³²³ Brazil argues that the “temporal coincidence” between

³¹⁶ Brazil Rebuttal Submission, para. 88.

³¹⁷ Brazil First Written Submission, Annex I, p. 36.

³¹⁸ Brazil Rebuttal Submission, para. 88.

³¹⁹ Weekly Export Performance Report (Exhibit US-30).

³²⁰ December WASDE Estimates (Exhibit US-31).

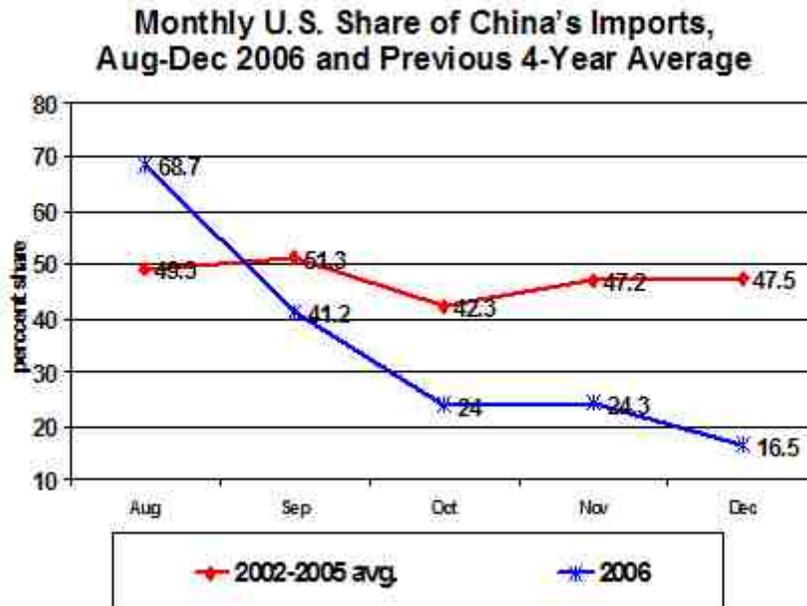
³²¹ Brazil Rebuttal Submission, para. 88.

³²² Brazil Rebuttal Submission, para. 77 (citing Cotton Market Weekly, O.A. Cleveland, 17 November 2006, p. 1 (Exhibit BRA-561)).

³²³ Brazil Rebuttal Submission, para. 82.

the termination of the Step 2 program and the decline in exports does not, in this context, signify any causal link. The United States also appreciates Brazil’s admission that a “temporal link” is not, alone, sufficient evidence of causation and that other “world demand and supply situations” must be taken into consideration. The United States expects that Brazil will agree that the same principle applies in the assessment of “temporal coincidence” in the case of payments under the marketing loan and counter-cyclical payment programs and requests that the Panel bear this point in mind as the United States addresses Brazil’s arguments in respect of those payments in Section IV.C.3 below.

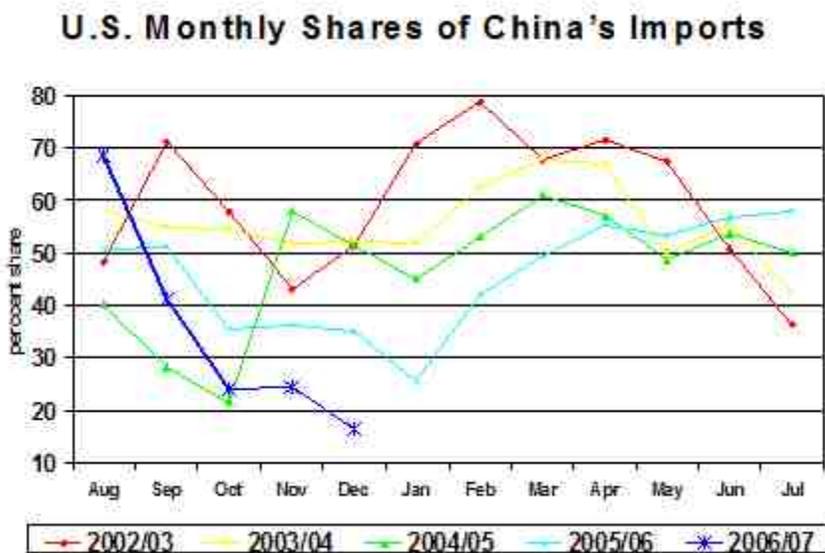
207. The United States also appreciates Brazil’s acknowledgment of the important of assessing the effects of “the specific needs of China”³²⁴ in assessing changes in the world cotton market. Brazil’s acknowledgment highlight the importance of conducting a meaningful assessment of the factors actually affecting the world cotton market, and world market prices; an exercise that Brazil unfortunately has not conducted in support of its claims against marketing loan and counter-cyclical payments. *See* Section IV.C.6 below. However, even taking into consideration the impact of China’s demand, U.S. exports appear to be at unusually low levels. Indeed, U.S. share of China’s December imports was only 16.5 percent. This is less than *half* the average share held by the United States in the previous four years.



³²⁴ Brazil Rebuttal Submission, para. 77 (citing Cotton Market Weekly, O.A. Cleveland, 17 November 2006, p. 1 (Exhibit BRA-561)).

Source: Global Trade Atlas³²⁵

208. Indeed, as shown below, U.S. share of China's imports in December were lower than at any time in *any* of the previous four years.



Source: Global Trade Atlas³²⁶

209. While changes in China's import needs may well explain – in some part – the absolute levels of U.S. exports, Brazil fails to explain why there is such a substantial shift in U.S. *share* of China's imports following termination of the Step 2 program.

210. Brazil also argues that:

the imminent elimination of the Step 2 subsidy – a lucrative export subsidy – naturally caused a temporary surge of U.S. exports in the months just prior to the elimination of the Step 2 subsidy with exporters cleaning out the stocks in their warehouses to take advantage of the Step 2 subsidy. This is consistent with USDA projections regarding MY 2006 exports, which indicate that the current decline in exports is going to be temporary.³²⁷

³²⁵ U.S. Rebuttal Submission Data Tables; Global Trade Atlas (Exhibit US-83) (accessed January 30, 2007)

³²⁶ U.S. Rebuttal Submission Data Tables; Global Trade Atlas (Exhibit US-83) (accessed January 30, 2007).

³²⁷ Brazil Rebuttal Submission, para. 82.

211. However, while Brazil correctly notes that there was an increase in exports just prior to the termination of the Step 2 program in August 2006, this does not explain why exports have been low compared to earlier years in the period after termination of the program. Brazil's theory that U.S. exporters "clean[ed] out the stocks in their warehouses" is not consistent with the data, which show that U.S. warehouses had a 6 million bale carry-over, one of the largest in recent years, entering into MY 2006.³²⁸ At the same time, world consumption levels in MY 2006 are projected to increase relative to those in MY 2005 (121 million bales in 2006 compared to 116 million bales in 2005), showing that there has been no general decline in consumption that can explain the decline in U.S. exports.³²⁹ In short, since termination of the Step 2 program, there continues to be as much purchasing of upland cotton as before, but just not as much purchasing of *U.S. upland cotton*. Again, this is not consistent with Brazil's theory of the effect of terminating the Step 2 program.

212. Brazil also asserts that, while the increase in exports just prior to termination of the Step 2 program skews the data, "based on longer-term trends, exports in MY 2006 are only slightly below average. This is consistent with the view that elimination of the Step 2 payments temporarily distorted U.S. export patterns."³³⁰ However, here again, the data do not support Brazil's assertions. Indeed, as the United States explained in its first written submission,³³¹ total U.S. export commitments – both sales and shipments – are currently approximately 32% below the 5-year average.³³² This hardly seems to be "slightly below average."

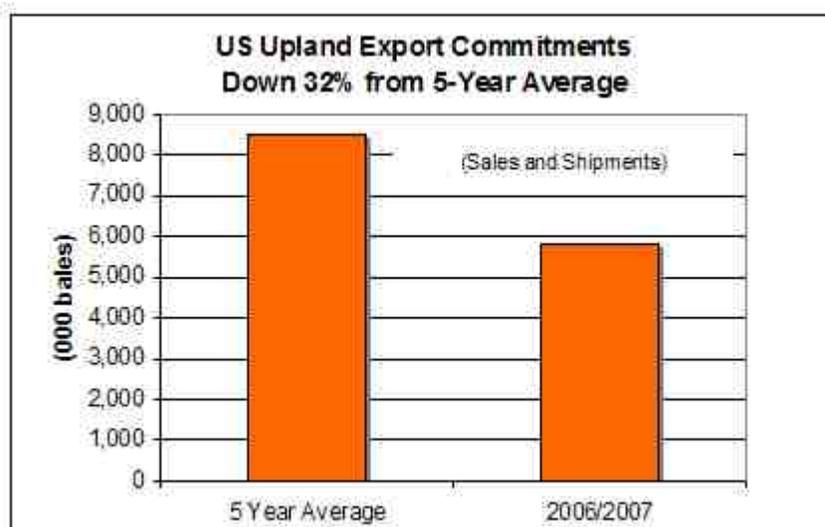
³²⁸ See U.S. Rebuttal Submission Data Tables; U.S. Beginning Stocks (Exhibit US-83).

³²⁹ World Agricultural Supply and Demand Estimates, USDA. WASDE 442-27. (January 12, 2007) (Exhibit US-84). U.S. Census data for August-November shows the sharp decline in U.S. upland cotton exports in marketing year 2006. Total exports are down 49 percent, and are the lowest absolute level since the same period in 2000. Exports to China are down 75 percent. In fact, exports to the top 10 markets are down between 30 and 83 percent, with only exports to Indonesia holding steady. U.S. Rebuttal Submission Data Tables; Global Trade Atlas (Exhibit US-83) (accessed January 30, 2007).

³³⁰ Brazil Rebuttal Submission, para. 79.

³³¹ U.S. First Written Submission, para. 193.

³³² Weekly Export Performance Report (Exhibit US-30).



Source: USDA³³³

213. As shown above, Brazil’s attempts to explain away the evidence of exceptionally low export levels do not withstand scrutiny. While China undoubtedly is factor, Brazil fails to explain why U.S. export levels are low *even* taking China’s impact into account.

6. Conclusion

214. Brazil, as the complaining party, bears the burden of proving that termination of the Step 2 program by the United States is insufficient to “remove the adverse effects [of] . . . or withdraw” the subsidy found to be causing serious prejudice. Brazil attempts to do so by, first, arguing that the effects of terminating the Step program are minimal; specifically, that termination “will likely have *no impact* on the level of U.S. production or exports” and “*little positive impact* on the world price for cotton in the long term.”³³⁴ However, Brazil fails to provide any empirical evidence to substantiate this assertion. Indeed, the empirical evidence tends to *undermine* Brazil’s assertions. Moreover, Brazil’s arguments to the present Panel are contradicted, in large part, by Brazil’s own arguments before the original panel.

C. BRAZIL HAS FAILED TO MAKE A *PRIMA FACIE* CASE OF “PRESENT” SERIOUS PREJUDICE WITHIN THE MEANING OF ARTICLES 5(C) AND 6.3(C) OF THE *SCM AGREEMENT*

³³³ U.S. Rebuttal Submission Data Tables; Export Sales Data (Exhibit US-83)

³³⁴ Brazil First Written Submission, para. 206 (quoting Brazil First Written Submission, Annex II, paras. 41-43).

215. Before turning to Brazil’s “present” serious prejudice claims, the United States wishes to address Brazil’s incorrect assertions regarding the time period that is relevant for the claims of “present” serious prejudice. Brazil argues that the panel should not consider the present marketing year – *i.e.*, MY 2006 – as the relevant period for purposes of Brazil’s “present” serious prejudice claims under Articles 5 and 6 of the *SCM Agreement*.³³⁵ Instead, Brazil argues that “[t]his compliance Panel should base its determinations on data from the most recent complete marketing year – namely, MY 2005 – which ended only two months prior to the establishment of this compliance Panel on 28 September 2006.”³³⁶ Brazil is confusing the issues. Brazil’s claims of “present” serious prejudice require an assessment of whether “the effect” of the challenged measures “is” significant price suppression (in the case of the claims under Articles 5(c) and 6.3(c)).³³⁷ The use of the present tense – “is” – signifies that the period relevant for these claims is immediate present, not a historical period (regardless of how close in time). If there were reliable data about what the effect of a challenged measure “is” today, obviously that would be the preferred data in assessing whether “the effect of the subsidy is . . . significant price suppression . . . in the same market.”³³⁸ Often, however, such data is not available and, in that circumstance, it is appropriate to look at historical data as a *proxy* for the “present” period for which complete data is unavailable. Indeed, Brazil appeared to recognize this in its first written submission, when it explained that:

Full-year data on marketing loan and counter-cyclical payments to U.S. upland cotton farmers for MY 2006 – the first year in which Step 2 is not provided – will not be available until September 2007. *Nevertheless*, the compliance Panel can determine whether the repeal of the Step 2 program is sufficient to bring the new “basket of measures” supporting U.S. upland cotton farmers into conformity with the covered agreements, based on data covering the full 2005 marketing year.³³⁹

216. Where there is reliable data available for MY 2006, or any part thereof, however, there is no reason why the Panel should not consider that data in assessing Brazil’s “present” serious prejudice claims. This is especially apt where the particular data for MY 2006 *is* complete, including, for example, futures data that would have been considered by U.S. producers at the time of planting for MY 2006 (*i.e.*, in the period January-March 2006). Brazil has no basis for suggesting that data is not relevant to its “present” serious prejudice claims.

³³⁵ Brazil Rebuttal Submission, para. 22.

³³⁶ Brazil Rebuttal Submission, para. 23.

³³⁷ In the case of claims under Articles 5(c) and 6.3(d), it is whether the effect of the challenged measures “is” “an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted.”

³³⁸ Article 6.3(c) of the *SCM Agreement*.

³³⁹ Brazil First Written Submission, para. 49.

1. Brazil Has Not Provided Persuasive Evidence Regarding that the Structure, Design, and Operation of the Marketing Loan and Counter-cyclical Payment Programs That Supports Its Claims of Significant Price Suppression

217. Brazil has yet to submit any persuasive evidence regarding the structure, design, and operation of the marketing loan and counter-cyclical payment programs that demonstrates that “the effect” of those payments under those programs is significant price suppression. Instead, Brazil has attempted to avoid this obligation by suggesting that the issues before this Panel have already been decided, that the U.S. arguments have already been rejected, and that Brazil is, effectively, presenting the Panel with a *fait accompli*.³⁴⁰ These assertions are patently incorrect. Indeed, one can only wonder why, if they were true, (a) Brazil has now submitted close to 400 pages of arguments in this proceeding, (b) why its economist has suddenly been moved to submit a new econometric model, even going as far as to attempt to discredit his own earlier modeling as “unnecessarily complicated and cumbersome” and “not directly appropriate to the issue at hand,”³⁴¹ or, (c) more fundamentally, how Brazil can, at the same time, claim that the marketing loan and counter-cyclical payment programs (and payments) constitute new “measures taken to comply” against which it should be permitted to launch whatever new or renewed claims of WTO-inconsistency it wishes. It is important to correct these misstatements by Brazil.

218. First, neither the original panel nor the Appellate Body has assessed the claim that Brazil is attempting to advance in this proceeding. Therefore, they have not answered the question of whether Brazil has submitted sufficient evidence and argument to show that “the effect” of *payments under the marketing loan and counter-cyclical payment programs* is “present” serious prejudice within the meaning of Articles 5(c) and Article 6.3(c) of the *SCM Agreement*. As Brazil has insisted elsewhere, “the findings, conclusions and recommendations of the original panel, and the recommendations and rulings of the DSB . . . pertain to the ‘mandatory price-contingent United States subsidy measures’ collectively.”³⁴² Those “mandatory price-contingent United States subsidy measures” are a package of payments made in MY 1999-2002 under the Step 2, marketing loan, and counter-cyclical payment programs; not the marketing loan and counter-cyclical payment programs, payments under those two programs, or any combination thereof.³⁴³

219. In short, Brazil is incorrect to state that “the original panel found that the structure, design and operation of *these two subsidies*, coupled with their very large magnitude and conditions of competition in the world market for upland cotton, caused significant price suppression in that market.”³⁴⁴ Whether or not the marketing loan and counter-cyclical payment programs or payments under the programs cause significant price suppression is a question of first impression.

³⁴⁰ See e.g., Brazil Rebuttal Submission, paras. 93-100.

³⁴¹ Brazil Rebuttal Submission, Annex I, para. 4.

³⁴² Brazil Submission Regarding U.S. Requests for Preliminary Ruling, para. 17.

³⁴³ *Upland Cotton (Panel)*, para. 8.1(g)(i).

³⁴⁴ Brazil Rebuttal Submission, para. 95 (emphasis added).

220. Second, Brazil does not even properly characterize the U.S. arguments, let alone demonstrate that they have been “systematically rejected.”³⁴⁵ Brazil purports to “respond[] to U.S. assertions that marketing loan and counter-cyclical subsidies . . . have *no effect on production, exports or world prices.*”³⁴⁶ To the extent Brazil does so, its arguments may readily be dismissed as they fail to respond to any arguments that have been made in this proceeding. The U.S. argument is that Brazil has failed to make a *prima facie* case that the marketing loan and counter-cyclical payments are causing *significant* production effects that, in turn, have resulted in “present” *significant* price suppression.

221. With respect to the structure, operation, and design of the programs, Brazil submitted the following in its first written submission:

(a) in respect of the **counter-cyclical payment program**, a statement by the original panel that “counter-cyclical payments may influence production decisions indirectly by reducing total and per unit revenue risk associated with price variability in some situations”³⁴⁷ and another to the effect that there appeared to be “a strong positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production,”³⁴⁸ and

(b) in respect of the **marketing loan payment program**, a citation to a USDA study that acknowledges – correctly – that U.S. marketing loans have “*potential* production-influencing effects” and a chart which shows that in a number of the years that the FSRI Act came into effect marketing loan payments were made.³⁴⁹

222. The United States submits that this evidence is insufficient to make a *prima facie* case of breach of Articles 5(c) and 6.3(c) of the *SCM Agreement*. Most importantly, in both cases, Brazil shows – at best – that payments under the marketing loan and counter-cyclical payment programs *could* affect production.³⁵⁰ This is hardly remarkable. As the United States explained in its first

³⁴⁵ Brazil Rebuttal Submission, para. 94. Indeed, the United States recalls that the Appellate Body has clarified that “the party who asserts a fact, whether the claimant or the respondent, is responsible for providing proof thereof.” *United States – Wool Shirts and Blouses (AB)*, p. 14. To the extent that Brazil asserts that the panel or Appellate Body has “rejected” any U.S. argument, it bears the burden of proving it. As the United States shows above, Brazil’s assertions are meritless.

³⁴⁶ Brazil Rebuttal Submission, para. 97 (emphasis in original).

³⁴⁷ Brazil First Written Submission, para. 128 (citing *Upland Cotton (Panel)*, para. 7.1302).

³⁴⁸ Brazil First Written Submission, para. 128 (citing *Upland Cotton (Panel)*, para. 7.1302).

³⁴⁹ Brazil First Written Submission, paras. 126-127.

³⁵⁰ The United States also explained that Brazil’s chart showing *actual* AWP and marketing loan payments is not relevant to the inquiry regarding the *effect* of marketing loan payments on production (i.e., planting) decisions. U.S. First Written Submission, para. 228. In particular it ignores the basic facts of upland cotton production; namely, that a cotton farmer’s planting decisions are made months in advance of the time he receives any *actual* revenue, whether from the market, a U.S. government program or both. Thus, as Brazil itself concedes, the proper

written submission, most economists agree that *any* payment to a producer, regardless of the conditions under which it is granted, *could* affect production.³⁵¹ The salient question is whether – taking into account the particular structure and design of the marketing loan program and the counter-cyclical payment program and the way that they operate under the market conditions prevailing at present – payments under the programs are *in fact* having such production effects, and if so, whether the *degree* of the effect is so significant that it is resulting in “present” significant price suppression. It is *significant price suppression* that is precluded under the *SCM Agreement*, not any possible effect on production or any actual effect on production that does not ultimately result in significant price suppression in the market identified by the complaining party.

223. Brazil has yet to submit evidence regarding the marketing loan and counter-cyclical payment programs that demonstrate that payments under the programs are *in fact* having significant production effects.

a. Recent economic studies and planting data undermine Brazil’s arguments about the allegedly “significant” effects of payments under the counter-cyclical payment program

224. The United States explained in its first written submission that Brazil has failed to address recent economic studies showing that counter-cyclical payments have had only minimal effects on acreage, that counter-cyclical payments tend to be capitalized into land rents and land values and, further, that data regarding cotton plantings are consistent with the view that payments under the counter-cyclical payment program do not induce upland cotton production. While Brazil purports to rebut these U.S. arguments, it fails to do so.

225. Before turning to those issues, however, the United States notes that Brazil’s arguments regarding the alleged effects of counter-cyclical payments are flawed at the outset because they assume arguments the United States has not made. Specifically, Brazil suggests that the United States has argued that counter-cyclical payments are – or are “very close to” – so-called “green box” measures under Annex 2 of the *Agreement on Agriculture*.³⁵² The United States has made no such argument. Rather, what the United States has argued – and it bears repeating – is that Members have expressly agreed that domestic support *can* be provided to agricultural producers with no or minimal trade distortive effects; Annex 2 of the *Agreement on Agriculture* is proof of this agreement.³⁵³ Thus, it is not sufficient for Brazil to assert that counter-cyclical payments provide income support to U.S. producers; that is not WTO-inconsistent. Nor is it sufficient for

inquiry is with respect to *expected*, not *actual*, prices and payments.

³⁵¹ Hennessy, D., “The Production Effects of Agricultural Income Support Policies Under Uncertainty.” *American Journal of Agricultural Economics* 80(1998):46-57 (Exhibit US-33).

³⁵² Brazil Rebuttal Submission, para. 115.

³⁵³ U.S. First Written Submission, para. 209.

Brazil to argue that the counter-cyclical payment *could* have effects on production; that, too, is not WTO-inconsistent. Brazil can only prevail on its claims under Articles 5(c) and 6.3(c) of the *SCM Agreement* only if it demonstrates that counter-cyclical payments *are* causing production effects that are so significant as to cause significant price suppression in the world market for upland cotton. As discussed here, and in the U.S. first written submission, however, Brazil has failed to do so.

(i) Recent economic studies indicate that any production effects of counter-cyclical payments are minimal

226. In its first written submission, the United States explained that, at the time of the original proceeding, the counter-cyclical payment program had just come into existence and, thus, the original panel had before it little evidence relating to how that program *actually* operated.³⁵⁴ Since that time, there have been a number of studies that take into account empirical evidence of how the program operates and consider the effects that the program may have on production. These recent studies undermine Brazil's claims that counter-cyclical payments are the cause of any significant changes in U.S. cotton plantings or suppression of world market prices. To the contrary, the studies show that, though there may be some effects on risk and wealth, these are minimal and do not translate into any significant production effects. Moreover, surveys conducted regarding the factors affecting actual acreage decisions by farmers confirm that counter-cyclical payments do not significantly affect plantings and, consequently, production.

227. Brazil attempts to discredit the U.S. studies by arguing, *inter alia*, that they do not deal specifically with upland cotton production. Brazil does not explain, however, why that precludes the Panel from considering the studies as being highly probative. More importantly, Brazil submits no empirical evidence of its own relating to upland cotton production that supports its claims of significant production and price effects. To the contrary, of the three studies that Brazil submits in this proceeding, only one even deals with counter-cyclical payments. That study was conducted in "a computer lab at the University of Wyoming" to test the responses of economics students ("laboratory decision makers") under certain parameters that were necessarily abstracted from actual features of the 2002 Farm Act and imposed a number of limiting assumptions that the authors themselves recognized affected the results of the study.³⁵⁵ These studies do not detract from the substantial evidence showing that counter-cyclical payments do not have the kinds of significant effects that Brazil alleges.

³⁵⁴ U.S. First Written Submission, para. 205.

³⁵⁵ McIntosh, Christopher R, Jason F. Shogren and Erik Dohman, "Supply Response to Counter-Cyclical Payments and Base Updating under Uncertainty: An Experimental Study," forthcoming paper in the *American Journal of Agricultural Economics*, November 2006, page 18. Exhibit BRA-565. The United States notes that this citation is in error since the article did not appear in the November 2006 issue of the *American Journal of Agricultural Economics*.

228. The United States address Brazil’s arguments about each of the specific studies below:

229. **Lin & Dismukes (2007):** Using a forward-looking empirical model, Lin & Dismukes examined the following question: “[g]iven the market price scenario for major field crops [corn, wheat, and soybeans] perceived by producers at planting decision times, how would CCPs have affected plantings of 2005 major field crops in the North Central region..”³⁵⁶ The authors explained that “the effects of CCPs on crop production are determined in an *ex ante* context by comparing two scenarios: (1) market conditions without CCPs, and (2) market conditions with CCPs.”³⁵⁷ In other words, the authors assessed effects on plantings in much the same counterfactual way that Brazil argues is appropriate in this context.

230. The authors found that “[t]he effect of CCPs on producers’ planting decisions . . . appears to be *very negligible* – an increase in the acreage of major field crops of less than 1%”³⁵⁸ As Brazil concedes, the study found acreage effects with respect to corn and wheat that are “not statistically significant.”³⁵⁹ In the case of soybeans, in the now-superseded 2005 version of the study, the authors found a 2.94 percent increase in soybean acreage where counter-cyclical payments were introduced.³⁶⁰ In the 2007 study, the authors updated their analysis to include both yield and price variability in the acreage response model. The updated results for soybeans shows no effect on soybean acreage from the introduction of counter-cyclical payments. These results do not square with the “*significant* . . . production- and trade-distorting effects” alleged by Brazil in this proceeding.

231. In an attempt to have the Panel dismiss this study, Brazil makes a series of misleading and irrelevant allegations. First, Brazil asserts that this study is “not directly applicable to the precise question before this compliance Panel” because it does not deal with upland cotton production.³⁶¹ Brazil fails to explain, however, why the fact that the study looks at effects on other program crops should disqualify it as highly relevant evidence. The United States recalls, in this regard,

³⁵⁶ Lin, William and Dismukes, Robert. “Supply Response Under Risk: Implications for Counter- cyclical Payments’ Production Impacts,” *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, (Spring 2007), p. 81 (Exhibit US-85). The United States submitted an earlier version of the paper as Exhibit US-34. The paper has since been updated for publication. The United States addresses the current version above but notes where the results differ from the earlier version submitted by the United States.

³⁵⁷ Lin, William and Dismukes, Robert. “Supply Response Under Risk: Implications for Counter- cyclical Payments’ Production Impacts,” *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 81 (Exhibit US-85).

³⁵⁸ Lin, William and Dismukes, Robert. “Supply Response Under Risk: Implications for Counter- cyclical Payments’ Production Impacts,” *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 83 (Exhibit US-85) (emphasis added).

³⁵⁹ Brazil Rebuttal Submission, para. 125, n. 185.

³⁶⁰ Lin, William and Dismukes, Robert. “Supply Response Under Risk: Implications for Counter-Cyclical Payments’ Production Impact,” Selected Paper, American Agricultural Economics Association, July 2005, p. 23.

³⁶¹ Brazil Rebuttal Submission, para. 127.

that neither of the two studies that Brazil cited as part of its first written submission addressed production effects specific to upland cotton (indeed, given that the studies predated the actual implementation of the counter-cyclical payment program, neither study even looked to actual evidence of the program's operation).³⁶² Indeed, it is curious that Brazil would insist on empirical evidence of effects on upland cotton production given that Brazil – the party bearing the burden of proving the significant production and price effects that it is claiming – has submitted no such empirical evidence itself.

232. Second, Brazil asserts that “the empirical model in the study uses data from 1991-2001, meaning that the supply responses being examined by the study reflect the policy scenarios in place under the 1990 and 1996 farm bills, not the FSRI Act of 2002, which entered into force starting with MY 2002.” This is simply wrong. The authors note that they “chose to not include input data from recent few years *in estimating the acreage response equations, but did accurately reflect major characteristics of CCPs in analyzing the payments’ potential production impact in the simulation analysis.*”³⁶³ Moreover, the author's explanation of parameters shows clearly that the study took into account recent market conditions (for example, “new crop futures prices in mid February 2005 after adjusting for basis to arrive at the farm price equivalents”) in assessing production effects.³⁶⁴ Indeed, as noted above, the authors state that “[a]nalysis in this section seeks to answer the following question: ‘Given the market price scenario for major field crops perceived by producers at planting decision times, how would CCPs have affected the plantings of 2005 major field crops in the North Central region?’”³⁶⁵ Hence, it is clear that Lin & Dismukes (2007) addressed the possible production impacts of counter-cyclical payments for the 2005 crop, not for MY 1999-2001 as Brazil has suggested.

233. Third, dismissing the “statistically insignificant” acreage effects found in respect of corn and wheat, Brazil seizes on the three percent acreage effect found for soybeans in the 2005 study.

³⁶² “The 2002 Farm Act: Provisions and Implications for Commodity Markets” at 14 (Paul C. Westcott, C. Edwin Young and J. Michael Price) (Exhibit BRA-42) (which specifically provided that “[t]here is no available research that provides quantitative measures of the potential impacts” of counter-cyclical payments and that, as a result, the study could provide only a “qualitative discussion of some of the[] *potential* influences”) (emphasis added) and “Agricultural Policies in OECD Countries,” Monitoring and Evaluation 2003, Highlights at 22 (BRA-5) (The other is a an OECD study from the same period which notes that “[t]he impact of the 2002 Farm Act, as it is estimated in this section, *strongly depends on a number of assumptions, most notably on the degree of the farmer’s risk aversion, and the settings on world markets as indicated by international commodity prices.*”) (emphasis added).

³⁶³ Lin, William and Dismukes, Robert. “Supply Response Under Risk: Implications for Counter- cyclical Payments’ Production Impacts,” *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 68 (Exhibit US-85) (emphasis added).

³⁶⁴ Lin, William and Dismukes, Robert. “Supply Response Under Risk: Implications for Counter- cyclical Payments’ Production Impacts,” *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 83 (Exhibit US-85).

³⁶⁵ Lin, William and Dismukes, Robert. “Supply Response Under Risk: Implications for Counter- cyclical Payments’ Production Impacts,” *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 81 (Exhibit US-85).

Brazil asserts that “[a]ssuming that the variance of upland cotton prices also has a negative effect on upland cotton acreage, as it does for soybeans, this study suggests that counter-cyclical subsidies, which reduce such fluctuations in upland cotton prices experienced by U.S. producers, have a significant positive impact on upland cotton acreage.”³⁶⁶ Not only does the 2007 study show no appreciable effect on production for any crop, but even the three percent production effect found in the earlier study for soybeans helps to put in perspective the grossly inflated results that Brazil’s economist generates for upland cotton.

234. Finally, Brazil attempts to make much of the author’s remarks at the end of the paper clarifying that the study addresses the “modest impact on production of major field crops in the Northcentral region” but that “longer term there may be structural implications to the extent that these payments keep farmers in business.”³⁶⁷ Brazil’s attempt to cast this statement regarding possible “longer-term” effects as a “finding” of the authors is disingenuous; as is clear from the context, the authors were clarifying that the study was not comprehensive as to all possible types of effects; not that they had found such “longer term” effects to exist. Nor is the suggestion that there *could* be such effects remarkable. The salient question, for purposes of Brazil’s claims, is whether such effects *do* exist and, if so, whether they are affecting production and prices presently.

235. **Goodwin & Mishra (2005):** In its first written submission, the United States cited to a 2005 study by Goodwin & Mishra which used acreage response models built from farm-level data for a sample of U.S. Corn Belt farmers and found little evidence of acreage effects from decoupled payments.³⁶⁸ The study also conducted a survey of farmers asking them to rate the factors important to their acreage decisions on a 5-point scale ranging from “not at all important” to “very important.”³⁶⁹ The study finds that almost half of farmers surveyed (44 percent) – in a nationwide survey comprising about 4,125 observations – indicated that counter-cyclical payments were strongly “not at all important” to their acreage decisions. The other substantial percentage (43 percent) indicated either ambivalence (that counter-cyclical payments were “neither important or unimportant”) or that counter-cyclical payments were “unimportant” to their acreage decisions.

236. Brazil does not contest the survey findings showing that of the thousands of farmers surveyed, comparatively few agree with the single farmer cited by Brazil who alleges to be

³⁶⁶ Brazil Rebuttal Submission, para. 126.

³⁶⁷ Brazil Rebuttal Submission, para. 126 (citing Lin, William and Dismukes, Robert. “Supply Response Under Risk: Implications for Counter- cyclical Payments’ Production Impacts,” *Review of Agricultural Economics–Volume 29, Number 1–Pages 64-86*, forthcoming, p. 83 (Exhibit US-85)).

³⁶⁸ Goodwin, B. and A. Mishra. “Another Look at Decoupling: Additional Evidence on the Production Effects of Direct Payments.” *American Journal of Agricultural Economics* 87(5):1200-1210, 2005 (Exhibit US-41).

³⁶⁹ Goodwin, B. and A. Mishra. “Another Look at Decoupling: Additional Evidence on the Production Effects of Direct Payments.” *American Journal of Agricultural Economics* 87(5):1200-1210, 2005 (Exhibit US-41).

“playing a game” and asserts that “[w]e’re just looking at the government payments”³⁷⁰ in making acreage decisions. Indeed, Brazil concedes that this survey information “is revealing because it provides the views of a large sample of U.S. farmers, i.e., the recipients of these subsidies,”³⁷¹ However, Brazil ignores entirely these *express* findings as to the factors affecting acreage decisions and, instead, argues that “evidence that counter-cyclical payments . . . are closely linked to meeting farmers cost of production and to enhancing farm productivity in the minds of farmers” can be found in the studies finding that “[f]armers indicated that they allocate 62 percent of *direct payments* to on-farm uses, of which, 27 percent would be used for operating expenses.”³⁷² Brazil asserts, without citation, support, or basis that “[t]he allocation of counter-cyclical payments to on-farm uses and operating costs is likely to be even higher than it is for direct payments, given that counter-cyclical payments are tied to prices.”³⁷³ Brazil’s assertions are directly undermined by the survey’s finding regarding factors affecting “farm productivity in the minds of farmers.”

237. **Westcott (2005):** In this study, Paul Westcott, the author of the 2002 study cited by the panel in the original proceeding, revisited the question of the effects of counter-cyclical payments on production and concluded that they are likely to be limited, particularly where the expected season average price is below loan rates (i.e. the counter-cyclical payment is expected to be at the maximum). Westcott determined that, in these circumstances, counter-cyclical payments “become more like ‘fixed’ payments.”³⁷⁴ Research has shown that fixed payments act like general income transfers to farm household and have only small effects on output.³⁷⁵ The United States demonstrated in its first written submission that, in all but one year since the FSRI Act came into effect, the expected counter-cyclical payment rate for upland cotton was at the maximum level. Thus, under Westcott’s analysis, the counter-cyclical payments on upland cotton base acres would have operated much like fixed direct payments over that period.³⁷⁶

238. Even though Brazil had no difficulty relying on Westcott’s 2002 analysis in its first written submission, Brazil disputes the author’s conclusion regarding expected season average prices. Brazil provides no basis for its challenge, however, and its attempted explanation is illogical. Brazil asserts that “there is no certainty in price expectations. Even if farmers expect to

³⁷⁰ Brazil Rebuttal Submission, para. 102 (citing “Cotton bailout: How your tax dollars prop up big growers and squeeze the little guy,” Atlanta Journal-Constitution, 1 October 2006, p. 2, accessed December 2006 at <http://www.ajc.com/search/content/metro/stories/cotton1.html>) (Exhibit BRA-563).

³⁷¹ Brazil Rebuttal Submission, para. 138.

³⁷² Brazil Rebuttal Submission, para. 138.

³⁷³ Brazil Rebuttal Submission, para. 138.

³⁷⁴ Paul A. Westcott, “Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited” (3rd Quarter 2005) (Exhibit US-35).

³⁷⁵ Paul A. Westcott, “Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited” (3rd Quarter 2005) (Exhibit US-35).

³⁷⁶ U.S. First Written Submission, para. 211.

receive the full counter-cyclical payment, they may not, as happened in MY 2003.”³⁷⁷ This is the same mistake Brazil makes repeatedly throughout its analysis; As Westcott’s analysis reflects, upland cotton production (through plantings) is necessarily a function of revenue expectations not actual prices or payments. The fact that actual prices or payments are ultimately different from those expected does not mean that a producer rewinds time and behaves differently at the time of (past) planting. Thus, Brazil’s suggestion that this argument undermines Westcott’s conclusion is baseless.³⁷⁸

239. At the same time that Brazil asserts that counter-cyclical payments are *not certain to be received*, however, it also argues that “[t]he expectation of a maximum payment does not change the fact that counter-cyclical subsidies reduce the risks to producers associated with price variability.”³⁷⁹ Yet, Brazil’s reasoning would tend to suggest that, because of uncertainty as to whether they would *get* the maximum payment, producers would be *less* likely to take counter-cyclical payments into account than fixed payments – *i.e.*, more conservative in terms of production than the recipient of the fixed payment – not the other way around.

240. Finally, purporting to “agree with Westcott’s characterization of counter-cyclical payments as a hybrid between direct payments and marketing loan payments,” Brazil asserts that “USDA data relied upon by the original panel showed a ‘strongly positive relationship’ between upland cotton counter-cyclical payments and current production of upland cotton, suggesting that they are much closer to marketing loan payments (i.e. coupled, and having direct effects on production decisions) than they are to direct payments.”³⁸⁰ This assertion too is inexplicable. The “USDA data” that it refers to here is the data discussed in Section IV.C.1.a(iii) below showing the ratio between upland cotton base acres and upland cotton planted acres on farms that hold such base acres. Brazil neglects to mention, however, that *the same base acres are used under both the direct payment program and the counter-cyclical payment program*. Thus, whatever “relationship” this data does or does not show for counter-cyclical payments is no different than the “relationship” the same data shows for direct payments. Indeed, as discussed below, for precisely this reason, there is no merit to Brazil’s suggestion that this “relationship” supports its claim of significant price suppression. Brazil’s suggestion here that this “relationship” renders counter-cyclical payments “closer to marketing loan payments . . . than they are to direct payments” is even more confounding.

241. ***Young, Effland, Westcott, & Johnson (2006)***: The authors reviewed a number of studies examining the effects of decoupled payments on consumption of goods versus leisure and the

³⁷⁷ Brazil Rebuttal Submission, para. 131.

³⁷⁸ Brazil’s argument about market loss assistance payments in MY 1999-2001 is also baseless. Indeed, Brazil fails to explain how Westcott’s reasoning regarding expectations of maximum counter-cyclical payments applies in the context of the *ad hoc* market loss assistance payments.

³⁷⁹ Brazil Rebuttal Submission, para. 132.

³⁸⁰ Brazil Rebuttal Submission, para. 130.

trade-offs between savings and investment, finding little evidence that the introduction of decoupled payments encouraged additional on-farm labor or led to additional farm-level investment.³⁸¹ Brazil does not contest these findings; it simply notes that the authors cite to the 2002 Westcott, Young, & Price study that indicates that counter-cyclical payments *could* have indirect production effects “in some price ranges for program crops.”³⁸² Nothing in this study, however, suggests the kind of “*significant* . . . production- and trade-distorting effects” alleged by Brazil in this proceeding and Brazil does not assert otherwise.

242. ***Goodwin & Mishra (2006)***: Brazil cites to this 2006 study for the proposition that market loss assistance payments (which pre-dated the counter-cyclical payments authorized in the FRSI Act of 2002) had significant impacts on corn acreage in the Corn Belt.³⁸³ As a preliminary matter, it is curious that – while Brazil attempts to discredit the Lin & Dismukes (2007) study on the (erroneous) basis that it does not include recent data about counter-cyclical payments – Brazil appears to consider this study to be acceptable even though this *expressly* deals only with market loss assistance payments, not the counter-cyclical payment program, and does not incorporate data for the period that the FRSI Act has been in effect (*i.e.*, 2002-present).

243. In addition, Brazil’s conclusions regarding the study are misleading. Goodwin & Mishra used two different data sets to analyze acreage impacts – one at the farm level and another at the county level – and analyzed effects with respect to corn, wheat and soybean. Of all the results found by the study, Brazil refers only to one – the finding for corn acreage using the farm level data set (showing a 10% impact on corn acreage).³⁸⁴ Although the study concluded that market loss assistance payments *did not have an appreciable effect* on wheat or soybean acres,³⁸⁵ Brazil does not acknowledge those results. Nor does Brazil explain why they are not relevant in assessing production effects with respect to upland cotton.

244. Brazil also fails to explain that the data used for the farm-level analysis for corn included aggregate disaster payments, which grouped market loss assistance payments together with all other supplemental assistance payments, including crop loss disaster payments. As such, the

³⁸¹ Young, C. Edwin, Anne Effland, Paul Westcott and Demcey Johnson. *US Agricultural Policy: Overview and Recent Analyses*. Presented at 93rd seminar of the European Association of Agricultural Economists, “Impacts of Decoupling and Cross Compliance on Agriculture in the Enlarged EU,” September 22-23, 2006, Prague, Czech Republic, p. 7 (Exhibit US-40).

³⁸² Brazil Rebuttal Submission, para. 134.

³⁸³ Brazil Rebuttal Submission, para. 138 (citing Goodwin B.K. and Mishra A (2006) “Are decoupled payments really decoupled?” *American Journal of Agricultural Economics* 88 (1) (Exhibit BRA-618)).

³⁸⁴ Brazil Rebuttal Submission, para. 138.

³⁸⁵ Brazil Rebuttal Submission, para. 138 (citing Goodwin B.K. and Mishra A (2006) “Are decoupled payments really decoupled?” *American Journal of Agricultural Economics* 88 (1), page 81 (Exhibit BRA-618)).

effect solely of market loss assistance payments is not apparent from the analysis.³⁸⁶ Moreover, Brazil does not discuss the findings made regarding corn acreage using county-level data. Specifically, because of shortcomings in the farm level data (e.g., the data are cross sectional, not time series so that the same farms are not observed over time), the analysts used a different data set based on county averages for variables such as acreage and program payments. The results of that analysis were the following:

In the case of MLA payments, a significant relationship with acreage is implied only for corn and soybeans, where an additional dollar per acre of MLA payments appears to raise county acreages by 225 and 138 acres, respectively. Again, this corresponds to a very small elasticity estimate of less than 0.01 in each case, which although statistically significant, is very close to zero. Thus, *at the county level, the results do not imply large effects from AMTA payments or the MLA payments.*³⁸⁷

245. Thus, contrary to Brazil's assertions, although this study found some modest production effects for MLA payments for corn using a farm-level data set, it found substantially smaller effects with a county-level data set. This combined with the fact that the study found no significant effects in respect of wheat and soybeans tend to undermine – rather than support – Brazil's argument that counter-cyclical payments in respect of upland cotton base acres have significant production effects.

246. **Key, Lubowski, & Roberts (2005):** Brazil's assertion that this study supports its allegations of significant production effects resulting from counter-cyclical payments is entirely misleading.³⁸⁸ First, this study does not address the counter-cyclical payments, or indeed *any* domestic support payments under the FSRI Act. Instead, as Brazil concedes, the study addresses "participation" generally under the programs in effect under the FAIR Act of 1996. Moreover, the study does not account for the different kinds of payments available under farm programs during this period. Thus, it is not possible to ascribe any effect to any particular program. The study further clarifies that it does *not* "indicate the aggregate magnitude of the distortion caused by domestic agricultural payments."³⁸⁹ Indeed, the authors explain that:

³⁸⁶ Goodwin B.K. and Mishra A (2006) "Are decoupled payments really decoupled?" *American Journal of Agricultural Economics* 88 (1), page 80-81 ("A second important dimension of farm program support in the post-FAIR environment involves the provision of ad hoc disaster assistance, including MLA payments. In the case of the ARMS survey data, information regarding MLA payments is grouped together with overall disaster relief.") (Exhibit BRA-618).

³⁸⁷ Goodwin B.K. and Mishra A (2006) "Are decoupled payments really decoupled?" *American Journal of Agricultural Economics* 88 (1), page 85 (Exhibit BRA-618).

³⁸⁸ Brazil Rebuttal Submission, para. 139.

³⁸⁹ Key, Nigel, Ruben Lubowski, and Michael Roberts, "Farm-Level Production Effect From Participation in Government Commodity Programs: Did the 1996 Federal Agricultural Improvement and Reform Act make a Difference," *American Journal of Agricultural Economics* (87) 5:1211-1219, 2005, p. 1218 (Exhibit BRA-566).

A marked decline in plantings of program-related crops would likely cause prices to rise, attenuating the overall decline in aggregate plantings. In the absence of agricultural program payments, we thus expect acreage would change by a smaller amount than our farm-level estimates for the effect of program participation. Moreover, our results should be viewed as preliminary. To our knowledge, this is the first attempt to examine effects of federal agricultural programs by comparing participants with nonparticipants. More work is needed to verify an absence of selection bias and determine more precisely the mechanisms through which these programs may be influencing production decisions.³⁹⁰

247. For the reasons above, Brazil’s suggestion that this study supports a finding of significant production effects of counter-cyclical payments is simply untenable.

248. **McIntosh, Shogren & Dohlam (2006):** Brazil cites to this study as “more recent and more relevant” than the any of the studies submitted by the United States regarding the actual structure, design, and operation of the counter-cyclical payment program and the actual responses of U.S. farmers as to the role of payments under the program. This is certainly a remarkable assertion by Brazil, given that this study does not even examine the behavior of actual farmers – let alone upland cotton farmers. Rather, the study is based on a highly stylized experiment conducted on students at the University of Wyoming (“laboratory decision makers”) that, by necessity, abstracted from actual features of the 2002 Farm Act and imposed a number of limiting assumptions. As acknowledged by the authors:

Our design did not address two features of the 2002 Act which could affect the interpretation of our results. First, there are no adjustments made in our bonuses for the fact that direct and counter-cyclical payments are made only on a percentage (85 percent) of base acres. If these adjustments were incorporated, the lump sum bonuses would have been lower, implying our results could overstate the effects of CCPs. Second, we excluded the marketing loan program to focus on the basic CCP structure—target price, market price, and direct rate. Adding the marketing loan program into our design would temper the basic effects of CCPs by providing an additional price support mechanism.³⁹¹

249. This study shows how under certain extremely restrictive conditions and assumptions –

³⁹⁰ Key, Nigel, Ruben Lubowski, and Michael Roberts, “Farm-Level Production Effect From Participation in Government Commodity Programs: Did the 1996 Federal Agricultural Improvement and Reform Act make a Difference,” *American Journal of Agricultural Economics* (87) 5:1211-1219, 2005, p. 1218 (Exhibit BRA-566).

³⁹¹ McIntosh, Christopher R, Jason F. Shogren and Erik Dohlman, “Supply Response to Counter-Cyclical Payments and Base Updating under Uncertainty: An Experimental Study,,: forthcoming paper in the *American Journal of Agricultural Economics*, November 2006, page 18 (Exhibit BRA-565). The United States notes that this citation is in error since the article did not appear in the November 2006 issue of the *American Journal of Agricultural Economics*.

for example, the players were required to update base acreage – economics students reacted to certain policy scenarios and conditions. As with other studies put forth by Brazil, this limited conclusion from a laboratory experiment does not “show that counter-cyclical payments have significant effects on production of the program crop.”³⁹²

250. ***Donoghue & Whitaker (2006)***: Finally, Brazil seeks to revive its arguments about the alleged “incentive to produce” as a result of what Brazil asserts is a possibility that producers will be able to update base acres in the future under the direct and counter-cyclical payment programs. The Panel may recall that the original panel rejected Brazil’s arguments in this regard as being “speculative”:

Since the time when base acres for deficiency payments were established by a rolling average of previous years’ plantings under the FACT Act of 1990, there has been only one opportunity to update base acres. Brazil asserts that:

the 2002 update and individual deficiency payment updates during 1985-1995 established the principle that acreage and yield base updates are a part of the farm policy in the United States. Even though no updates are explicitly provided for during the lifespan of the 2002 FSRI Act, farmers may reasonably expect future updates, either as a part of ad hoc legislation or as a part of the regularly scheduled new law in 2007.

The Panel notes that updating was not permitted throughout the term of the FAIR Act of 1996, and is not permitted throughout the term of the FSRI Act of 2002. It has been permitted only once since 1996. There is no evidence before the Panel as to what the United States Congress intends to do in future farm bills. There is no evidence, only speculation, as to whether producers will expect to be able to update their base acres under future farm bills.³⁹³

251. Brazil has not shown that the possibility of base updating under the counter-cyclical payment program is any less speculative now than it was when the original panel rejected Brazil’s arguments. Indeed, the O’Donoghue & Whitaker (2006) study to which Brazil refers provides little insight in this regard. Brazil cites that study for the proposition that “farms producing program crops increased in size following the base acre update in 2002.”³⁹⁴ However, Brazil does not explain that the study addresses only direct payments,³⁹⁵ which the original panel specifically

³⁹² *Rebuttal Submission of Brazil*, 11 January 2007, para. 140.

³⁹³ *Upland Cotton (Panel)*, paras. 7.404-7.405.

³⁹⁴ Brazil Rebuttal Submission, para. 142.

³⁹⁵ O’Donoghue, Erik J. and James Whitaker. “How distorting are direct payments?,” Paper prepared for presentation at the 2006 American Agricultural Economics Association in Long Beach, CA, p. 2 (Exhibit BRA-568).

found did not contribute to any significant price suppression.³⁹⁶ The study also uses as the variable for a producer’s production decision ‘harvested acres,’³⁹⁷ which are not an appropriate variable for examining a producer’s planting decision. The appropriate variable is ‘planted acres’ as harvested acres can vary considerably from planted acres because of weather and other factors outside the control of producers. Further, the authors note that they cannot account for changes in commodity base acres – for example, from wheat to corn – which was a critical aspect of producers’ decisions in the context of updating base acres in 2002.

252. **Conclusion:** Brazil identifies no empirical research or evidence that shows any significant effect of counter-cyclical payments on production. Brazil continues to rely on qualitative statements that CCPs *may* influence production indirectly through wealth or risk effects.³⁹⁸ But the growing body of economic analysis, while recognizing the possibility of such risk and wealth effects, point to minimal production effects.

(ii) A significant portion of counter-cyclical payments are capitalized into higher land rents and land values

253. In its rebuttal submission, Brazil attempts to counter the U.S. evidence showing that much of the increase in wealth from farm payments – including counter-cyclical payments – accrues to non-operator landlords. Brazil’s objections to this evidence are somewhat curious given that it acknowledges that the original panel found that the benefits of some payments – specifically, the production flexibility contract, direct, market loss assistance and counter-cyclical payments – are being “captured,” by land-owners and, thus, not “passed-through,” to producers.³⁹⁹ Brazil has provided no reason why this important fact should not be taken into account – along with the studies showing minimal production effects – in assessing whether counter-cyclical payments causing significant effects on production that, in turn, result in significant suppression of world market prices. Nonetheless, the United States addresses Brazil’s specific arguments below.

254. First, Brazil asserts that “counter-cyclical payments are not decoupled payments, and do not meet the definition of ‘decoupled income support’ within the meaning of paragraph 6 of the Annex 2 of the *Agreement on Agriculture*.”⁴⁰⁰ This argument is irrelevant; whether or not payments “meet the definition of ‘decoupled income support’ within the meaning of paragraph 6 of the Annex 2 of the *Agreement on Agriculture*” does not determine whether payments are capitalized into land rents and land values (and, contrary to Brazil’s assertions, the United States has not suggested otherwise).

³⁹⁶ *Upland Cotton (Panel)*, para. 8.1(ii).

³⁹⁷ O’Donoghue, Erik J. and James Whitaker. “How distorting are direct payments?,” Paper prepared for presentation at the 2006 American Agricultural Economics Association in Long Beach, CA, p. 2 (Exhibit BRA-568).

³⁹⁸ See e.g., Brazil Rebuttal Submission, para. para. 144.

³⁹⁹ Brazil Appellee Brief, para. 602 (citing *Upland Cotton (Panel)*, para. 7.1226).

⁴⁰⁰ Brazil Rebuttal Submission, para. 145.

255. Second, Brazil asserts that the uncertainty regarding whether or not counter-cyclical payments will ultimately be received means that they are not “easily capitalized into land values.”⁴⁰¹ However, Brazil does not support its assertion with any citation to evidence or economic literature (save the opinion of its own hired economist). Nor does Brazil explain what relevance this argument has where, as here, farmers’ expectations have been that they would receive a fixed amount of counter-cyclical payments (the maximum) in almost every year that the FSRI Act has been in effect. Indeed, this has led some economists to conclude that the counter-cyclical payments have behaved much like a fixed, direct payment in recent years.⁴⁰² Brazil also overlooks, in this regard, the long history of economic theory and analysis that concludes that agricultural supports in general, whether coupled or decoupled, are capitalized into land values.⁴⁰³ Moreover, Brazil fails to explain the fundamental inconsistency between its arguments about uncertainty in this context and its own general contention that, despite any uncertainty, U.S. *producers* nonetheless allow their production decisions to depend on expectations of counter-cyclical payments.

256. Finally, the United States notes Brazil’s attempts to show that any rate of capitalization of farm payments into land values or rents is “relatively minor.”⁴⁰⁴ Brazil’s analysis in this regard is flawed. For example, Brazil cites to a USDA study suggesting that production flexibility contract payments “led to an increase in U.S. farmland values of 8 percent.”⁴⁰⁵ This is hardly “relatively minor.” If 8 percent of farmland value were equal to the dollar value of PFC payments made, that would suggest a full capitalization of PFC payments into farmland values. For example, according to an earlier study cited by Brazil, in 2000 the total value of farmland harvested in eight program crops was \$312.3 billion.⁴⁰⁶ An 8-percent increase is \$25 billion, substantially larger than all PFC payments, which were \$5.5 billion in marketing year 2000/01.

257. Brazil cites several studies purporting to show that the effects of decoupled payments on land values is minor.⁴⁰⁷ Most of these studies, however, were reviewed by the OECD. The OECD review shows that, despite using different methods and data sources, all of these studies confirm some degree of pass-through of government payments to land values or land rents. Some show very high rates of pass-through. For example: “[The Lence and Mishra (2003)] results

⁴⁰¹ Brazil Rebuttal Submission, para. 146.

⁴⁰² Paul A. Westcott, “Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited” (3rd Quarter 2005) (Exhibit US-35).

⁴⁰³ See, e.g., Floyd, John E., “The Effects of Farm Price Supports on the Returns to Land and Labor in Agriculture.” *The Journal of Political Economy*, Vol. 73, No. 2. (Apr., 1965), pp. 148-158. (Exhibit US-86).

⁴⁰⁴ Brazil Rebuttal Submission, para. 147.

⁴⁰⁵ Brazil Rebuttal Submission, para. 147.

⁴⁰⁶ Brazil’s Answers to Questions of the Panel, para. 164 (27 October 2003) (referring to Barnard C., Nehring R, Ryan J., Collender R. “Higher Cropland Value from Farm Program Payments: Who Gains?” Economic Research Service, USDA. *Agricultural Outlook*, November 2001, p. 29 (Exhibit BRA-309)).

⁴⁰⁷ Brazil Rebuttal Submission, para. 147.

indicate landowners capture *most of the benefits from PFC and MLA payments — an additional dollar of PFC or MLA payments leads to an estimated increase in cash rents of approximately USD 0.85.*⁴⁰⁸ The authors of the OECD review conclude:

Empirical work suggests that PFC and MLA payments had a significant effect on land values and rental rates. Given the importance of the rental market for land in the United States, it appears that *there was a relatively high “pass-through” of the additional income generated by the payments to landowners, many of whom are not the actual operators of the land.* It appears that the payments primarily had the effect of increasing the value of the principal fixed asset in agriculture—land.⁴⁰⁹

258. While the majority of the economic literature to date has focused on production flexibility contact and market loss assistance payments, its conclusions remain valid for direct and counter-cyclical payments. These studies confirm that, because of pass-through to non-operator landlords, the scope for payments such as counter-cyclical payments to influence production is small, contrary to Brazil’s assertions. As the OECD study concludes:

If PFC and MLA payments were captured largely by landowners through higher land values and land rents, then the scope for these payments to influence agricultural production would be narrowed. Farmers renting land would not be able to use payments associated with their rented land to cover fixed or variable costs. These farmers would be no more able to secure capital from traditional lenders than in the absence of the payments. They would see no increase in wealth, at least on the land that they rent, ruling out a risk-related wealth effect. Expectations of future payments associated with rented land would not affect decisions by renters because they would not capture these payments. The payments would not affect a renter’s decision to remain in or to exit from agriculture, although they could affect a landlord’s decision to keep land in agriculture.⁴¹⁰

259. Brazil also purports to show that “[a] comparison of actual land rents and the amount of

⁴⁰⁸ Abler, David, and David Blandford. A Review Of Empirical Studies Of The Acreage And Production Response To US Production Flexibility Contract Payments Under The Fair Act And Related Payments Under Supplementary Legislation, Directorate For Food, Agriculture And Fisheries Committee For Agriculture, OECD, Paris, AGR/CA/APM(2004)21/FINAL, p.17 (March 25, 2005) (Exhibit US-32) (emphasis added).

⁴⁰⁹ Abler, David, and David Blandford. A Review Of Empirical Studies Of The Acreage And Production Response To US Production Flexibility Contract Payments Under The Fair Act And Related Payments Under Supplementary Legislation, Directorate For Food, Agriculture And Fisheries Committee For Agriculture, OECD, Paris, AGR/CA/APM(2004)21/FINAL, p.17 (March 25, 2005) (Exhibit US-32) (emphasis added).

⁴¹⁰ Abler, David, and David Blandford. A Review Of Empirical Studies Of The Acreage And Production Response To US Production Flexibility Contract Payments Under The Fair Act And Related Payments Under Supplementary Legislation, Directorate For Food, Agriculture And Fisheries Committee For Agriculture, OECD, Paris, AGR/CA/APM(2004)21/FINAL, p.17 (March 25, 2005) (Exhibit US-32).

direct and counter-cyclical payments per acre demonstrates that only a relatively small portion of the counter-cyclical payments could possibly be shifted to land rents or capitalized into the value of land.”⁴¹¹ However, this analysis too suffers from serious flaws. For one, Brazil uses for purposes of this comparison an average rental rate that is an *imputed* economic cost to land that USDA calculates by valuing the alternative uses of the asset (for example, renting it to another producer). So, for example, if a cotton farmer fully owns the land he operates, he would have no expenditures for land rental or for loans to pay for purchased land. However, USDA imputes an economic cost by valuing the alternative uses of the asset, such as renting it to another producer. This item does not represent “actual land rents,” as Brazil alleges.⁴¹²

260. In addition, the rental values that Brazil uses are an average for all base and non-base acres. This is not an appropriate comparison; the proper comparison would be to base acres only which would presumably have a higher rental value precisely *because* of the payments associated with them. Actual survey data shows a wide range of cropland rental rates depending on location and quality. For example, 2005 survey data for three key cotton-producing states are:⁴¹³

| | | |
|-------------|----------------------|-------------------------|
| Texas: | irrigated – \$57.50 | non-irrigated – \$23.00 |
| Mississippi | irrigated – \$93.00 | non-irrigated – \$60.00 |
| Georgia | irrigated – \$115.00 | non-irrigated – \$41.00 |

261. Thus, contrary to its assertions, Brazil’s purported “comparison of actual land rents and the amount of direct and counter-cyclical payments” does not support Brazil’s assertion that “the maximum capitalization of counter-cyclical payments would about \$15 dollars per acre, or about 20 percent of the value of counter-cyclical payments.”⁴¹⁴

262. In short, the evidence supports the conclusion that a substantial portion of counter-cyclical payments is being disposed of in a way that cannot have any effect on production. This is important evidence in assessing the effects of counter-cyclical payments and, together with the studies above finding minimal production effects, undermines Brazil’s claims that counter-cyclical payments have significant effects on production and world market prices of upland cotton.

(iii) Ratio of actual plantings on farms with upland cotton base acres to base acres held show that counter-cyclical payments do not induce planting of upland cotton

263. As the United States explained in its first written submission, there is yet further evidence

⁴¹¹ Brazil Rebuttal Submission, para. 148.

⁴¹² See e.g., U.S. Further Rebuttal Submission, para. 119.

⁴¹³ NASS, USDA, *Land Values and Cash Rents 2006*, Summary August 2006 (Exhibit US-87).

⁴¹⁴ Brazil Rebuttal Submission, para. 148.

indicating that, contrary to Brazil’s arguments, counter-cyclical payments do *not* have significant production inducing effects. Specifically, while Brazil alleges a “strong positive relationship” between holders of upland cotton base acres holders and upland cotton production,⁴¹⁵ the fact is that a significant portion of U.S. upland cotton planted acreage (over MY 2002-2005, an average of about 17 percent) is on farms with cotton planted acreage that exceeds cotton base acres, or, indeed, on farms with no cotton base acres at all. Moreover, even on farms that have upland cotton base acres (and thus may receive cotton counter-cyclical payments), the ratio of cotton *planted* acres to total upland cotton *base* acres was only 60 percent in MY 2002-2005. In other words, U.S. producers of upland cotton were planting only approximately 60 percent of the cotton acres that they planted in the historical period used to calculate base acres.

264. Brazil’s attempts to dismiss these facts as “unimportant” are inexplicable and baseless. To put this in context, recall that Brazil is arguing that counter-cyclical payments induce U.S. producers to produce upland cotton *despite the fact that they do not have to do so in order to get payments*. In other words, in Brazil’s view, something about the fact of holding upland cotton base acreage (and being eligible for payments thereon) has “significant” effects on the production of upland cotton. Given Brazil’s arguments, it would seem to be *very* “important” whether, in fact, U.S. producers holding upland cotton base acres are continuing to produce upland cotton and if so, whether they are producing cotton in such a way as to evidence the “significant” production effects that Brazil has alleged.

- How then can Brazil assert that it is “unimportant” that *in fact* U.S. producers who hold upland cotton base acres are only planting approximately 60 percent of the upland cotton acres that they planted in the historical period when the base acres were established – in other words, that U.S. producers have shifted 40 percent of their historical cotton acreage (for which they may receive counter-cyclical payments) away from cotton?

265. Not only does this appear to be quite “important;” it appears to undermine Brazil’s theory of significant production effects, especially Brazil’s unfounded assertions regarding producing for the possibility of base updating.

266. Brazil provides no legitimate answer to these questions. Rather, according to Brazil, the “important” fact is that 95 percent of U.S. upland cotton planted acreage was on farms that held upland cotton base acreage because this allegedly supports a finding that there is a “strongly positive relationship” between upland cotton production and recipients of upland cotton counter-cyclical payments. Brazil fails to explain what this has to do, however, with its claim that counter-cyclical payments have significant production effects. Indeed, the United States notes that the direct program shares exactly the same base acreage. Thus, the same “relationship” exists between upland cotton production and recipients of direct payments. Yet, this did support a

⁴¹⁵ Brazil Rebuttal Submission, para.114.

finding that direct payments had any significant production or price effects in the original proceeding. Brazil fails to explain why the analysis should be different for counter-cyclical payments.

(iv) Conclusion

267. Brazil has yet to submit any credible evidence showing the significant production effects from counter-cyclical payments that it alleges. Nor does it explain how its allegations square with (a) the recent studies showing, at most, minimal production effects, (b) the evidence showing that substantial amount of government payments, including counter-cyclical payments, are “passed-through” to non-operator landowners in the form of higher land rent and land values, or (c) the acreage data showing that, in fact, holding upland cotton base acreage has not induced upland cotton production.

b. Brazil has not provide evidence of the structure, design and operation of the marketing loan payment program that supports its claim of significant price suppression

268. Brazil’s rebuttal arguments about the structure, design, and operation of the marketing loan program are, yet again, premised on a mischaracterization of the U.S. arguments. Brazil asserts that “the United States argues that upland cotton producers do not expect to receive marketing loan payments. . . . The United States argues that marketing loan payments . . . have no effect on planted acreage, no effect on production, no effect on exports, and no effect on the world price of cotton.”⁴¹⁶ This is not what the United States has argued and the United States respectfully refers the Panel to the U.S. first written submission at paragraphs 203-225 where the actual U.S. arguments are set out in detail.

269. The United States has argued that, to determine whether marketing loan payments have effects in any given year, it is necessary to examine the planting decisions made by U.S. producers in light of the conditions as they existed as of the time of planting for each marketing year (*i.e.*, January-March).⁴¹⁷ A producer *expectations* at that time about market revenue and/or revenue from government payments, costs and other factors will determine whether cotton or some other crop is planted, or if the land is put to other use. Brazil conceded this point in the original proceeding: “Brazil counters that farmers decide what to plant based on expected market prices as well as expected payments under the challenged subsidy programs, such that planted acreage responds to both these factors.” And Brazil, through its economic model, accepts – and

⁴¹⁶ Brazil Rebuttal Submission, para.101.

⁴¹⁷ *See e.g.*, Cotton Percent Planted, 15 Selected States (Exhibit US-44).

ostensibly attempts to implement – the same principle in this proceeding.⁴¹⁸

270. While Brazil implicitly agrees today (and explicitly agreed in the original proceeding) as to the correct analysis, it fails to provide any credible evidence showing that U.S. cotton producers' expectations regarding marketing loan payments have actually led to significant shifts in planting. Instead, as "evidence," Brazil refers to a newspaper article citing a U.S. farmer as saying "[w]e're just playing a game. . . . [Market] prices don't have anything to do with what we're doing. We're just looking at the government payments."⁴¹⁹ This statement is not even consistent with Brazil's own arguments in this dispute let alone a credible basis for a finding of significant price suppression. Indeed, as discussed above, in a nationwide survey of farmers yielding over 4,000 observations, almost half of farmers (44 percent) responded that counter-cyclical payments were "not at all important" to their acreage decisions and another 43 percent of farmers indicated that counter-cyclical payments were "unimportant" or "neither important or unimportant" to their decisions. The statement of the single farmer Brazil repeatedly cites must be weighed in view of the overwhelming evidence that counter-cyclical payments do not figure largely in the production decisions of most farmers.

271. Brazil provides no other evidence. Instead, it attempts to discredit the U.S. efforts to assess the actual planting decisions made by U.S. farmers in MY 2006 as well as other recent years. Brazil asserts that "the United States made the very same arguments regarding cotton farmers' expectations before the original panel and Appellate Body. They were all rejected."⁴²⁰ This argument is baseless; Brazil itself argued before the Appellate Body that the original panel *had* assessed the impact of marketing loan program payments taking into account the information submitted by the parties on expected prices and payments.⁴²¹ Indeed, it is inexplicable that Brazil would suggest that the panel and Appellate Body rejected the same approach to assessing

⁴¹⁸ See Brazil First Written Submission, Annex I, para. 36 ("U.S. cotton producers respond to the *expected* prices and *expected* rates of subsidy that apply at the time planting and other key decisions are made in the production cycle") (emphasis added) and Brazil First Written Submission, Annex I, para. 58 ("[t]he magnitude of the impact on incentives to produce cotton is equal to the *expected* difference between the loan rate, which is known at planting time, and the grower's *expectations* at the time of planting about the AWP for cotton that will apply when the grower makes that marketing loan transaction.") (emphasis added). Brazil Further Submission, Annex I, para. 17-18.

⁴¹⁹ Brazil Rebuttal Submission, para. 102 (citing "Cotton bailout: How your tax dollars prop up big growers and squeeze the little guy," Atlanta Journal-Constitution, 1 October 2006, p. 2, accessed December 2006 at <http://www.ajc.com/search/content/metro/stories/cotton1.html>) (Exhibit BRA-563).

⁴²⁰ Brazil Rebuttal Submission, para. 101.

⁴²¹ *Upland Cotton (AB)*, para. 441 ("We note that the United States presented extensive evidence and arguments to the Panel in relation to expected prices and planting decisions. Brazil also points to several questions asked by the Panel and responses to the Panel regarding planting decisions of United States upland cotton producers to demonstrate that the Panel was aware of the United States' arguments in this regard *and took them into account*. The Panel Report makes it clear that the Panel specifically addressed '*upland cotton planting decisions*', '*expected prices*', and '*expected market revenue*." (emphasis added).

production decisions that Brazil’s own econometric model relies upon here.⁴²²

272. Brazil also challenges the U.S. approach of using futures prices minus a 5 cent basis to assess whether, in any given year, a U.S. producer might have expected to receive a marketing loan payment at the time of harvest and marketing. Brazil argues, at length, that the proper approach would require discounting the futures price substantially since allegedly “[t]he AWP is typically far lower than the average price of the December futures contract at the time of planting (*i.e.*, February).”⁴²³ This is simply another variation on Brazil’s oft-repeated mistake of attempting to explain producers’ planting decisions based on actual prices at time of harvest, rather than expected prices at the time of planting.

273. Recall that the question is one of what producers had in mind at the time of planting. The question is *not* whether they were ultimately right or wrong. Brazil has explained that “[t]rading [in the New York Cotton Exchange’s futures market] is conducted with price levels reflecting the daily perception of the market participants worldwide on *how prices of cotton will develop in the future, as well as in the near and medium-term.*”⁴²⁴ Thus, under Brazil’s own explanation, the average New York futures price in January-March 2006 for the December cotton contract – which is the price used by the United States in its assessment of U.S. producers’ planting decisions – reflects the perceptions of U.S. producers at the time of planting regarding the prices that will prevail at the time of harvest.

274. In any event, the United States has examined the planting decisions made by U.S. producers even in those years when expected prices were lower than the marketing loan payment program threshold of USD\$0.52 (including MY 2005, which Brazil insists is an important year for purposes of its “present” serious prejudice claim). As explained in the U.S. first written submission, the market reports show that *even in those years*, U.S. producers’ planting decisions were shaped by market factors (for example, in MY 2005, “excellent planting moisture” and “impact of Asian rust on soybeans”).⁴²⁵ Brazil has provided no evidence in rebuttal (nor can it). Instead, it has attempted to dismiss this analysis by simply asserting that it is “mere speculation.”⁴²⁶ Brazil’s assertion is devoid of explanation, citation, or support. It is, furthermore, entirely baseless as the U.S. analysis is based on planting reports compiled by

⁴²² To the extent Brazil suggests that the original panel or Appellate Body “rejected” U.S. arguments about whether and how the marketing loan program payments have affected planting decisions under *current* (*i.e.*, MY 2006) market conditions, Brazil is patently wrong. Neither the original panel nor the Appellate Body had this question of “present” significant price suppression relating to MY 2006 before it. Moreover, the original panel specifically *declined* to address any of Brazil’s future-looking claims that would have required it to consider the conditions that might have appeared *likely* to prevail in MY 2006.

⁴²³ Brazil Rebuttal Submission, para. 107.

⁴²⁴ Brazil First Written Submission, Annex II, para. 15.

⁴²⁵ U.S. First Written Submission, para. 234.

⁴²⁶ Brazil Rebuttal Submission, para. 108.

USDA that Brazil *itself* submitted as evidence.⁴²⁷

275. In short, Brazil fails to demonstrate that the marketing loan program payments – taking into account the particular structure and design of the program, and the way that it operates under the current market conditions – *are* in fact causing production effects that are so significant as to be suppressing the world market price for cotton. In particular, Brazil fails to analyze properly the planting decisions made by U.S. producers in light of the market conditions and considerations that they *actually* faced at the time of planting, even as Brazil concedes that this is the appropriate inquiry. While Brazil attempts to discredit the U.S. analysis of producers’ planting decisions, it has provided no legitimate basis for its arguments. Brazil has, thus, clearly failed to make a *prima facie* case of breach in this regard.

c. *Size of outlays under the marketing loan and counter-cyclical payment programs*

276. In its first written submission, the United States challenged the evidence that Brazil has submitted purportedly to show that “[t]he continued high magnitude of U.S. marketing loan and counter-cyclical payments for upland cotton supports the existence of a causal link between these two subsidies and significant price suppression in the world market for upland cotton.”⁴²⁸ As the United States explained, Brazil’s “evidence” consisted of nothing more than (a) Brazil’s own self-serving characterizations of the size of outlays under the programs; and (b) unfounded assertions about the alleged “enormous advantage” that the marketing loan and counter-cyclical payment programs provide to U.S. producers and exporters to “secure sales.”⁴²⁹

277. Notably, Brazil does not even defend the latter assertions in its rebuttal submission. Moreover, with respect to the former, Brazil’s sole response is that “Brazil notes that the United States does not dispute that the annual amounts of marketing loan and counter-cyclical payments are ‘large,’ ‘very large,’ ‘huge,’ or ‘massive.’”⁴³⁰ Brazil misses the point. As the United States explained in its first written submission, it does not consider that such a labeling exercise advances the analysis in this proceeding. One reason is evident when one considers Brazil’s changing arguments regarding the Step 2 program and, in particular, its insistence that outlays under the Step 2 program now be labeled as “relatively modest” for purposes of this proceeding.⁴³¹ Another reason is that such labeling says nothing about the effects of payments on

⁴²⁷ U.S. First Written Submission, para. 234 (discussing Cotton and Wool Situation and Outlook Yearbook at 2 (November 2005) (BRA-448))

⁴²⁸ U.S. First Written Submission, para. 238 (Brazil First Written Submission, para. 119).

⁴²⁹ Brazil First Written Submission, paras. 114 and 115.

⁴³⁰ Brazil Rebuttal Submission, para. 168.

⁴³¹ This was not an argument Brazil made in the original proceeding. To the contrary, there, Brazil argued that, notwithstanding the different size of outlays under the programs, they should each be labeled generically as “very large.” Brazil Appellee Submission, para. 464.

world market prices. In Brazil's words, "very large untargeted subsidies can have small effects, while a highly-targeted subsidy can have much greater effects relative to its size."⁴³²

278. Rather than attempting to substantiate its assertions that the size of government outlays under the marketing loan and counter-cyclical payment programs "supports the existence of a causal link between these two subsidies and significant price suppression in the world market for upland cotton,"⁴³³ Brazil argues that the Panel should demand from the United States certain data that would allow Brazil to allocate counter-cyclical payments for both cotton base acres and non-cotton base acres to upland cotton production using its self-titled "Brazil methodology."⁴³⁴ As the United States explained in its letter dated January 19, 2007, the United States has already submitted the data that Brazil seeks in respect of MY 2005 (MY 2006 is not yet available and earlier years are not relevant to Brazil's claim of "present" serious prejudice). Brazil's request is, therefore, now moot.

279. More importantly, there is no basis for Brazil's argument that counter-cyclical payments should be allocated according to the so-called "Brazil methodology." Indeed, Brazil's argument misrepresents the panel and Appellate Body's analyses in the original proceeding and ignores the resulting recommendations and rulings of the DSB. This "Brazil methodology" was *not* applied in the context of the panel's assessment of significant price suppression, as Brazil has implied, and therefore neither the Panel's finding of serious prejudice, nor the resulting DSB recommendations and rulings, extended to counter-cyclical payments for non-cotton base acres. Rather, as is clear from a review of Brazil's citations,⁴³⁵ the so-called "Brazil methodology" was only addressed in the context of the original panel's analysis of "support to a specific commodity" under Article 13(b) of the *Agreement on Agriculture* (the "Peace Clause" analysis). And, even in that context it was specifically *rejected*. In fact, while Brazil touts the original panel's characterization of this methodology as "appropriate,"⁴³⁶ that panel did not rely on the methodology in its Peace Clause analysis.⁴³⁷ Brazil fails to mention, in addition, that when it raised the methodology on appeal, the Appellate Body specifically indicated that the methodology was unacceptable:

⁴³² Brazil Appellee Submission, para. 485 (16 November 2004).

⁴³³ Brazil First Written Submission, para. 119.

⁴³⁴ This is the methodology under which Brazil attempts to further exaggerate the amount of counter-cyclical payments by including payments made in respect of base acres for other programs crops simply because they were made on farms on which the number of acres planted to cotton exceeded the number of upland cotton base acres held by the farm operator. Brazil Rebuttal Submission, para. 171.

⁴³⁵ Brazil cites to paragraph 7.646 of the original panel report in its rebuttal submission. See Brazil Rebuttal Submission, para. 172, n. 273. Moreover, in its November 1, 2006 letter in which it first requested this data, the citations are to the following paragraphs: 7.608-7.633 and 7.641-7.647. These citations relate to the section of the original panel report entitled "Conclusion regarding Article 13(b)" and to an "Attachment to Section VII:D" (which is itself entitled "Domestic Support Measures and Article 13 of the *Agreement on Agriculture*").

⁴³⁶ See, e.g., Brazil Rebuttal Submission, para. 172.

⁴³⁷ *United States – Upland Cotton (Panel)*, para. 7.580.

[W]e see little in the Panel's finding or on the record that would allow us to discern a link between the support-conferring measures with respect to non-cotton historical base acres and current production of upland cotton. *We do not, therefore, accept the methodology submitted by Brazil* that included, in the Article 13(b)(ii) calculation, payments with respect to both cotton and non-cotton base acres flowing to current production of upland cotton.⁴³⁸

280. Thus, because “support-conferring measures with respect to non-cotton historical base acres” were *not* included in the support found to exceed the limitation in the Peace Clause proviso, such measures were exempt, by virtue of the Peace Clause, from actions, including Brazil’s serious prejudice claims. Therefore, there could have been no, and there were no, DSB recommendations and rulings with respect to such measures, and counter-cyclical payments for non-cotton base acres are not “measures taken to comply” within the meaning of DSU Article 21.5.

d. Conclusion

281. As discussed above, Brazil has yet to submit any persuasive evidence regarding the structure, design, and operation of the marketing loan and counter-cyclical payment programs, or their magnitude, that demonstrates that “the effect” of those measures is significant price suppression. This reason alone provides a basis for dismissing claims against the marketing loan and counter-cyclical payment programs under Articles 5(c) and 6.3(c) of the *SCM Agreement* for failure to make a *prima facie* case.

2. Brazil Fails To Provide Any Credible Evidence Showing That U.S. Producers and Exporters Do Not Respond To Market Signals

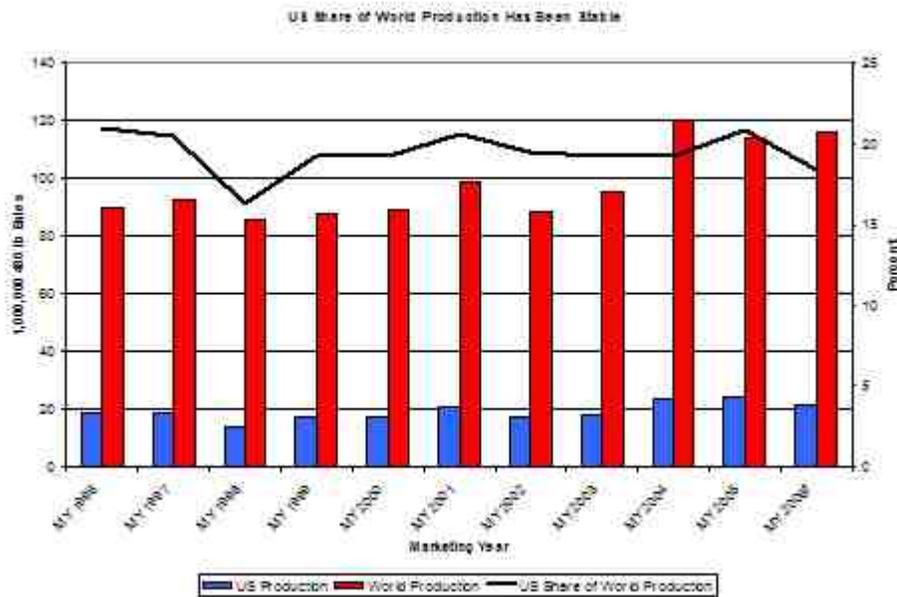
a. The empirical evidence confirms that Brazil’s theory of market insulation is baseless

282. Brazil’s arguments in this dispute regarding the allegedly significant price suppressive effects of the marketing loan and counter-cyclical payment programs fail for one simple reason: the empirical evidence fatally undermines Brazil’s theory.

283. Brazil’s theory is that (a) U.S. marketing loan and counter-cyclical payments provide revenue when market prices are low; (b) because U.S. producers receive revenue from the U.S. marketing loan and counter-cyclical payment programs when market prices are low, they do not heed market signals to curb their production; (c) as a result, they do not “reduce[] plantings,

⁴³⁸ *United States – Upland Cotton (AB)*, para. 380.

production, and exports” “like any rational non-subsidized producer”⁴³⁹ faced with comparatively low market prices; and (e) the excess production and exports ultimately significantly suppress world market prices.⁴⁴⁰ However, Brazil has no credible answer to the a fundamental question in this regard – *if U.S. producers continue to plant and produce, and U.S. exporters continue to export, in circumstances where “any rational non-subsidized producer” would have “reduced plantings, production, and exports,” why has U.S. share of world production and world exports not increased over the life of the FSRI Act of 2002?*



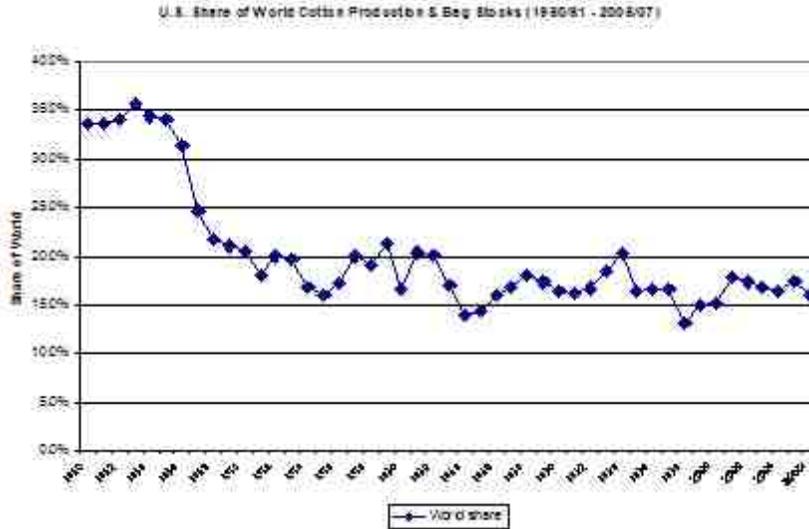
Source: USDA, PS&D⁴⁴¹

284. Far from increasing, U.S. share of world production has been stable over the entire life of the FSRI Act of 2002 and, in fact, for many years prior to that. As shown below, the U.S. share of world production has been stable from well before *either* the marketing loan or the counter-cyclical payment program came into effect. This fact, alone, is sufficient to reject Brazil’s claims about the alleged “insulation” brought on by those programs.

⁴³⁹ Brazil Rebuttal Submission, para. 199.

⁴⁴⁰ Brazil Rebuttal Submission, paras. 180-208.

⁴⁴¹ U.S. Production Supply and Distribution (Exhibit US-27); World Production Supply and Distribution (Exhibit US-27).



Source: USDA, PS&D⁴⁴²

285. The stable share of U.S. production indicates that whatever signal the “world market” is sending, U.S. producers are receiving it clearly and responding to it in much the same way as their foreign counterparts. This is clear not only when one considers market share but also when one considers the rate of change in change in production from year to year.

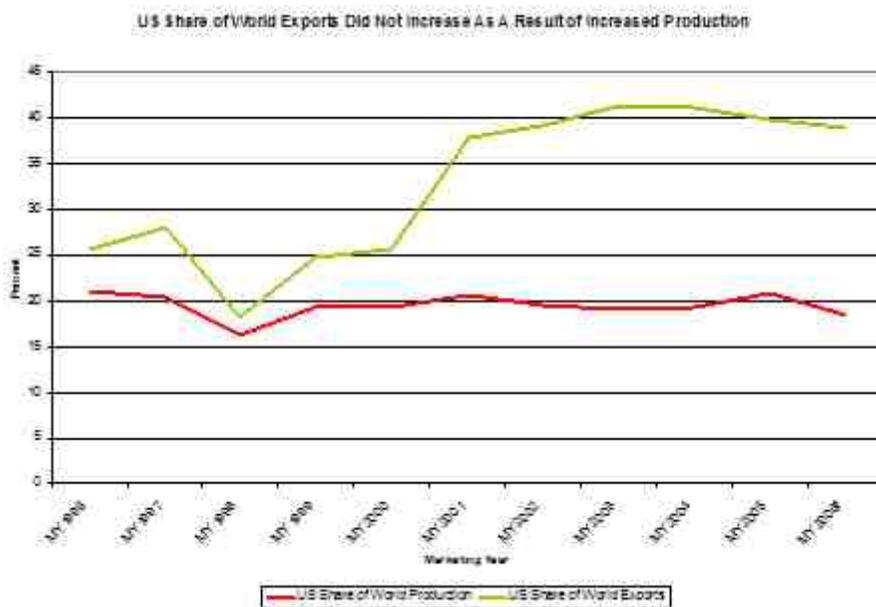
⁴⁴² U.S. Production Supply and Distribution (Exhibit US-27); World Production Supply and Distribution (Exhibit US-27).



Source: USDA, PS&D⁴⁴³

286. Moreover, while U.S. share of world market exports increased in the period MY 1999-2002, for the reasons explained by the United States in its first written submission (and acknowledged by Brazil's own cotton industry), U.S. share of world exports has been stable over the entire period of the FSRI Act of 2002 as well.

⁴⁴³ See U.S. Rebuttal Submission Data Tables; U.S. and Foreign Production Change (Exhibit US-83).



Source: USDA, PS&D⁴⁴⁴

287. Brazil does not rebut the U.S. evidence. Nor can it. Instead, it attempts to confuse the issues. In its rebuttal submission, Brazil expends significant effort to show that the U.S. marketing loan and counter-cyclical payments provide income support to U.S. producers when prices are low.⁴⁴⁵ Brazil peppers its discussion with baseless allegations that the United States “effectively asks this compliance Panel to overturn . . . one of the central findings of the original panel and the Appellate Body” as to whether payments under the programs provide income support.⁴⁴⁶ The Panel may disregard these allegations. The United States does not now – and has not ever – suggested that the marketing loan and counter-cyclical payment programs do not provide income support to U.S. producers. It is remarkable, in fact, that Brazil has submitted pages of argument and multiple charts to attempt to show what is clear from the formulae for payments under these programs – payments are provided when certain prices (the AWP in the case of the marketing loan payment program and the season average farm price in the case of counter-cyclical payment program) fall below certain thresholds. *That does not however respond to the question that is before the Panel.*

⁴⁴⁴ U.S. Production Supply and Distribution (Exhibit US-27); World Production Supply and Distribution (Exhibit US-27).

⁴⁴⁵ Indeed, the entire first section (paragraphs 180-194) of Brazil’s rebuttal submission relating to the alleged market “insulation” is devoted to this issue.

⁴⁴⁶ Brazil Rebuttal Submission, para. 181.

288. While Brazil would undoubtedly prefer that the inquiry stop with the question of whether the marketing loan and counter-cyclical payment programs provide income support in times of low prices the fact is that there is no WTO obligation to abstain from providing such income support. Indeed, the United States recalls the four “cases” under Article 6.3 of the *SCM Agreement* in which “serious prejudice” within the meaning of Article 5(c) “may” arise – *i.e.*, where one or more of the following apply:

- (a) the effect of the subsidy is to displace or impede the imports of a like product of another Member into the market of the subsidizing Member;
- (b) the effect of the subsidy is to displace or impede the exports of a like product of another Member from a third country market;
- (c) 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;
- (d) the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years and this increase follows a consistent trend over a period when subsidies have been granted.⁴⁴⁷

289. As is apparent from the text, “income support” is not one of the four “cases” listed in Article 6.3. Instead, any subsidy – whether it is in the form of “income support,” preferential loan rates, debt relief, or anything else – implicates “serious prejudice” under Article 5(c) *only* if it causes one or more of the four types of “effects” reflected in Article 6.3.

290. This is consistent with the Members’ express acknowledgment in the context of the *Agreement on Agriculture* that there is nothing inherently problematic about income support programs; indeed, they may be so minimally trade distorting as to be free of the limitations that Members otherwise agreed to in the area of agricultural supports (*i.e.*, so-called “green box” measures under Annex 2 of the *Agreement on Agriculture*). Indeed, as this dispute amply demonstrates, even when income support measures are *not* deemed to fall within the parameters of the “green box,” they do not necessarily cause any of the effects in which serious prejudice may arise under Articles 5(c) and 6.3 of the *SCM Agreement*.⁴⁴⁸

⁴⁴⁷ (Footnote omitted).

⁴⁴⁸ Note that Brazil includes direct payments and crop insurance payments in Figure 6 of its rebuttal submission, attempting to show that these payments, too, allegedly “insulate U.S. upland producers’ income from market prices.” Brazil Rebuttal Submission, para. 190. However, as Brazil explained to the Appellate Body, “the

291. Thus, contrary to Brazil’s suggestions, the key question is *not* whether the marketing loan and counter-cyclical payment programs provide payments when prices are low (what Brazil terms “insulating United States producers *from low prices*”).⁴⁴⁹ The answer to that question is not in dispute; nor is determinative on the question of WTO-inconsistency that Brazil raises. Rather, the question is whether the provision of these payments is causing, at present, the kind of significant effects on planting, production, exports, and – ultimately – world market prices that Brazil alleges. As explained here and in the U.S. first written submission, Brazil has submitted *no* empirical evidence of these effects and, indeed, the empirical evidence that the United States has submitted flatly contradicts Brazil’s arguments in this regard.

292. Second, Brazil asserts that the U.S. arguments about the stable U.S. share of world production exports “boil down to an assertion that this compliance Panel could find that adverse effects from the marketing loan and counter-cyclical subsidies *only* if U.S. acreage, production, exports, and world market share continue to *increase*.”⁴⁵⁰ Brazil argues that “adverse effects” do not “arise” from “increases as such.”⁴⁵¹ Regrettably, Brazil, again, mischaracterizes the U.S. arguments.

293. The United States has *not* suggested that there can only be adverse effects where there are “increases as such” in “U.S. acreage, production, [or] exports.” The United States has noted the fact that increasing U.S. *share* of production and export is a necessary implication of *Brazil’s* theory of market insulation. Indeed, as the United States explained in its first written submission:

If U.S. producers *were* cut off from market signals, as Brazil alleges, one would expect that in times of anticipated low prices, foreign production would fall off but U.S. producers – allegedly expecting “large,” “very large,” “huge,” or “massive” U.S. government payments under the marketing loan and counter-cyclical payments programs – would continue to plant and produce at artificially high levels.³⁴⁰

³⁴⁰ If U.S. producers were to increase or maintain their plantings at the same time that foreign planting declined – or even if U.S. producers *decreased* their plantings, but less so than their foreign counterparts – they would substantially increase their share of world production. Indeed, this is what Brazil suggests in its first written submission. Brazil First Written Submission, para. 115 (“U.S. producers and exporters can afford to produce and successfully market their

[original] Panel’s analysis demonstrates that even billions of dollars in particular types of subsidies provided to upland cotton producers (such as PFC, DP and crop insurance subsidies) may not be sufficient to cause a particular type of serious prejudice.” Brazil Appellee Submission, para. 493.

⁴⁴⁹ Brazil Rebuttal Submission, para. 183.

⁴⁵⁰ Brazil Rebuttal Submission, para. 197.

⁴⁵¹ Brazil Rebuttal Submission, para. 198.

upland cotton even at low world market prices because the U.S. Government makes up the difference in the U.S. producers' bottom-line revenue. Brazilian and other non-subsidized producers do not have that luxury.")

294. Brazil has not provided any valid rebuttal to the U.S. arguments in this regard. Instead, it touts "the obvious proposition" that "in the absence of price-contingent subsidies, which cover a significant portion of U.S. upland producer' total costs, U.S. acreage, production, and exports would decline."⁴⁵² Brazil cannot satisfy its burden of proof through the self-serving assertion of "obvious propositions." In any event, as noted above, the empirical evidence does not support Brazil's arguments and, as discussed below in Section IV.C.4, Brazil's assessment regarding costs of production is fundamentally flawed.

295. Third, Brazil asserts that the stable U.S. share of world production and exports is *itself* evidence that U.S. producers and exporters do not respond to market signals. In other words, Brazil appears to believe that the Panel should consider as evidence that U.S. producers and exporters *do not* respond to market signals, (a) the fact that U.S. producers *do* respond to market signals in much the same way as foreign producers and (b) the fact that exporters *do* respond to market signals in much the same way as foreign exporters. This is an absurd argument. As noted above, a key aspect of Brazil's theory of significant production- and price-effects is that U.S. producers and exporters do not "reduce[] plantings, production, and exports" "like any rational non-subsidized producer"⁴⁵³ faced with comparatively low market prices. The facts simply do not support this assertion. As such, Brazil's theory – which is premised on this assertion – is clearly without basis.

b. Brazil does not submit any credible evidence to support the alleged "strong link" between the marketing loan and counter-cyclical payment programs and U.S. planted acreage, production, or exports

296. In its first written submission, Brazil claimed to demonstrate an alleged "strong link" between the marketing loan and counter-cyclical payment programs and allegedly "high levels" of U.S. planted acreage, production and exports.⁴⁵⁴ Brazil indicated that it would demonstrate this alleged "strong link" by showing an alleged *absence* of a "link" between "prices, on the one hand, and [U.S.] planted acreage, production, and exports, on the other hand. . . ."⁴⁵⁵ Towards this end, Brazil presented a series of flawed comparisons between U.S. plantings, production, and exports and prices; comparisons that failed even to take into account the most basic facts of upland cotton production and that made serious misstatements about the bases for U.S. producers' planting

⁴⁵² Brazil Rebuttal Submission, para. 198.

⁴⁵³ Brazil Rebuttal Submission, para. 199.

⁴⁵⁴ Brazil First Written Submission, para. 137.

⁴⁵⁵ Brazil First Written Submission, para. 145.

decisions.⁴⁵⁶ The United States identified the flaws in Brazil’s analysis in its first written submission.⁴⁵⁷

297. Brazil’s rebuttal submission not only fails to address the identified defects in logic but Brazil now presents an even *more* flawed and misleading comparison between U.S. *planted* acreage and foreign *harvested* acreage (a fact that it carefully buries in footnotes). The United States responds to Brazil’s rebuttal arguments and new comparison below.

298. First, in its first written submission, Brazil presented two charts purporting to compare annual U.S. upland cotton production and export levels to farm prices for each marketing year.⁴⁵⁸ The United States explained that neither comparison was defensible. In the case of its comparison relating to U.S. production, Brazil assumed incorrectly that (a) planting decisions can be explained *solely* on the basis of cotton prices; (b) U.S. farmers *know* at the time that they plant (in January-March of a given year) what the actual farm price will be in the upcoming marketing year, which does not even start until August; and (c) U.S. farmers know and can control all the factors that will affect the ultimate level of production.⁴⁵⁹ In the case of its comparison relating to U.S. exports, Brazil failed even to address the important developments in the U.S. textile and apparel industry – the main U.S. consumer of upland cotton – that were responsible for the changes in U.S. export patterns in the period MY 1998 to 2002 (developments that, ironically, Brazil’s own cotton industry has no difficulty recognizing).⁴⁶⁰

299. Brazil complains that the United States “makes much of a single paragraph and two accompanying graphs” and asserts – inexplicably and without support or citation – that its comparisons are “simply provided an alternative means of updating, for the period 2003-2005, the original panel’s findings that U.S. producers’ planted acreage decisions do not respond to futures prices.”⁴⁶¹ Brazil’s failure to offer a valid defense for its analysis confirms that the analysis is baseless and not helpful in analyzing the issues before the Panel.

300. Second, Brazil presented a chart purporting to compare “changes in futures prices and amount of planted acreage.”⁴⁶² The United States observed that the comparison looked only to changes in futures prices for *upland cotton*, which is an inappropriate basis for assessing U.S. producers plantings decisions. Those decisions are not based a multitude of factors including, importantly, *the relative attractiveness of cotton compared to competing crops*. Brazil itself has

⁴⁵⁶ Brazil First Written Submission, para. 142-145..

⁴⁵⁷ U.S. First Written Submission, paras. 253-269.

⁴⁵⁸ Brazil First Written Submission, paras. 144-145.

⁴⁵⁹ U.S. First Written Submission, paras. 262-265.

⁴⁶⁰ U.S. First Written Submission, para. 266-269 and 249.

⁴⁶¹ Brazil Rebuttal Submission, para. 219.

⁴⁶² Brazil First Written Submission, para. 142.

specifically acknowledged the importance of competing crops in the planting decision before the Appellate Body, stating that an examination of farmers' planting decisions would "depend on [examining] projected or expected net returns from planting upland cotton, as compared to planting some other crop."⁴⁶³

301. Despite this, Brazil now asserts that the panel and Appellate Body *rejected* the *fact* that U.S. producers base their planting decisions in consideration not only of upland cotton but also of other factors, including those relating to competing crops.⁴⁶⁴ Brazil's assertion is unfounded. Indeed, looking at the paragraph of the Appellate Body's report that Brazil cites in support of its allegation that the latter allegedly "rejected" the U.S. arguments regarding competing crops, one finds the Appellate Body actually clarifying that "the Panel *did* take into account evidence of this kind" (i.e., "data showing that 'U.S. upland cotton planted acreage did respond to expected market prices of cotton and other competing crops.'")

302. Having offered no basis for the acreage/production/export comparisons conducted in its first written submission, Brazil now asserts that it is "revealing" but "contrary to the U.S. argument" to compare "foreign acreage" with New York upland cotton futures prices.⁴⁶⁵ Brazil's argument here is unavailing. For one, it continues to compare acreage *solely* with upland cotton futures prices. As the United States and Brazil have both acknowledged this is an inappropriate and overly simplified basis on which to assess planting decisions. Second, Brazil compares U.S. *planted* acreage with foreign *harvested* acreage. This fact alone fatally undermines Brazil's analysis.

303. Third, in Figure 8 of Brazil's rebuttal submission, Brazil purports to show that "foreign acreage is broadly in line with the developments in expected prices as measured by futures market prices. By contrast, as noted previously, U.S. acreage is essentially stable and does not show any relationship to futures prices."⁴⁶⁶ However, this is simply sleight of hand on Brazil's part; as is apparent from Brazil's chart, foreign acreage (even *harvested* acreage) is many orders of magnitude greater than U.S. planted acreage. Plotted against one another in a chart, U.S. planted acreage will *inevitably* appear to be flat relative to foreign acreage. The point can be illustrated by replicating Brazil's chart to include a number of other producers of upland cotton:⁴⁶⁷

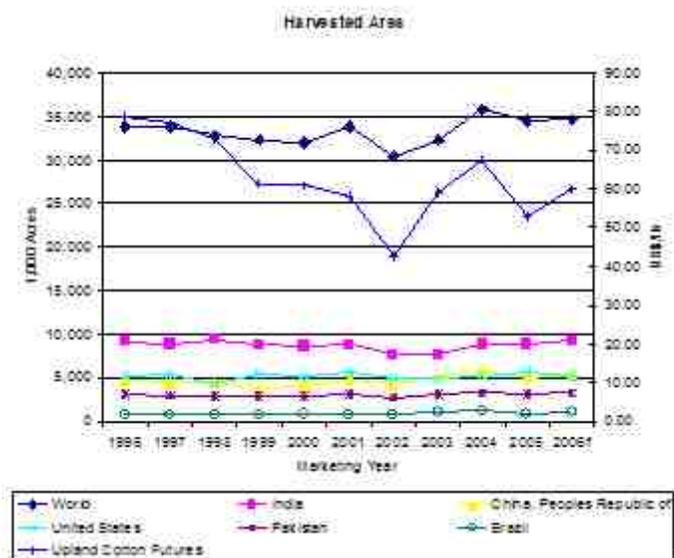
⁴⁶³ See e.g., Brazil Appellee Submission, para. 689.

⁴⁶⁴ Brazil Rebuttal Submission, para. 214.

⁴⁶⁵ Brazil Rebuttal Submission, para. 221.

⁴⁶⁶ Brazil Rebuttal Submission, para. 222.

⁴⁶⁷ The United States includes "world" rather than "foreign" totals since there are a number of countries charted.



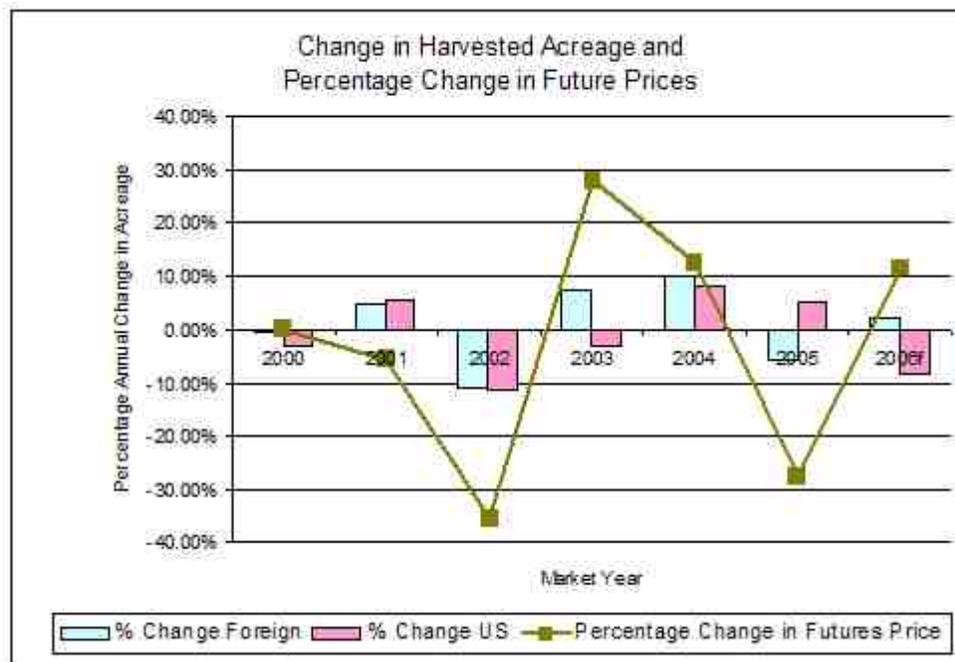
304. Surely, Brazil is not suggesting that *no country* (itself included) “reacts to changes in expected prices, as measured by the New York futures price at planting time because, based on this representation, their acreage appears “essentially stable and does not show any relationship to futures prices”? The United States submits that such an assertion would be baseless if made against every country depicted above; it is no less baseless when made with respect to the United States.

305. Brazil attempts also to compare *changes* in U.S. *planted acreage*, changes in foreign *harvested* acreage, and *changes* in the futures prices for upland cotton, asserting that “the differences in direction and intensity of acreage response” between U.S. and foreign producers “are consistent with the conclusion that U.S. producers are still ‘numbed’ from market forces.”⁴⁶⁸ Here again, the comparison of changes in acreage solely to upland *cotton* futures is inappropriate and unhelpful in assessing planting decisions.

306. Moreover, when the same (flawed) analysis is conducted using harvested acres, it is apparent that the analysis *undermines* rather than *supports* Brazil’s claims that the marketing loan and counter-cyclical payment programs are causing significant production, export, and price suppressive effects. The United States stresses, in this regard, that this is not an proper comparison because *planting decisions* are more appropriately assessed by looking at *planted acres*; harvested acres may be affected by any number of factors including weather, pest problems and other things that are entirely out of the control of producers. Therefore, the United States does *not* endorse the following comparison. Indeed, the assessment is useful in part because it

⁴⁶⁸ Brazil Rebuttal Submission, para. 224.

demonstrates precisely the very limited utility of Brazil's approach.



307. As shown above, foreign and U.S. harvested acreage *both* increased in MY 2001, even though futures prices *fell*. In MY 2002, U.S. foreign and U.S. harvested acreage *both* fell as futures prices fell even further. In MY 2003, U.S. harvested acreage *decreased* but foreign harvested acreage *increased* as futures prices increased. In MY 2004, *both* U.S. and foreign acreage increased even though prices increased far less than the year before. In MY 2005, U.S. harvested acreage increased and foreign acreage decreased as futures prices fell compared to year before. In MY 2006, U.S. acreage is projected to decline and foreign acreage is projected to increase slightly; futures prices are increased from year-before.

308. What this comparison shows is that *neither* U.S. nor foreign harvested acreage moves closely in line with futures prices of cotton alone. Nonetheless, even if the comparison were valid (and it is not), it would show that, where changes in U.S. and foreign area diverge, U.S. harvested acreage tends to react more *conservatively* than foreign acreage to increasing prices (as in MY 2003 and 2006).

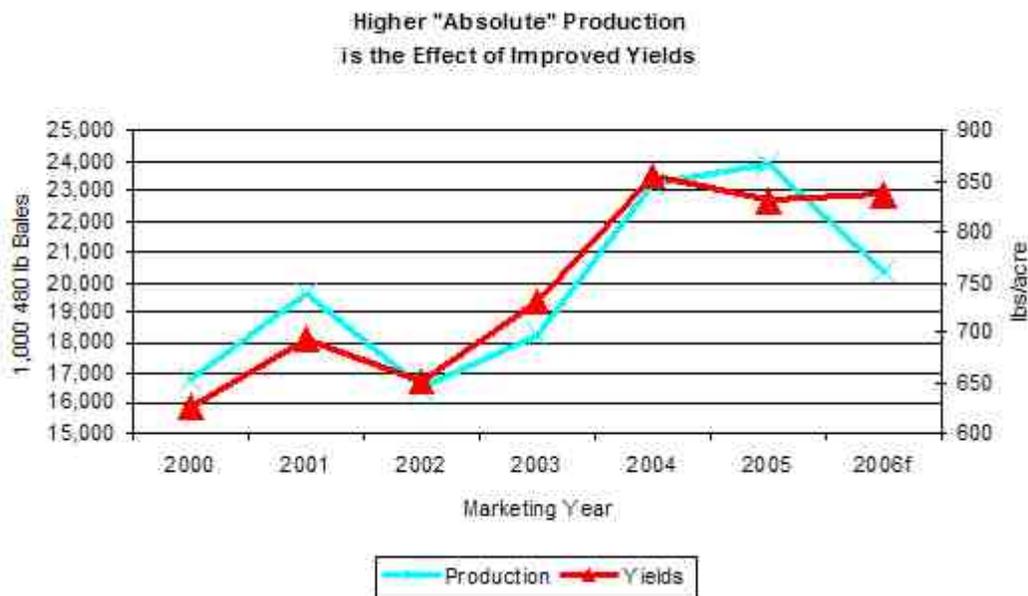
309. For the reasons above, it is apparent that none of the empirical evidence that Brazil has submitted in support of its claim of significant price suppression actually provides such support. Thus, even now, Brazil fails to make any *prima facie* case of breach under Articles 5(c) and 6.3(c) of the *SCM Agreement*.

c. *Brazil continues to assert incorrectly that increased absolute levels of production are “the effect” of the marketing loan and counter-cyclical payment programs*

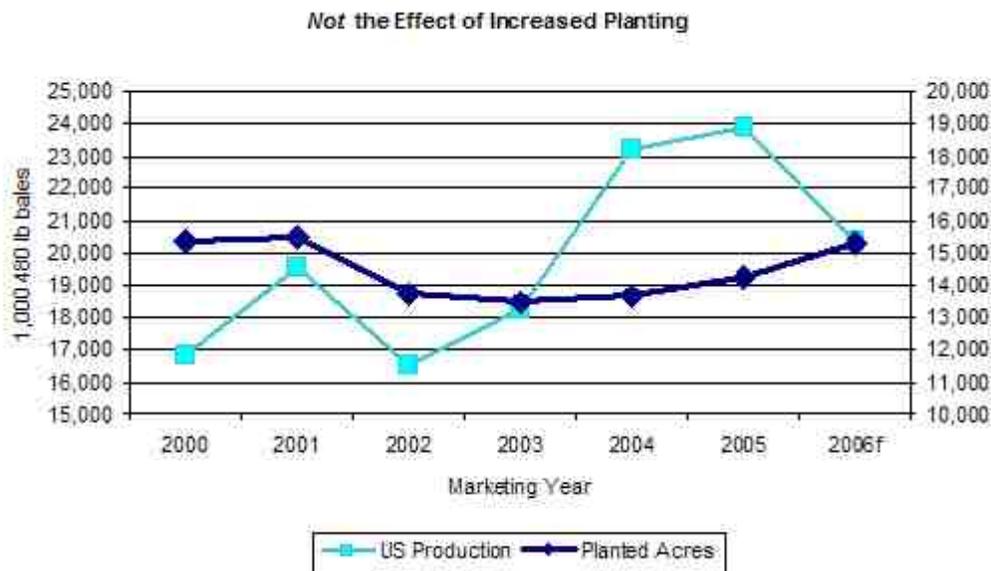
310. Brazil continues to assert incorrectly that *increases* in the absolute levels of U.S. production over the period from MY 2002-2005 were the effect of the marketing loan and counter-cyclical payment programs.⁴⁶⁹ But Brazil’s arguments in this regard are not even internally consistent, let alone supported by the facts.

311. Brazil purports to “emphasize[]” that “this argument was directly tied to its arguments that *one effect of the U.S. subsidies was to maintain high levels of planted acreage.*” The fact is, however, that U.S. planted acreage has been relatively stable over the life of the FSRI Act. Thus, any *increase* in production was *not* the result of any change in planting on the part of U.S. producers. To the extent absolute levels of production *increased*, under these circumstances, they did so because of factors such as the record yields in the period from MY 2002 though 2005.

312. This is clear when one compares changes in absolute levels of production in MY 2002-2005 to changes in yields, on the one hand, and planted acreage, on the other. As shown in the following charts from the U.S. first submission, the absolute level of U.S. production increased from MY 2002 to MY 2005. At the same time, yields increased at the almost identical rate. By contrast, from MY 2002 to MY 2005, there is no similar increase seen in U.S. planting.



⁴⁶⁹ Brazil Rebuttal Submission, paras. 226-233.



Source: USDA, PS&D,⁴⁷⁰ USDA NASS

313. In light of the above, Brazil has “no legitimate basis” to argue that any increase in U.S. production in the period MY 2002 to 2005 is the result of the U.S. marketing loan and counter-cyclical payment programs. Brazil cannot, therefore, credibly suggest that this analysis provides empirical evidence of the alleged “link” between U.S. marketing loan and counter-cyclical payment programs and the alleged suppression of world market prices.

3. Brazil Fails to Show Any “Discernible Temporal Coincidence” Between the Marketing Loan and Counter-cyclical Payment Programs and Any Alleged “Significant Price Suppression”

314. The United States demonstrated in its first written submission that, contrary to its assertions, Brazil had not “reinforce[d] the original panel’s finding . . . of a discernible temporal coincidence of suppressed world market prices and the price-contingent U.S. subsidies.”⁴⁷¹ In rebuttal, Brazil once again attempts to mischaracterize the U.S. arguments; this time with language that it simply invents and attributes to the United States. Brazil asserts that “the United States accuses Brazil of seeking to establish causation by using only a ‘simple correlation’ –

⁴⁷⁰ U.S. Production Supply and Distribution (Exhibit US-27); Foreign Production Supply and Distribution (Exhibit US-27).

⁴⁷¹ U.S. First Written Submission, paras. 277-291.

which, according to the U.S. reading of the Appellate Body’s decision, would not be sufficient to demonstrate causation.”⁴⁷²

315. The United States does not do so (indeed, the term ‘simple correlation’ does not appear anywhere in the U.S. first written submission). The United States has instead cited the Appellate Body’s clarification that “mere correlation between payment of subsidies and significantly suppressed prices would be insufficient, without more, to prove that the effect of the subsidies is significant price suppression.”⁴⁷³ Moreover, the United States has argued that Brazil *has not even established a “mere correlation.”*⁴⁷⁴

316. In particular, the United States walked through each factor considered by the original panel in making its finding of a “discernible temporal coincidence” and demonstrated that these do *not* support finding of a “discernible temporal coincidence” between the marketing loan and counter-cyclical payment programs and any “present” significant price suppression. Specifically, the United States showed that:

- U.S. planted acreage has been stable for the entire period that the FSRI Act has been in effect and, in fact, is substantially lower now than in the period examined in the original proceeding. Thus, since the FSRI Act came into effect, there has been no “overall increase” in plantings similar to that observed by the panel in the original proceeding.⁴⁷⁵
- U.S. share of production has not increased over the period of the FSRI Act, as it appeared to do between MY 1998 and MY 2002, the period examined by the original panel. To the contrary, U.S. share of world production *declined* slightly from MY 2002 to 2003 (from 19.5 to 19.2 percent), and stayed at that level until MY 2005, when it shifted up slightly (to 20.9 percent), returning to a level only slightly higher than in MY 2001 (when it was at 20.6 percent).
- The U.S. prices received by U.S. upland cotton producers have not decreased since the FSRI Act came into effect. Rather, prices (the U.S. farm, mill, and spot prices and the A-Index) moved up in MY 2003, moved down in MY 2004, but moved up again in MY 2005. And they are projected to continue to increase.⁴⁷⁶
- The A-Index has trended downwards for more than 25 years now – well before the FSRI Act came into effect – and the fact that the A-Index has gone *up* from the

⁴⁷² Brazil Rebuttal Submission, para. 232.

⁴⁷³ U.S. First Written Submission, para. 277 (citing *Upland Cotton (AB)*, para. 451).

⁴⁷⁴ U.S. First Written Submission, para. 277.

⁴⁷⁵ *Upland Cotton (Panel)*, para. 7.1351.

⁴⁷⁶ Compiled Statistics – Prices & Futures (Exhibit US-25).

levels that prevailed *before* the FSRI Act came into effect as of MY 2002 would tend to suggest that, to the extent there is any price *suppression*, it is not “the effect” of the marketing loan and counter-cyclical payment programs.

- Although the absolute volume of U.S. exports has gone up over the period of the FSRI Act, U.S. share of world exports has *not* increased. To the contrary, it *declined* in MY 2005.
- U.S. imports of upland cotton have been at low levels for many decades and, as the U.S. textile industry shrunk, the demand for cotton generally has declined (whether domestically produced or imported). The low level of imports, therefore, has little to do with the marketing loan and counter-cyclical payment programs.

317. Brazil’s attempt to rebut this evidence consists of the recycled – and unsubstantiated – assertions, including that the stability of U.S. production and export market share is evidence of significant price suppression. The United States has rebutted these Brazilian arguments above, and they are equally unavailing in this context.

318. One remarkable aspect of Brazil’s rebuttal, however, is Brazil’s assertion that it should be excused from making even the minimum showing of a “discernible temporal coincidence” as conducted by the original panel – *i.e.*, which would not even be sufficient *alone* to support a finding of significant price suppression – because that would require showing “significant *additional* levels of trade distortion” in the MY 2001-2005 period. The implications of Brazil’s assertion are disturbing. In essence, Brazil’s position appears to be that “discernible temporal coincidence” means simply asserting that the current market conditions are evidence of “significant price suppression,” regardless of whether those conditions are dynamic or static, whether U.S. planted acreage, exports and production increase, decrease, or remain stable, and whether foreign planted acreage, production, and export shifts are comparable.

319. Indeed, before the original panel, Brazil argued that it was the dynamic situation in the market – and the resulting decline in prices – that should simply be attributed, by virtue of a “discernible temporal coincidence,” to the Step 2, marketing loan, and counter-cyclical payment programs. Now, there is no such dynamic situation – instead, there is, in Brazil’s words, a “relatively stable state of affairs” and prices appear to be rebounding. But that appears to be of no consequence to Brazil’s claims. Now, Brazil simply asserts that it is the “relatively stable state of affairs” itself that should be deemed to be evidence of the “significant price suppressive” effects of the marketing loan and counter-cyclical payment programs. (And the evidence of rebounding prices is irrelevant, in Brazil’s view, because its claim is of significant “price suppression” – *i.e.*, price effects that only its economist can “discern”).

320. Brazil’s approach effectively eviscerates the balance of rights and obligations struck in Articles 5(c) and 6.3(c) of the *SCM Agreement* and the requirement that a complaining party

make a *prima facie* case of breach; that approach cannot be credited.

4. Cost of Production

321. Brazil argues in this proceeding that there is a “gap” between U.S. upland producers’ total costs and their market revenue from the production of upland cotton.⁴⁷⁷ In Brazil’s view, payments under the marketing loan and counter-cyclical payment program are “the most crucial subsidies” able to fill this alleged “gap” and *only* “gap”-filling by those two programs allows U.S. producers to remain in the business of producing cotton.⁴⁷⁸ As the United States has explained, however, Brazil’s arguments are based on an incomplete and distortive analysis that ignores fundamental facts of upland cotton production.⁴⁷⁹

a. The economic literature and the Appellate Body agree that variable costs are important in assessing year-to-year planting decisions and total costs are relevant in making longer-term decisions

322. In its rebuttal submission, Brazil asks the Panel to disregard the fact that producers make year-to-year planting decisions with reference primarily to *variable* costs of production (among other factors) and that *total* costs (among other factors) are relevant with respect to longer-term decisions, such as whether to exit the cotton sector. The economic literature that the United States has submitted in this dispute confirms these fundamental facts.⁴⁸⁰ And Brazil has not submitted any economic literature or empirical data that contradicts the U.S. evidence.

323. However, Brazil insinuates that the U.S. arguments have already been “asserted and lost before the original panel and Appellate Body.”⁴⁸¹ Brazil is wrong. Indeed, as Brazil later concedes, the Appellate Body expressly stated that:

[w]e agree with the general proposition of the United States that variable costs may play a role in farmers' decision-making as to whether to plant upland cotton or some alternative crop, and how much of each crop to plant. From a short-term perspective, variable costs may be particularly important.⁴⁸²

Moreover, the Appellate Body agreed that “from a longer-term perspective, total costs may be

⁴⁷⁷ Brazil Rebuttal Submission, para. 246.

⁴⁷⁸ Brazil Rebuttal Submission, para. 246.

⁴⁷⁹ U.S. First Written Submission, paras. 292 *et. seq.*

⁴⁸⁰ The United States discussed the extensive literature in this regard in its submissions to the panel in the original proceeding. *See e.g.*, U.S. Further Rebuttal Submission in the Original Proceeding, paras. 117-122 (18 November 2003).

⁴⁸¹ Brazil Rebuttal Submission, para. 248.

⁴⁸² *Upland Cotton (AB)*, para. 453.

relevant. Thus, contrary to Brazil's suggestions, the U.S. approach to variable and total costs vis-a-vis the planting decision is both accepted and appropriate here.

b. Brazil has not shown that U.S. producers are unable to meet their variable costs of production without marketing loan and counter-cyclical payment programs

324. The United States has addressed Brazil's arguments bearing in mind that there are two ways in which production costs could possibly affect production. With respect to year-to-year planting decisions, the United States showed that U.S. producers covered their variable costs in every year that the FSRI Act has been in effect, including in MY 2005.⁴⁸³ Therefore, it was economically rational for U.S. producers to have produced upland cotton in these years. Brazil suggests, in its rebuttal submission, that the reasonableness of the producers' planting decisions should be determined on the basis of *expected* costs and *expected* revenue. Unlike futures prices, however, there is no ready measure of producers' *expected costs*. Nonetheless, the United States notes that, for the period of the FSRI Act, MY2002-2005, the January-March average futures price for the December contract for upland cotton was 56 cents/lb.⁴⁸⁴ In comparison, variable costs for upland cotton in the same period were only an average of 36 cents/lb.⁴⁸⁵ Thus, it is apparent that, contrary to Brazil's assertions, U.S. producers likely expected to cover their variable costs of producing upland cotton.

325. Brazil now accuses the United States of "mischaracteriz[ing] land, labor, and capital recovery costs as fixed costs, when they are, in fact, *variable costs*."⁴⁸⁶ Brazil then attempts to inflate the variable costs by shifting these items into that category, arguing that when the variable costs are adjusted in this way, U.S. producers actually do *not* cover their variable costs. As discussed below, Brazil's efforts to recharacterize land, labor, and capital recovery costs are not supported by the economic literature.⁴⁸⁷ Moreover, Brazil has provided no factual basis for its

⁴⁸³ U.S. First Written Submission, para. 300.

⁴⁸⁴ U.S. Rebuttal Submission Data Tables; Area Harvested (Exhibit US-83).

⁴⁸⁵ See chart below.

⁴⁸⁶ Brazil Rebuttal Submission, para. 257 (emphasis in original).

⁴⁸⁷ Brazil's insistence that the Panel rely on an ICAC study to conduct cross-country cost assessments is equally baseless. Brazil Rebuttal Submission, para. 284-288. As the United States has noted, that study warns that "[r]eal comparisons among countries are difficult due to a *lack of complete data from all countries*. Difficulties also exist because of the method of estimating cost of production, the relative significance of different inputs in production systems and estimation of opportunity costs. *Data should be used carefully*, particularly when comparing net cost per kilogram of lint . . . Survey of the Cost of Raw Cotton, International Cotton Advisory Council, at 5 (November 2004). Brazil provides no valid reason why the Panel should disregard the study's own warnings and nonetheless conduct the kind of superficial comparisons that Brazil is urging. Indeed, Brazil fails to explain how this study supports its claim of significant price suppression. Brazil's view appears to be that a producing country's market share must be directly proportional to its cost structure. This is an overly-simplistic suggestion that ignores the many factors other than cost that could possibly affect market share and does little to advance the analysis of the

approach; it has not shown that farmers actually take these costs – for example, an “imputed cost of unpaid labor”⁴⁸⁸ – into account in each year in deciding between planting cotton or some other crop or putting the land to some other use. That is, after all, the purpose of the analysis – to understand how producers *actually* make planting decisions and the extent to which marketing loan payments and counter-cyclical payments *actually* affect those decisions.

(i) Brazil’s attempts to inflate the variable costs of producing upland cotton are unfounded

326. As noted above, Brazil asks Panel to reject the long-standing practice of USDA and the agricultural economists⁴⁸⁹ and treat land, labor, and capital recovery costs as variable cash costs. Brazil’s argument is, however, devoid of support and is untenable with respect to land, *unpaid* labor, and capital recovery costs. With respect to *paid* labor that does not have farm ownership claims, there is difference in opinion as to whether to classify the costs as fixed or variable. Accordingly, as a conservative measure, for purposes of the assessment below, the United States considers that cost as a variable cost. As shown below, however, this does not change the results of the assessment.

327. **Opportunity cost of unpaid labor.** Brazil’s assertion that an imputed value for the opportunity cost of unpaid labor should be treated as a variable cash outlay has no basis in the economics literature.⁴⁹⁰ There are two major categories of farm labor recognized in agricultural economics: (1) hired labor without farm ownership claims, and (2) unpaid farm labor and salaried farm labor having ownership claims.⁴⁹¹ “Opportunity cost,” which is the basis for classifying unpaid labor as an economic cost under the category “allocated overhead” is not a cash outlay.⁴⁹² Consistent with this, and contrary to Brazil’s assertions, the ICAC does *not* treat an imputed value for the opportunity cost of unpaid labor as a variable cash outlay.⁴⁹³ In fact, the ICAC standard

issues before the Panel.

⁴⁸⁸ Brazil Rebuttal Submission, para. 264.

⁴⁸⁹ Brazil Rebuttal Submission, para. 257.

⁴⁹⁰ Brazil Rebuttal Submission, para. 264.

⁴⁹¹ *Commodity Costs and Returns Estimation Handbook*, updated 09/30/2005, A Report of the AAEA Task Force on Commodity Costs and Returns. (Exhibit US-88).

⁴⁹² *Commodity Costs and Returns Estimation Handbook*, updated 09/30/2005, A Report of the AAEA Task Force on Commodity Costs and Returns. (Exhibit US-88) (“though unpaid farm labor does not generally receive a wage, it does have an economic cost. Implicit compensation for unpaid farm labor is based on the opportunity cost of off-farm work, or the return available in the next best alternative use of this labor time and effort.”)

⁴⁹³ The ICAC does *not* employ any category labeled “labor” that appears under its variable costs of production. See Survey of the Cost of Production of Raw Cotton, ICAC, November 2004, Glossary, page 103-104 (Exhibit BRA-480).

format does not even provide for the opportunity cost of unpaid labor.⁴⁹⁴

328. **Land costs are properly treated as a fixed cost:** Brazil's assertion that land should be treated as a variable cash cost⁴⁹⁵ also has no support in agricultural economics. A determinative factor as to whether an input cost can be classified as a fixed or a variable cost is whether it is the cost of an expendable or capital input. Land is clearly a capital input.⁴⁹⁶ Contrary to Brazil's assertions, whether or not there is a vibrant land rental market does not change this fact.

329. Brazil asserts that the ICAC includes the cost of land as a variable cost of production and claims this as support for Brazil's proposed treatment of land. However, although the ICAC describes land cost as "land rent for cotton," it is unclear what this variable measures.⁴⁹⁷ To the extent that ICAC does include land costs as a variable cash input, the United States notes that it is not consistent with accepted practice in agricultural economics.⁴⁹⁸

330. Brazil also asserts that even land that is *owned* by a farm operator should be included as a variable cash cost.⁴⁹⁹ Once, again, Brazil's argument is untenable and disregards the key distinction between capital and expendable inputs. Moreover, there is no conceptual justification in the economics literature to include an opportunity cost for land as a variable input cost.⁵⁰⁰

331. **Capital recovery costs should not be treated as a variable cash cost:** Brazil also asserts

⁴⁹⁴ Brazil Rebuttal Submission, 11 January 2007, para. 264. See Survey of the Cost of Production of Raw Cotton, ICAC, November 2004, Glossary, page 103-104 (Exhibit BRA-480).

⁴⁹⁵ Brazil Rebuttal Submission, para. 265.

⁴⁹⁶ *Commodity Costs and Returns Estimation Handbook*, updated 09/30/2005, A Report of the AAEA Task Force on Commodity Costs and Returns. (Exhibit US-88) ("An important distinction is drawn between expendable inputs which are used up during the production period and capital inputs which provide service over several production periods. Land has at least two distinguishing characteristics. The first is its location fixity. As a result of land's location fixity, if the control of land is to be transferred, the users of the land must relocate their production activities. Land's second distinguishing characteristic is its ability to maintain over time and use its physical qualities that give it value. Capital [is defined as] a stock that is not used up during a single production period, provides services over time, and retains a unique identity. Land is thus clearly a capital input. And because land can exist for a long time without significant deterioration, it is also considered to be a durable input. . . . Land that can exist for an infinitely long time without significant deterioration is referred to as an infinitely lived durable.")

⁴⁹⁷ In the case of the United States, for example, the ICAC appears to include the opportunity cost for land from the USDA cost and returns data. For 2004, the opportunity cost of land for U.S. cotton was \$47.71 per planted acre, or \$117.89 per hectare. This compares to the ICAC entry for land rent of \$117.67 per hectare. The ICAC data contains 51 entries for 30 countries. 34 of the 51 entries and 19 of the 30 countries have data for "cotton land rent," which means that costs for many countries are underestimated. See Exhibits BRA-480 and US-47.

⁴⁹⁸ *Commodity Costs and Returns Estimation Handbook*, updated 09/30/2005, A Report of the AAEA Task Force on Commodity Costs and Returns. (Exhibit US-88).

⁴⁹⁹ Brazil Rebuttal Submission, 11 January 2007, para. 265.

⁵⁰⁰ *Commodity Costs and Returns Estimation Handbook*, updated 09/30/2005, A Report of the AAEA Task Force on Commodity Costs and Returns. (Exhibit US-88).

that capital recovery costs (depreciation of durable goods such as machinery and equipment) should be treated as a variable cash cost.⁵⁰¹ Again, Brazil fails to appreciate the distinction between a capital asset and a variable input.⁵⁰²

Capital assets are factors of production that are not used up during a single production period, provide services over time, and retain a unique identity. The term durable asset is often used to describe physical capital because the word durable denotes not temporary or long-lived.

*It is common in preparing cost of production estimates to assume that durables such as machinery and buildings provide a constant quality of service over their lifetime with regular maintenance.*⁵⁰³

332. Brazil fails to provide any support for its argument that capital recovery costs should be classified as variable costs and, not surprisingly, fails to complete such a calculation itself.

(ii) Prices were sufficiently high to cover variable costs of production and, in many cases, total costs of production both on a national and regional basis

333. As discussed above, Brazil’s novel proposals regarding reclassification of costs find no support in the agricultural economics literature, and Brazil provides no valid basis for these changes. Brazil’s new cost estimates based on the attempted reclassifications are thus unfounded and should be dismissed.⁵⁰⁴

334. Moreover, even classifying *paid* labor as a variable cost – as suggested by some of the economics literature⁵⁰⁵ – it is apparent that U.S. upland cotton producers have been able to more than cover their operating costs, and much of their overhead costs over the period 1999 -2005.

Average Upland Cotton Lint Costs and Returns

| | 2002 | 2003 | 2004 | 2005 |
|------|------|------|------|------|
| Item | | | | |

⁵⁰¹ Brazil Rebuttal Submission, 11 January 2007, para. 266.

⁵⁰² *Commodity Costs and Returns Estimation Handbook*, updated 09/30/2005, A Report of the AAEA Task Force on Commodity Costs and Returns. (Exhibit US-88).

⁵⁰³ *Commodity Costs and Returns Estimation Handbook*, updated 09/30/2005, A Report of the AAEA Task Force on Commodity Costs and Returns. (Exhibit US-88) (emphasis added).

⁵⁰⁴ Brazil Rebuttal Submission, paras. 269-271.

⁵⁰⁵ *Commodity Costs and Returns Estimation Handbook*, updated 09/30/2005, A Report of the AAEA Task Force on Commodity Costs and Returns. (Exhibit US-88).

| | | | | |
|-----------------|------|------|------|------|
| Total costs | 0.77 | 0.52 | 0.53 | 0.59 |
| Operating costs | 0.42 | 0.33 | 0.32 | 0.37 |
| Harvest price | 0.42 | 0.66 | 0.51 | 0.48 |

1/ Adjusts for cottonseed revenue/ginning costs as described below and includes hired labor.
 Source: USDA⁵⁰⁶

335. Contrary to Brazil’s assertions, these results hold for regional costs in MY2004 and MY2005 as well:

Upland Cotton Lint Costs and Returns by Region

| Item | Heartland | Prairie Gateway | Southern Seaboard | Fruitful Rim | Mississippi Portal | Eastern Uplands |
|-----------------|-------------------|-----------------|-------------------|--------------|--------------------|-----------------|
| | dollars per pound | | | | | |
| 2004 | | | | | | |
| Total costs | 0.44 | 0.51 | 0.61 | 0.44 | 0.57 | 0.54 |
| Operating costs | 0.28 | 0.28 | 0.38 | 0.26 | 0.37 | 0.34 |
| Price | 0.48 | 0.53 | 0.44 | 0.54 | 0.49 | 0.46 |
| 2005 | | | | | | |
| Total costs | 0.54 | 0.52 | 0.61 | 0.57 | 0.68 | 0.48 |
| Operating costs | 0.34 | 0.31 | 0.39 | 0.35 | 0.45 | 0.31 |
| Price | 0.49 | 0.45 | 0.50 | 0.55 | 0.49 | 0.53 |

1/ Excludes ginning costs and includes hired labor.
 Source: USDA⁵⁰⁷

336. The above cost data is relevant in assessing Brazil’s “present” serious prejudice claims. In terms of Brazil’s “threat” claims, data for future marketing years show, similarly, that U.S. producers are forecast to more than cover operating costs, as well as a large share of total costs.⁵⁰⁸

Upland Cotton Lint Costs and Returns, Forecast 2006-2008

⁵⁰⁶ Cost of Production Data (Exhibit US-89)

⁵⁰⁷ See Regional Cost of Production Data (Exhibit US-90) and “Cost of production forecasts for U.S. major field crops, 2006-2008F” (“Exhibit Bra-575”).

⁵⁰⁸ The United States notes in this regard that recent yield improvements are not yet reflected in the FAPRI yield projections for MY2007-2008; the projections are far below recent yields. Using more realistic yield projection would render the costs and returns picture even more positive. Compare for example, to the higher yields reflected in the more recent baselines projections from the Congressional Budget Office (“CBO”) (Exhibit US-91).

| Item | 2006 | 2007 | 2008 |
|-----------------------|-------------------|------|------|
| | Dollars per pound | | |
| Total costs | 0.61 | 0.69 | 0.70 |
| Operating costs | 0.38 | 0.43 | 0.44 |
| Price | 0.46 | 0.53 | 0.55 |
| Yield (lb/harv. acre) | 819 | 763 | 770 |

1/ Adjusts for cottonseed revenue/ginning costs as described below and includes hired labor.
Source: USDA⁵⁰⁹

337. Finally, Brazil argues that the fact that the cost data represent *averages* can mask differences in cost structures.⁵¹⁰ However, contrary to Brazil's suggestions, the effect of this is to *understate* the cost-effectiveness of U.S. producers. Indeed, when one considers actual share of production of high, middle, and low-cost farms, it is apparent that, contrary to Brazil's suggestions, the overwhelming majority of U.S. production took place on farms that not only met their variable (operating) costs but also their total costs. Indeed, only high-cost producers, accounting for approximately 8 percent of U.S. production, did not cover their operating costs in 2003.⁵¹¹

Costs of Production for Cotton, by Cost Group, 2003

| Item | Low-cost | Middle-cost | High-cost | All farms |
|------------------------------|--------------------------|-------------|-----------|-----------|
| | dollars per planted acre | | | |
| Operating costs 1/ | 197.07 | 256.23 | 233.28 | 232.44 |
| Total costs | 356.29 | 446.24 | 388.22 | 408.41 |
| Operating costs (\$/lb.) | 0.20 | 0.33 | 0.79 | 0.31 |
| Total costs (\$/lb.) | 0.35 | 0.57 | 1.37 | 0.55 |
| Harvest month price (\$/lb.) | 0.64 | 0.67 | 0.68 | 0.66 |
| Actual yield (lb per acre) | 1,009 | 781 | 283 | 742 |
| Share of production (%) | 39 | 53 | 8 | 100 |

1/ Includes hired labor. Data on cottonseed value are not available. Using the average 2003 cottonseed revenue as a share of total value (13 percent), cottonseed value is assumed to account for 13 percent of total value of production. Ginning costs are then adjusted as described below.
Source: USDA⁵¹²

⁵⁰⁹ See e.g., Exhibit BRA-575, Exhibit BRA-479. The 2006 yield is from the January 2007 World Agricultural Supply and Demand Estimates (WASDE) Report (Exhibit US-92).

⁵¹⁰ Brazil Rebuttal Submission, para.272.

⁵¹¹ This is the last year in which USDA conducted a complete cost survey for upland cotton production; average cost data for upland cotton for more recent years are updated with price indices but the detailed survey data are not updated.

⁵¹² Exhibit US-93 (WTO-CONFIDENTIAL).

(iii) Ginning costs are appropriately excluded from the calculation of costs of production for U.S. upland cotton lint

338. Brazil accuses the United States of presenting a “misleading presentation of cost of production data” because it adjusts the seed cotton (i.e., cotton lint plus cottonseed) costs and revenues to isolate the revenue and costs for cotton lint (the product that is at issue under Brazil claims).⁵¹³ This accusation is baseless.

339. Brazil first complains that the United States has not provided support to establish the common practice in the United States of ginning costs being paid out of the proceeds gained by the gin from sale of the cottonseed separated out in the ginning process.⁵¹⁴ In this regard, the United States submits an annual survey of eight gins in the mid-south region conducted by a certified accounting firm located in Vicksburg, Mississippi.⁵¹⁵ Data for this survey is collected annually and is currently available for MY 2000-2005. The survey shows the following average net income for the gins per year:

2000 - \$30.56 per bale (only 7 gins in the survey)
2001 - \$18.36 per bale (8 gins surveyed)
2002 - \$23.19 per bale
2003 - \$27.28 per bale
2004 - \$19.76 per bale
2005 - \$11.49 per bale

340. The survey includes revenue from cottonseed sales, warehouse rebates, gain/loss on the sale of assets, mote sales, interest and other income. There is, however, no category for producer fees, confirming that ginning costs are not paid separately by producers.

341. In addition, the United States submits an annual report developed by a cooperative gin operated in California showing that in 2006 it provided its producer clients with rebate payments of approximately \$40.00 per bale, again reflecting the difference between the gin’s costs and revenue generated from cottonseed sales and other sources of income.⁵¹⁶ This suggests that, instead of subtracting from the cotton producer’s profit margin, many gins are able to *contribute* to the producer’s profit margin.

⁵¹³ Brazil Rebuttal Submission, para. 278.

⁵¹⁴ Brazil Rebuttal Submission, para. 279.

⁵¹⁵ Exhibit US-94.

⁵¹⁶ Annual Report of Buttonwillow, California gin (Exhibit US-95).

342. Brazil argues that “the U.S. assertion that cottonseed proceedings equal ginning costs is wrong as a matter of fact” because USDA’s cost of production data show ginning costs exceeding cottonseed proceedings.⁵¹⁷ However, the United States has never indicated that ginning costs “equal” revenue from cottonseed sales. As shown above, that revenue can exceed ginning costs and there may be circumstances in which ginning costs will exceed revenue from cottonseed. However, in order to replicate the costs that the U.S. producer contemplates for producing upland cotton lint, excluding ginning costs is an appropriate approach. It best approximates how cottonseed revenue and ginning costs are treated, as a matter of practice, in the U.S. industry.

343. The fact that USDA’s cost of production data shows ginning costs exceeding cottonseed revenue does *not* mean, moreover, that overall the former is greater than the latter, as Brazil assumes.⁵¹⁸ USDA determines the ginning cost by adding together total cash payment for ginning and various other cost items, such as compress, bag, and tie charges.⁵¹⁹ The sum is then multiplied by yield to get the per-acre cost which is reflected in the USDA cost data. This transfer to a per-acre basis means ginning costs increase when yields increase (even though the ginning cost per pound itself does not increase). Thus, the difference in amount between ginning costs and cottonseed revenue reflected in the USDA data does not undermine the fact that ginning costs are paid out of the latter, and that, as such, both are appropriately excluded in assessing costs and revenues for upland cotton lint. Nonetheless, to eliminate further complaints, the United States has, as a conservative measure, adjusted ginning costs for the cottonseed revenue and then included any excess in its calculation of costs above.

c. Brazil has no basis to contest the economic literature showing that long-term decisions about upland cotton production take total costs of producing upland cotton into account as one of many other factors including off-farm income and income from other sources

344. With respect to longer-term decisions, such as whether to continue or exit upland cotton farming, the United States has explained that the total cost of producing upland cotton is not the *sole* consideration.⁵²⁰ As the economic literature confirms, whole-farm costs and revenues – including off-farm revenue and revenue from other sources – are also important considerations in making those kinds of decisions.⁵²¹ Brazil’s attempts to show that U.S. producers would have

⁵¹⁷ Brazil Rebuttal Submission, para. 280.

⁵¹⁸ Brazil Rebuttal Submission, para.280.

⁵¹⁹ Cotton Costs and Returns Report, NASS, USDA (Exhibit US-96).

⁵²⁰ U.S. First Written Submission, paras. 295-297.

⁵²¹ See e.g., Hoppe, Robert A. and Korb, Penni. Understanding U.S. Farm Exits. Economic Research Report 21. June 2006, p. 20 (Exhibit US-46) (“Off-farm work has become important to farm operators. About one-third of farmers have worked off the farm at least 200 days per year—essentially full-time—since 1978. Off-farm work could hypothetically affect exits in two ways. First, off-farm work may be the first step in an exit from farming, which would be reflected in higher exits for farms the operators of which work off-farm. Second, off-farm

exited upland cotton production in the long-term solely on the basis of a comparison of costs and revenues for cotton are, thus, not sound.

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

346. Instead, Brazil relies on misstatements of the U.S. position to avoid addressing the actual issues. Brazil argues, for example, that “in essence” the United States “is asking the compliance Panel to ignore evidence of a \$98 billion long-term (MY 2000-2006) deficit between total costs and market revenue for upland cotton on the basis that farmers should be presumed to cross-subsidize upland cotton production with returns from other crops and off-farm revenue.”⁵²² And, in fact, far from suggesting that the long-term costs and losses of upland cotton production be ignored, the United States has argued that it is *one* factor among many others that affect U.S. upland producers’ long-term farming decisions. The United States has observed, in this regard, that Brazil cannot legitimately draw conclusions about whether U.S. producers would continue or exit upland cotton farming based on a comparison of the long-term costs and losses of upland cotton production alone. Moreover, the United States has not suggested that the Panel “presume cross-subsidization,” as Brazil asserts. Rather, the United States has submitted evidence that Brazil has yet to address – let alone rebut – showing that whole-farm costs and revenues are the relevant consideration in such long-term decisions.

347. Brazil’s sole response, in this regard, is that the income from other sources “is not legally or factually relevant *to an analysis of U.S. upland [cotton] production costs and returns.*”⁵²³ But Brazil appears to miss the point. The ultimate question before the Panel is not one regarding the balance of upland cotton production costs and returns. The question is whether the marketing loan and counter-cyclical payment programs are causing significant price suppression of the world market price for upland cotton. It is Brazil that raises “U.S. upland [cotton] production costs and returns” in this context because, according to Brazil, payments under these programs sustain upland cotton production that would otherwise not take place. Whether or not that is true is a factual question that is for Brazil to prove. The *fact* that U.S. producers consider more than just the balance of upland cotton costs and revenue in making long-term production decisions, including whether or not to exit cotton farming, hardly seems irrelevant to that question, as Brazil argues. To the contrary, an analysis – such as the one Brazil presents – that purports to show that U.S. producers would make *different* long-term production decisions in the absence of the marketing loans and counter-cyclical payments is not valid if it disregards how U.S. producers

work might lower the probability of exit by providing farm operator households with another source of income.”)

⁵²² Brazil Rebuttal Submission, para. 249.

⁵²³ Brazil Rebuttal Submission, para. 251.

actually make these decisions.

348. Finally, the United States notes that Brazil has yet to show that, even if some U.S. upland cotton producers were to decide to exit cotton farming in the absence of marketing loan and counter-cyclical payments, this would necessarily result in any significant decline in U.S. cotton plantings. Significantly, while Brazil recognizes that “there are many types of U.S. upland cotton farms, some with relatively higher costs, others with relatively lower costs” and asserts that there are “wide differences in cost structure,” Brazil provides no assessment as to the effect these differences would have in the event of any change in the marketing loan or counter-cyclical payment programs.⁵²⁴ For example, basic economic theory would dictate that even if “farms . . . with relatively higher costs” decided to exit cotton farming, “farms . . . with relatively lower costs” in the United States would simply expand their production to offset the decline. The fact that Brazil has not even addressed this issue, let alone provided relevant evidence also demonstrates that Brazil has not met its burden of proof.

5. Neither Brazil’s New Modeling Exercise Nor the Studies It Selectively and Misleadingly Cites Supports Its Claim of Significant Price Suppression

349. As discussed above, Brazil has not submitted any credible empirical basis for its claim that the U.S. marketing loan and counter-cyclical payment programs are causing “present” significant price suppression. Rather, Brazil’s claim depends, critically, on the new econometric modeling by Dr. Sumner, the economist it has retained for purposes this dispute. On the basis of its new model, Brazil asserts that “world market prices for upland cotton would have been 9 to 11 percent higher *but for* the effects of [the marketing loan and counter-cyclical payment programs in MY 2005].”⁵²⁵

350. Brazil’s new econometric model substantially overstates, however, any possible effects on world market prices from the removal of the marketing loan and counter-cyclical payment programs. As explained in the U.S. first written submission, Brazil has argued incorrectly that its new model “employs many of the same parameters used in the model and analysis submitted to the original panel, as well as parameters commonly used by USDA and Food and Agricultural Policy Research Institute (“FAPRI”) economists.”⁵²⁶ Brazil’s new model is actually based on a series of untenable economic assumptions that are *not* consistent with those used by FAPRI or USDA economists and were *not even used by Brazil in its own analysis before the original panel*.

351. When certain basic assumptions are changed to *actually* reflect FAPRI and other well-established parameters, the effects predicted by Dr. Sumner’s model decline sharply. Indeed, as

⁵²⁴ Brazil Rebuttal Submission, para. 272.

⁵²⁵ Brazil First Written Submission, para. 167 (emphasis in original).

⁵²⁶ Brazil First Written Submission, para. 168.

re-calibrated, the new model shows *complete* removal of the marketing loan and counter-cyclical payment programs resulting in an increase in world prices of only 1.41 percent over baseline levels over the period MY 2002-2005 and of only 0.96 percent over the period MY 2006-2008.⁵²⁷ Using long-run values for supply and demand elasticities, *complete* removal of the two programs would only show an increase in world prices of 2.26 percent over the period MY 2002-2005 and 1.52 percent over the period MY2006-2008.⁵²⁸ This dramatic change in effects – resulting from the adjustment of some very basic modeling parameters – confirms that Brazil’s modeling results are unreliable.

a. *Brazil’s arguments in support of its novel modeling approach directly contradict its arguments to the original panel*

352. In its rebuttal submission, Brazil concedes that it has *not* used “many of the same parameters used in the model and analysis submitted to the original panel, as well as parameters commonly used by USDA and . . . FAPRI economists.”⁵²⁹ Brazil asserts that the use of these novel modeling assumptions “reflect the opportunity to apply more appropriate parameters after being freed from the cumbersome restraints of the FAPRI framework.”⁵³⁰ And, in an attempt to establish the “appropriateness” of the new parameters – and discredit the re-calibration conducted by the United States using parameters consistent with FAPRI – Brazil now asserts that the FAPRI-based modeling framework was an “unnecessarily complicated and cumbersome model that was not directly appropriate to the issue at hand.”⁵³¹ These assertions directly contradict the arguments made by Brazil to the original panel.

353. Brazil did not argue in the original panel proceeding that the “significant price suppression” that it was purporting to show through its modeling exercise was the product of an “unnecessarily complicated and cumbersome model that was not directly appropriate to the issue at hand.”⁵³² Nor did Brazil suggest in that proceeding – as it attempts to do here – that the comprehensive nature of the FAPRI framework “often introduces potential error and makes the model unnecessarily complicated to operate and understand.”⁵³³ To the contrary, Brazil argued that the FAPRI model is “well-known,” “widely-used” and “well-established and detailed”:

Professor Daniel Sumner has used a well-established and detailed econometric simulation model of the U.S. farm programs and the world cotton market to

⁵²⁷ U.S. First Written Submission, Annex I, Table A-9.

⁵²⁸ U.S. First Written Submission, Annex I, Table A-9.

⁵²⁹ Brazil Rebuttal Submission, Annex I, para. 3.

⁵³⁰ Brazil Rebuttal Submission, Annex I, para. 3.

⁵³¹ Brazil Rebuttal Submission, Annex I, para. 4.

⁵³² Brazil Rebuttal Submission, Annex I, para. 4.

⁵³³ Brazil Rebuttal Submission, Annex I, para. 5.

analyze quantitatively the impacts of adjusting U.S. policy for upland cotton. The model is adapted from the well-known farm policy simulation framework developed by the Food and Agricultural Policy Research Institute (FAPRI) at Iowa State University and the University of Missouri. The FAPRI model has been widely used for policy analysis in the United States and elsewhere for almost 20 years. U.S. commodity groups, including the U.S. cotton industry, have regularly used the FAPRI model to analyze farm commodity program options. The FAPRI model is also the key model used by the U.S. Congress in considering farm program options. For almost two decades the U.S. Congress has provided special appropriations to support the continued use and development of the FAPRI model. In both the 1996 and the 2002 Farm Bill processes, the FAPRI model provided the most influential projections of likely program impacts.⁵³⁴

354. Further, insisting that the Panel should rely on the results of its allegedly “FAPRI-like” model, Brazil emphasized FAPRI’s expertise in “analyz[ing] the complex economic interrelationships of the food and agriculture industry”:

FAPRI uses comprehensive data and computer modeling systems to analyze the complex economic interrelationships of the food and agriculture industry. FAPRI’s mission is to provide objective qualitative and quantitative analyses of alternative U.S. and international agricultural policies.

FAPRI is considered the leading U.S. agricultural policy research institute and ever since the 1985 farm bill has conducted analyses of alternative policies that have helped shape U.S. farm legislation. In July 2002, FAPRI received the USDA Secretary’s Honor Award, the highest award bestowed by the U.S. Department of Agriculture, for its analysis of various farm bill proposals that led to the 2002 FSRI Act. Professor Bruce Babcock described the award as follows:

This award recognizes the outstanding research effort by FAPRI at [Iowa State University] and [the University of] Missouri in analyzing policy proposals during the 2002 farm bill debate. This group has dedicated itself to being the world’s best at conducting agricultural policy analysis.... World economic integration makes it increasingly vital that we understand the impacts of U.S. policy decisions on U.S. and world markets, producers and consumers. Increasing numbers of policy proposals and their complexity requires that we continually update our analytical capabilities and our market intelligence.

⁵³⁴ Brazil Further Submission, para. 214.

FAPRI is the leading research institution that fulfills this task in the United States. FAPRI prepares baseline projections each year for the U.S. agricultural sector and international commodity markets. The multi-year projections are published as FAPRI Outlooks, which provide a starting point for evaluating and comparing scenarios involving macroeconomic, policy, weather, and technology variables. These projections are intended for use by farmers, government agencies and officials, agribusinesses, and others who do medium-range and long-term planning. . . .

In sum, FAPRI is the most influential organization in the United States analyzing farm policy and its effects on U.S. and world commodity markets, i.e., that has the highest reputation and experience in answering the kind of “but for” questions faced by this Panel.⁵³⁵

355. It is simply astonishing that, having argued that FAPRI “has the highest reputation and experience *in answering the kind of ‘but for’ questions faced by this Panel*” in an effort to advance its allegedly “FAPRI-like” model in the original proceeding, Brazil now asserts that the model was an “unnecessarily complicated and cumbersome model *that was not directly appropriate to the issue at hand.*”⁵³⁶

356. These bald contradictions undermine Brazil’s new arguments about the alleged “significant improvement[s]” it has made in its modeling exercise. As discussed in detail in Annex I, these alleged “improvement[s]” are not “well-known,” “widely-used” or “well-established” and serve no purpose other than to inflate any possible effect of removing the marketing loan and counter-cyclical payment programs.

b. The inflated nature of Brazil’s modeling results is apparent when they are compared to the modeling results from the original proceeding

357. The fact that Brazil’s new model grossly exaggerates any possible effects of removing the marketing loan and counter-cyclical payment programs is apparent, as well, when one considers that Brazil now attempts to attribute to only *two* programs the same price effects that it had previously attempted to attribute to *six* programs. Specifically, in the original proceeding, Brazil asserted that the removal of the production flexibility contract/direct payments, market loss assistance/counter-cyclical payments, crop insurance payments, marketing loan payments, Step 2 payments, and some alleged subsidy component of the GSM-102 export credit guarantee program would have resulted in a total 12.6 percent impact on world price in MY 1999-2002 and a 10.8 percent impact in MY 2003-2007.⁵³⁷ Now, Dr. Sumner ascribes almost the *same* price impact

⁵³⁵ Answers of Brazil to Questions from the Panel After 2nd Meeting, paras. 21-24 (22 December 2003).

⁵³⁶ Brazil Rebuttal Submission, Annex I, para. 4.

⁵³⁷ Brazil Further Submission, Annex I, at 1, paras. 70-75.

(9.3 to 10.7 percent) to just the marketing loan and counter-cyclical payment program.⁵³⁸

358. Indeed, under Brazil’s original model, Brazil estimated that the price impact of removal of *just* the marketing loan and counter-cyclical payment programs in MY 2003-2007 would be 3.94 percent. Now, however, Brazil asserts an effect that is between *double* and *triple* that amount.

359. Brazil’s rebuttal arguments in this regard are unavailing. Brazil attempts, first, to dismiss as “relatively small” the differences between the price effects that it has attempted to attribute to the marketing loan and counter-cyclical payment programs between the original proceeding and this one.⁵³⁹ Brazil notes that in the original proceeding, it ascribed an average 6.33 percent effect to the marketing loan and counter-cyclical payment programs for the period MY 1999-2002. And, in the present proceeding, it ascribes an 8.30 percent difference to the same programs in the same period (MY 1999-2002). Brazil asserts that – despite this more than 30 percent inflation in the price effect – the results are “in fact, consistent.”⁵⁴⁰ The United States strongly disagrees.

360. Nonetheless, the United States appreciates Brazil’s clarification that it considers the difference between the two sets of results – *i.e.*, a 2 percent impact on world prices – to be of little consequence. This is an important clarification for purposes of the Panel’s assessment of whether Brazil has proven “significant” price suppression within the meaning of Article 6.3(c) of the *SCM Agreement* and “serious prejudice” to the interests of Brazil within the meaning of Article 5(c). As discussed above and in the U.S. first written submission, when Brazil’s model is re-calibrated to incorporate reasonable modeling parameters that are consistent with the “well-known,” “widely-used” and “well-established” parameters used by FAPRI economists (and relied upon by Brazil in the original proceeding), the model shows price effects of between 0.96-1.52 percent over the period MY 2006-2008.⁵⁴¹ Brazil’s clarification that a 2 percent impact on world prices can be disregarded confirms that there is, in fact, no “significant” price suppression that is “the effect” of the marketing loan and counter-cyclical payment programs.

361. The United States notes, in this regard, that Brazil suggests that only “a small portion” of the difference in effects is attributable to the different models, but that the remaining differences can be explained by “changes in the quantities of U.S. subsidies paid, U.S. production and U.S. exports among other issues.”⁵⁴² This is obviously untrue for the 2 percent difference that Brazil cites for MY 1999-2002; that difference is for the same exact period and involves precisely the same “changes in the quantities of U.S. subsidies paid, U.S. production and U.S. exports among other issues.” Moreover, even for later years (MY 2003-2007), Brazil fails to provide any explanation or support for its assertion that other factors are able to explain why it has increased

⁵³⁸ Brazil First Written Submission, Annex I, para. 9.

⁵³⁹ Brazil Rebuttal Submission, para. 296-297.

⁵⁴⁰ Brazil Rebuttal Submission, para. 296.

⁵⁴¹ U.S. First Written Submission, Annex I, Table A-9.

⁵⁴² Brazil Rebuttal Submission, para. 297.

its asserted price effects *almost three-fold*. In fact, there is no explanation other than that the unreasonable, unsupported modeling assumptions employed by Brazil in its new econometric model exaggerate any possible effects of removing the marketing loan and counter-cyclical payment programs.

c. Brazil's efforts to justify its flawed modeling results by comparing them to the results of studies examining completely different scenarios are logically unsound

362. Asserting the reasonableness of its newly-inflated results, Brazil argues that “Professor’s Sumner’s findings . . . are consistent with the findings of other economists.”⁵⁴³ Brazil lists in this regard, (a) a 2006 World Bank study that examines the elimination of *all* subsidies and tariffs across *all* countries and estimates that this amounts to a 12.9 percent impact on the world price for upland cotton,⁵⁴⁴ (b) a 2004 study by the Overseas Development Institute (“ODI”) that examines the elimination of domestic supports in the China, Greece, Spain, and the United States and estimates price effects of between 18-28 percent;⁵⁴⁵ (c) and a study by FAO that examines the elimination of all domestic support in all countries and estimates price effects of between 3.1 and 5 percent.⁵⁴⁶

363. One obvious flaw in Brazil’s reasoning is apparent even from this summary of the studies to which it cites: none of them addresses the particular question that Brazil raises as to whether or not the marketing loan and counter-cyclical payment programs have “present” significant price suppressive effects. *Every* one of the cited studies examines the effects of measures *in addition* to the marketing loan and counter-cyclical payment programs. This includes U.S. domestic support measures expressly found by the original panel to *not* be causing any significant price suppression, but also includes domestic support measures in other countries (in the case of *all* three studies), and tariffs in the United States and in other countries (in the case of the World Bank and FAO studies).⁵⁴⁷

364. In other words, *none* of the studies breaks out and attributes any effects to just the

⁵⁴³ Brazil Rebuttal Submission, para. 300.

⁵⁴⁴ Exhibit BRA-481 (Anderson, Kym and Valenzuela, Ernesto, “WTO Doha Cotton Initiative: A Tale of Two Issues,” Development Research Group, World Bank, February 2006).

⁵⁴⁵ Exhibit BRA-578 (Gilson, Ian et al., “Understanding the Impact of Cotton Subsidies on Developing Countries,” Overseas Development Institute).

⁵⁴⁶ Exhibit U.S-55(Poonyth, Daneswar, et al., “The Impact of Domestic and Trade Policies on the World Cotton Market,” FAO Commodity and Trade Policy Research Working Paper No. 8, April 2004).

⁵⁴⁷ Exhibit BRA-481 (Anderson, Kym and Valenzuela, Ernesto, “WTO Doha Cotton Initiative: A Tale of Two Issues,” Development Research Group, World Bank, February 2006), Exhibit BRA-578 (Gilson, Ian et al., “Understanding the Impact of Cotton Subsidies on Developing Countries,” Overseas Development Institute), and Exhibit U.S-55(Poonyth, Daneswar, et al., “The Impact of Domestic and Trade Policies on the World Cotton Market,” FAO Commodity and Trade Policy Research Working Paper No. 8, April 2004).

marketing loan and counter-cyclical payment programs. To the extent that such a break-out is even possible for the programs, the effects estimated with respect to the marketing loans and counter-cyclical payment programs under these studies would appear to *substantially lower* than those estimated under Brazil model (for example, a *fraction* of the 12.9 percent effect estimated by the World Bank given that it looks to effects from the elimination of *all* subsidies and tariffs across *all* countries). Therefore, Brazil’s assertion that the results of its new modeling exercise are “consistent” with those in these other studies must be approached with caution, at the outset, since none of them even addresses the same question.

365. Another significant flaw in Brazil’s analysis is its failure to take into account the manner and methodology in which each study conducted its assessment of price effects to determine whether its assertions of “consistency” are even sustainable. Consider each of the studies cited by Brazil:

366. **World Bank:** Brazil declares its modeling exercise “consistent” with that of the World Bank even though the World Bank model includes the marketing loan program, production flexibility/direct payments, market loss assistance/counter-cyclical payment program, the crop insurance program and the Step 2 program and makes no differentiation between them.⁵⁴⁸ In other words, the World Bank study assumes that a dollar spent under *any* one of these programs (for example, direct payments which were found to not have been causing any significant price suppression by the original panel) has the same effect with respect to world market prices as a dollar spent under *any* other program (for example, the marketing loan payments which *were* found to be causing significant price suppression in the original proceeding).

367. This approach is clearly inconsistent with the approach taken by the panel and affirmed by the Appellate Body in this dispute.⁵⁴⁹ It also appears to be inconsistent with Brazil’s arguments in this dispute that payments under the programs have different effects (for example, Brazil’s new argument that the elimination of the Step 2 program has “*little positive impact* on the world price for cotton in the long term”⁵⁵⁰ but that payments under the marketing loan and counter-cyclical payment program allegedly have “significant” price effects). Indeed, under these circumstances, one would expect that Brazil would underscore that the two modeling exercises are, in fact, *not consistent*. But, Brazil does not do so.

368. Instead, Brazil attempts to dismiss the differences in modeling, arguing that “the World Bank analysis assessed the impact of U.S. subsidies based on an *ad valorem* subsidization rate of 40.2 percent for production subsidies in 2000-2003. . . . This subsidization rate is, in fact, less

⁵⁴⁸ Exhibit BRA-481 (Anderson, Kym and Valenzuela, Ernesto, “WTO Doha Cotton Initiative: A Tale of Two Issues,” Development Research Group, World Bank, February 2006, p. 5).

⁵⁴⁹ See, e.g., Upland Cotton (Panel), paras. 8.1(g)(i) and 8.1(g)(ii).

⁵⁵⁰ Brazil First Written Submission, para. 206 (quoting Brazil First Written Submission, Annex II, paras. 41-43).

than the subsidization rate from marketing loan and counter-cyclical payments alone in MY 1999, 2001, 2002, 2004 and 2005.”⁵⁵¹ Brazil provides no explanation, whatsoever, as to how a failure to properly account for the different structure, design, and operation of different programs is remedied by using “a subsidization rate . . . less than the subsidization rate from marketing loan and counter-cyclical payments alone in MY 1999, 2001, 2002, 2004 and 2005.”⁵⁵² Indeed, this is an illogical assertion that reveals, yet again, Brazil’s difficulty with maintaining a consistent position in this dispute regarding the importance of the *size* versus the structure, design, and operation of subsidies in determining its effect.⁵⁵³

369. **ODI Report:** Similarly, in the case of the ODI report, Brazil fails to explain that the authors used a model developed in an earlier report (Goreux 2003) to examine possible price effects of domestic supports in a number of countries – China, Greece, Spain, and the United States – with respect to West African cotton producing countries.⁵⁵⁴ The original Goreux model suffers from a number of significant flaws, however. First, like the World Bank approach, Goreux (2003) lumps together all payments and treats every payment dollar exactly like every other payment dollar, regardless of the structure, design, and operation of the program under which it is made.⁵⁵⁵

370. Second, the Goreux model does not permit production and world price to fully interact.⁵⁵⁶ Specifically, it assumes that removal of subsidies reduces production, and thus causing prices to rise.⁵⁵⁷ Then, in response to the higher prices, production recovers substantially, but the model does not allow a second-round adjustment by prices.⁵⁵⁸ Economic theory dictates that the actual effect of any removal of subsidies is properly captured by a number of rounds of adjustment to mimic the working of markets.

⁵⁵¹ Brazil Rebuttal Submission, para. 279.

⁵⁵² Brazil Rebuttal Submission, para. 279.

⁵⁵³ Had the size of payments been the determinative factor in assessing the effect of subsidies, it is certainly curious that in the original proceeding Brazil insisted that it should not even have to quantify the amount of the subsidy subject to its claims under Article 5(c) and 6.3(c). Brazil Appellee Submission, para. 458 ([A] serious prejudice analysis by a WTO panel calls ‘for a qualitative and, to some extent, quantitative analysis of the existence and nature of the subsidy and the serious prejudice caused.’ Its focus is on the ‘effects’ of the subsidies, *not their magnitude, amount or value.*”)

⁵⁵⁴ Gilson, Ian et al., “Understanding the Impact of Cotton Subsidies on Developing Countries,” p. 27 Overseas Development Institute (Exhibit BRA-578).

⁵⁵⁵ Goreux, Louis, “Prejudice Caused by Industrialized Countries Subsidies to Cotton Sectors in Western and Central Africa,” p.23 (June 2003) (Exhibit US-97).

⁵⁵⁶ Goreux, Louis, “Prejudice Caused by Industrialized Countries Subsidies to Cotton Sectors in Western and Central Africa,” pp.22-24 (June 2003) (Exhibit US-97).

⁵⁵⁷ Goreux, Louis, “Prejudice Caused by Industrialized Countries Subsidies to Cotton Sectors in Western and Central Africa,” pp.22-24 (June 2003) (Exhibit US-97).

⁵⁵⁸ Goreux, Louis, “Prejudice Caused by Industrialized Countries Subsidies to Cotton Sectors in Western and Central Africa,” pp.22-24 (June 2003) (Exhibit US-97).

371. Third, in two of the ODI's studies' scenarios, the authors use similar elasticities as Geroux: an elasticity of demand at -0.1 and a uniform elasticity of supply at 0.5.⁵⁵⁹ As the U.S. demonstrated in the first written submission to this Panel, this demand elasticity is generally smaller than in most other studies, including analysis done by Brazil.⁵⁶⁰ A greater elasticity would have dramatically reduced the estimated 18 to 28 percent price effect that the study estimated for MY 2001.

372. Fourth, in the two scenarios where the authors differentiated supply elasticities for different countries, two significant producers – Australia and Uzbekistan – were restricted from increasing their supply given the reduction in production from subsidized producers, thereby biasing up the increased price change due to this limited supply.⁵⁶¹ Given these shortcomings, the ODI Report does not provide any appropriate benchmark for assessing the reasonableness of Brazil's econometric model.

373. **FAO Study:** Brazil also asserts that its modeling exercise is consistent with a 2004 FAO study.⁵⁶² However, the FAO study estimates price effects of *only* 3.1 to 5 percent and it does so for “*complete elimination of domestic subsidies as notified to the WTO and tariffs.*”⁵⁶³ This means *every domestic support* and *every tariff* for *every* country in the world that notifies either to the WTO. In other words, necessarily, any possible effect of U.S. domestic supports would be less than the 3.1 to 5 percent. Brazil's assertion that “world market prices for upland cotton would have been 9 to 11 percent higher *but for* the effects of [the marketing loan and counter-cyclical payment programs in MY 2005]”⁵⁶⁴ would seem patently *inconsistent* with the results of the FAO study. Brazil's attempts to argue otherwise are untenable.

374. Brazil notes, first, that the FAO study's findings are based on MY 1997-1999 and, according to Brazil, “U.S. subsidies in those years were relatively low, which partially explain the lower effects that FAO found in its simulations.”⁵⁶⁵ This is an misleading suggestion. Recall that the FAO study examines complete elimination of *every domestic support* and *every tariff* for *every* country, and that Brazil has not explained how each such measure is treated in the model, or the degree of effect that changes in any of the measures could have on ultimate result. Accordingly, Brazil simply has no basis to argue that it was the difference in marketing loan and

⁵⁵⁹ Goreux, Louis, “Prejudice Caused by Industrialized Countries Subsidies to Cotton Sectors in Western and Central Africa,” p.22 (June 2003) (Exhibit US-97).

⁵⁶⁰ U.S. First Submission, Annex I, p. 8.

⁵⁶¹ Exhibit BRA-578 (Gilson, Ian et al., “Understanding the Impact of Cotton Subsidies on Developing Countries,” Overseas Development Institute, pp. 27-28)

⁵⁶² Brazil Rebuttal Submission, para. 303.

⁵⁶³ Poonyth, Daneswar, et al., “The Impact of Domestic and Trade Policies on the World Cotton Market,” FAO Commodity and Trade Policy Research Working Paper No. 8, April 2004, p. i (Exhibit US-55).

⁵⁶⁴ Brazil First Written Submission, para. 167 (emphasis in original).

⁵⁶⁵ Brazil Rebuttal Submission, para. 303.

counter-cyclical payment levels between MY 1997 and 1999 that can “explain the lower effects that FAP found in its simulations.”⁵⁶⁶

375. Brazil then complains that FAO “focuses on the very long run” and, thus, assumes “unrealistically” that there would be “a full transmission of world market prices to producers in all regions of the world.”⁵⁶⁷ Brazil asserts that if the more “realistic” assumptions of its own economist are adopted, the FAO study “would likely have found effects much closer to those reported by Professor Sumner.”⁵⁶⁸ This is a remarkable illustration of circular logic. Brazil asserts that the FAO study is consistent with the modeling performed by Brazil’s economist because if the FAO study had conducted modeling similar to that of Brazil’s economist, it “would likely have found effects much closer to those reported by Professor Sumner.”⁵⁶⁹

376. In any event, Brazil’s objections to the use of long run elasticities contrasts sharply to Brazil’s position in other disputes. In *United States – Continued Dumping and Subsidy Offset Act*, for example, Brazil argued (together with co-complainants) that, in estimating trade effects, “the Requesting Parties submit that elasticity values should be taken from long-run estimates and not short run estimates.”⁵⁷⁰ Moreover, Brazil cannot argue in this instance that long-term analyses should be dismissed because Brazil no longer agrees that there is full transmission of world prices; indeed, the United States recalls that Brazil has argued throughout this dispute (to establish that there is a “world market”) that there is allegedly close movement of the A-Index and prices in various domestic markets and hence transmission of prices to other suppliers.⁵⁷¹ Thus, contrary to Brazil’s assertions, none of the specific studies it identifies demonstrates that its modeling of the effects of the marketing loan and counter-cyclical payment programs is reasonable. Even less persuasive is Brazil’s attempt to place its results “in the mid-range” of the studies surveyed by the FAO, World Bank, and International Food Policy Research Institute (“IFPRI”).⁵⁷²

377. Brazil acknowledges that the original panel “reviewed some of these studies as well as many others during the course of its analysis” and “recognized that many of the parameters including magnitude, and time period of the subsidies, elasticities, measures, and selection of

⁵⁶⁶ Brazil Rebuttal Submission, para. 303.

⁵⁶⁷ Brazil Rebuttal Submission, para. 304 (citing Poonyth, Daneswar, Alexander Sarris, Ramesh Sharma, and Shangan Shui. “The Impact of Domestic and Trade Policies on the World Cotton Market,” FAO Commodity and Trade Policy Research Working Paper No. 8, April 2004, p. 10) (Exhibit US-55)).

⁵⁶⁸ Brazil Rebuttal Submission, para. 304.

⁵⁶⁹ Brazil Rebuttal Submission, para. 304.

⁵⁷⁰ *United States – Continued Dumping and Subsidy Offset Act*, para 3.101 (22.6).

⁵⁷¹ See e.g., Brazil First Written Submission, paras. 98-100.

⁵⁷² See Brazil Rebuttal Submission, paras. 306-313. The United States notes that the IFPRI report simply restates the range of studies cited by FAO and then calculates that 10% is somewhere in the middle.

baselines did not address exactly the time period or legal issues before the original panel.”⁵⁷³ Accordingly, as Brazil acknowledges, the *only* conclusion that the original panel considered appropriate to draw from these widely divergent, inapposite studies was that “subsidies bestowed by Member governments have the *potential* to distort production and trade;”⁵⁷⁴ a fact that is neither remarkable nor sufficient to answer the question of “significant” price suppression that Brazil attempts to advance before the original panel.

378. Yet while it recognizes that the original panel did not consider it appropriate to make any finding on the *degree* of effects on the basis of these studies, Brazil now asks this Panel to do so by seeking a finding that a 9-11 percent effect attributed *solely* to two U.S. programs is reasonable because it allegedly falls “in the mid-range” of the studies surveyed by the FAO/IFPRI and World Bank. No such approach was taken by the original panel, and for good reason. Brazil’s argument is nonsensical. The fact that Brazil attributes to removal of the marketing loans and counter-cyclical payments programs comparable effects to those that other studies attribute to completely different scenarios (such as full worldwide market liberalization of cotton or of cotton and textiles; changes to the market structure and domestic supports of China, the EU and other countries, etc.) is evidence that Brazil’s model *grossly exaggerates* any possible effects of those two programs alone, not evidence that it is a reasonable approach.

d. Brazil fails to rebut the recent studies finding minimal effects of the marketing loan and counter-cyclical payment programs

379. Finally, Brazil attempts to minimize recent studies finding that the marketing loan and counter-cyclical payment programs are likely only to small effects. For example, the United States noted that a June 2006 study conducted by Texas Tech University researchers, and published in the Journal of Cotton Science, estimated that complete elimination of *four* programs – the Step 2, marketing loan, counter-cyclical payment, *and* direct payment programs – would have only an average 1.58 percent impact on the A-Index in the period MY 2003-2007.⁵⁷⁵ Unlike the studies submitted by Brazil, the 2006 Texas Tech study actually examines measures that are close in scope to those challenged before this Panel. The study also examines a period closer in time to the period before this Panel. And it uses a partial equilibrium model using well-accepted FAPRI parameters.

380. Brazil attacks the study noting that it is published in a journal that “as implied by [its] name . . . primarily focuses on agronomy, breeding, plant pathology and weed science, not agricultural economics.”⁵⁷⁶ (In fact, the study itself is conducted by well-known Texas Tech University researchers). Brazil also notes that the publication is “maintained” on “a webpage of

⁵⁷³ Brazil Rebuttal Submission, para. 309.

⁵⁷⁴ Brazil Rebuttal Submission, para. 309.

⁵⁷⁵ U.S. First Written Submission, footnote 439.

⁵⁷⁶ Brazil Rebuttal Submission, para. 314.

the U.S. National Cotton Council.”⁵⁷⁷ (In fact, the NCC’s webpage contains only a link to the website of the journal). These assertions are irrelevant and do not undermine the validity of the study.

381. Brazil’s sole attempt at a substantive response is to assert that this study is inconsistent with earlier work conducted by Texas Tech University. In comparing the results of this study to the earlier work that examined the impact of the U.S. Doha proposal, Brazil concluded that the results in the newer study are “facially incompatible with, and rendered implausible by CERI’s Doha Round findings relating to a mere reduction in marketing loan and counter-cyclical payments.”⁵⁷⁸ This conclusion, however, is drawn on a faulty interpretation of the Doha Round study results.

382. In the Doha analysis, Texas Tech University analyzes a reduction in the target price of 12 percent and an 8 percent reduction in the loan rate. Given the relationship between the target price and the market prices assumed in the study, a 12 percent reduction in the target price is the equivalent of almost total elimination of counter-cyclical payments. Additionally, marketing loan benefits fall by 41 percent by the end of the period. Brazil’s use of 30 percent is misleading as it is based on a reduction in total outlays including direct payments, for which the study does not ascribe any production impacts. Brazil then mistakenly asserts that a 30 percent reduction in outlays could be extrapolated to approximate the impacts of a full elimination. This is inappropriate as an economic method. The primary differences between the results of the two studies are due to differences in time periods and the baseline assumptions – and the differences are actually minor.

383. Nor is the 2006 Texas Tech University study a “single, anomolous study.” In fact, two other studies by researchers at CERI support the findings of the 2006 Texas Tech study published in the *Journal of Cotton Sciences*.⁵⁷⁹ In a 2004 study, Fadiga et al. looked at the impact of removing U.S. cotton support programs (Step 2, direct payments, CCPs and marketing loans) on the cotton export earnings of West and Central African nations. This paper analyzed the effects of elimination of U.S. cotton subsidy programs on the world cotton market using a partial equilibrium model of the world fiber market. Removal of U.S. programs would increase world cotton prices by around 2% in the initial years. However, the impacts die out after a few years of program elimination as the major cotton producing and exporting countries expand their

⁵⁷⁷ Brazil Rebuttal Submission, para. 314.

⁵⁷⁸ Brazil Rebuttal Submission, para. 318.

⁵⁷⁹ Fadiga, Mohamadou L., Samarendu Mohanty and Suwen Pan, “The Impact of U.S. Cotton Programs on the West and Central African Countries Cotton Export Earnings,” paper prepared for presentation at the American Agricultural Economics Association Annual Meeting, Denver, Colorado, August 1-4, 2004 (Exhibit US-98) and Pan, Suwen, Mark Welch, Samarendu Mohanty and Mohamadou Fadiga, “Assessing the Impacts of Chinese TRQ System and U.S. Subsidies on the World Cotton Market,” Working Paper CER-WR05-02, Cotton Economics Research Institute, Texas Tech University, July 2005 (Exhibit US-99).

production.⁵⁸⁰

384. In the 2005 study, Pan et al. compared the impact of removing the Chinese TRQ system to the removal of U.S. subsidies on the world cotton market. In this study, the authors remove the following U.S. cotton programs: direct payments, CCPs, marketing loan and Step-2 payments. The authors look at the impacts over the period 2004/05 to 2008/09. Their simulation of the removal of these U.S. cotton programs results in an average increase of the world price of 1.1 percent. As with the Fadiga et al. study, the greatest impacts occur in the second and third year (2.39 percent and 1.63 percent respectively) before the impacts decrease as supply and demand adjust to the change in prices.⁵⁸¹

385. Researchers at CERI are not alone in finding small impacts from the removal of U.S. cotton programs. As discussed above, FAO found that the removal of U.S. programs only resulted in a 3 percent to 5 percent increase in world prices.⁵⁸² Additionally, research at the IMF also found small impacts on world prices from the removal of U.S. programs.⁵⁸³ Using a partial equilibrium model and 2000 as a base year, Tokarick estimated the effect of removing marketing loss assistance payments, Step-2 and the marketing loan program. He found that the removal of these U.S. cotton support programs resulted in an increase of world prices by 2.0 percent.⁵⁸⁴

386. In sum, Brazil's econometric modeling exercise relies on flawed parameters that Brazil *itself* did not use in the original proceeding. It is not a reliable tool for use here. Moreover, Brazil's efforts to share up the study by comparing it to other studies is availing as no other studies conduct the same or similar exercise to the one here.

6. Brazil Has Not Ensured that the Price Effects Of Other Factors Are Not Attributed to the Marketing Loan and Counter-cyclical Payment Programs

387. The United States observed in its first written submission that Brazil has failed to undertake any meaningful assessment of the world upland cotton market, of actual world market

⁵⁸⁰ Fadiga, Mohamadou L., Samarendu Mohanty and Suwen Pan, "The Impact of U.S. Cotton Programs on the West and Central African Countries Cotton Export Earnings," paper prepared for presentation at the American Agricultural Economics Association Annual Meeting, Denver, Colorado, August 1-4, 2004, p12 (Exhibit US-98).

⁵⁸¹ Pan, Suwen, Mark Welch, Samarendu Mohanty and Mohamadou Fadiga, "Assessing the Impacts of Chinese TRQ System and U.S. Subsidies on the World Cotton Market," Working Paper CER-WR05-02, Cotton Economics Research Institute, Texas Tech University, July 2005, Table 2, pg 7 (Exhibit US-99).

⁵⁸² Poonyth, Daneswar, Alexander Sarris, Ramesh Sharma and Shangan Shui, "The Impact of Domestic and Trade Policies on the World Cotton Market," FAO Commodity and Trade Policy Research Working Paper No. 8, April 2004, p. i (Exhibit US-55).

⁵⁸³ Tokarick, Stephen, "Measuring the Impact of Distortions in Agricultural Trade in Partial and General Equilibrium," IMF Working Paper, WP/03/110, May 2003 (Exhibit US-100).

⁵⁸⁴ Tokarick, Stephen, "Measuring the Impact of Distortions in Agricultural Trade in Partial and General Equilibrium," IMF Working Paper, WP/03/110, May 2003 (Exhibit US-100).

prices, or of the factors that are observed to be affecting U.S. and foreign supply and demand and, ultimately, world market prices.⁵⁸⁵ The Appellate Body has underscored the importance of such an assessment in this dispute, explaining that in order to prove a claim under Article 5(c) and 6.3(c) of the *SCM Agreement*, “it is necessary to ensure that the effects of other factors on prices are not improperly attributed to the challenged subsidies.”⁵⁸⁶ Brazil has not carried that burden here.

388. By way of example, the United States noted the almost complete absence of any discussion of the role of China’s upland cotton trade in Brazil’s first written submission.⁵⁸⁷ In over 100 pages of arguments about the “world” market price of upland cotton, the alleged suppression thereof, and the causes of this alleged world market price phenomenon, Brazil’s first written submission made only *three* references to China.⁵⁸⁸ Yet, China is the world’s largest producer of upland cotton, the world’s largest consumer of upland cotton, and the world’s largest importer of upland cotton.⁵⁸⁹ Moreover, it has been a very dynamic factor in the market, with its share of world imports rising from only 1% in MY1998 to 44% in MY 2005.⁵⁹⁰ Rather than assess and distinguish any impacts of China’s trade on world market prices, Brazil’s rebuttal has consisted of unsupported assertions by Brazil’s market expert that “[t]he uncertainty regarding Chinese demand and the fact that domestic production continues to account for the majority of domestic consumption, limits the ability of the Chinese market to “drive” international prices . . .”⁵⁹¹ and “[t]he U.S. market continues to be the most important market influencing cotton prices throughout the world.”⁵⁹²

389. Brazil first resorts to the now-familiar tactic of asserting without basis that the argument has already been “lost.”⁵⁹³ This time, Brazil asserts that the United States is “in reality” “challenging the original panel’s and Appellate Body decision in asserting that Brazil’s argument that the United States exerts a substantial proportional influence on the world market price of upland cotton is ‘overly simplistic and inconsistent with the realities of the world cotton market.’”⁵⁹⁴ However, the United States has made no such argument. The United States has argued, instead, that Brazil cannot try to avoid its obligation “to ensure that the effects of other factors on prices are not improperly attributed to the challenged subsidies” by relying on the

⁵⁸⁵ U.S. First Written Submission, paras. 308-318.

⁵⁸⁶ *Upland Cotton (AB)*, para. 437.

⁵⁸⁷ U.S. First Written Submission, paras. 580-598. China’s trade in upland cotton is only such factor.

⁵⁸⁸ See Brazil First Written Submission, paras. 92, 210, and 288.

⁵⁸⁹ Cotton: Review of the World Situation, ICAC (May-June 2006) (Exhibit BRA-485).

⁵⁹⁰ Cotton: Review of the World Situation, ICAC (May-June 2006) (Exhibit BRA-485).

⁵⁹¹ Brazil First Written Submission, Annex II, para. 26.

⁵⁹² Brazil First Written Submission, Annex II, para. 23.

⁵⁹³ Brazil Rebuttal Submission, paras. 324-328.

⁵⁹⁴ Brazil Rebuttal Submission, para. 328.

unfounded and overly-simplistic statements of its market expert to the effect that “[t]he U.S. market continues to be the most important market influencing cotton prices throughout the world”⁵⁹⁵ and that “the United States functions as a key ‘driver’ of the world market price”⁵⁹⁶ Brazil’s attempts to mis-portray the U.S. arguments cannot be credited.

390. Brazil argues next that the United States arguments “suffer from a fundamental misunderstanding of Brazil’s claims.”⁵⁹⁷ Brazil clarifies that its claims deal with price *suppression*, not price *depression*, and that, as such, the “claim does not depend on the precise level of actual prices”⁵⁹⁸ But the United States is well aware that Brazil’s claim in this proceeding is of price suppression. In fact, the United States explained precisely this point⁵⁹⁹ in objecting to Brazil’s efforts to claim as evidence of price “suppression” the fact that the A-Index price in recent years – including the years that the FSRI Act has been in effect – have been “low by historical standards.”⁶⁰⁰

391. Moreover, the market reports and data that the United States submits are relevant to price *suppression*. Indeed, as noted above, certain of the market reports expressly note the role of China’s trade in “prevent[ing] a significant price increase in 2005/2006.”⁶⁰¹ Whether or not a significant price increase is “prevented” would seem to be a question of significant price “suppression;” not price “depression.” As the original panel clarified, price “suppression” refers to “the situation where ‘prices’ – in terms of the ‘amount of money set for sale of upland cotton’ or the ‘value or worth’ of upland cotton – either are *prevented or inhibited from rising* (i.e. they do not increase when they otherwise would have) or they do actually increase, but the increase is less than it otherwise would have been.”⁶⁰² Brazil confirms that this is the appropriate definition of price “suppression” but yet claims – inexplicably – that the U.S. arguments deal with price depression, not suppression.

392. There is no basis for Brazil’s accusation that the United States “fundamental[ly] misunderstand[s]” Brazil’s claim to be one of price depression.⁶⁰³ Moreover, Brazil’s arguments in this regard confirm that Brazil does not – and, as discussed above, cannot – show on the basis of any empirical evidence that “the effect” of the U.S. marketing loans and counter-cyclical

⁵⁹⁵ Brazil First Written Submission, Annex II, para. 23.

⁵⁹⁶ Brazil First Written Submission, Annex II, para. 24.

⁵⁹⁷ Brazil Rebuttal Submission, para. 329.

⁵⁹⁸ Brazil Rebuttal Submission, para. 330.

⁵⁹⁹ U.S. First Written Submission, para. 386.

⁶⁰⁰ Brazil First Written Submission, para. 152.

⁶⁰¹ U.S. First Written Submission, para. 315-316 (citing, for example, “Cotton: Review of the World Situation”, International Cotton Advisory Committee at 7 (May-June 2006) (BRA-485)).

⁶⁰² *Upland Cotton (Panel)*, paras. 7.1276-7.1277. The Appellate Body agreed that this was an appropriate interpretation of “price suppression.” *Upland Cotton (AB)*, para. 424.

⁶⁰³ Brazil Rebuttal Submission, para. 329.

payments is significant price suppression. Instead, Brazil now attempts to clarify that its claim “does not depend on the precise level of actual prices” and, further, that price *movements* (and their causes) are also “irrelevant to Brazil’s claim.”⁶⁰⁴ Brazil’s claims apparently do not refer to *actual* world market prices for upland cotton or *actual* movements in this price but rather the theoretical – and, evidently, unobservable – “suppression” that its economist purports to identify by means of the new modeling exercise performed for purposes of this proceeding.⁶⁰⁵ In other words, as the United States has noted elsewhere, Brazil’s claims are not supported by the empirical evidence but rather depend critically on its own econometric modeling. The United States has shown Brazil’s modeling exercise to be deeply flawed, and inconsistent even with Brazil’s own modeling efforts in the original proceeding. This strongly supports rejection of Brazil’s claim.

393. Finally, Brazil attempts to discredit the information submitted by the United States showing the influence of China’s upland cotton trade on world market prices. Brazil argues, for example, that the United States has incorrectly asserted a strong correlation between Chinese supply and demand and the A-Index; according to Brazil, the United States has shown “at best, a rough correlation between A-Index prices and Chinese imports for certain periods.”⁶⁰⁶ Brazil’s argument is surprising, given that Brazil itself submitted market reports that show precisely this correlation.⁶⁰⁷ The same correlation is also noted by UNCTAD, which describes the “parallel” movements in the A-Index and China’s net exports (see below). It seems unlikely that a chart showing “at best a rough correlation” would be published repeatedly in market reports in this way; indeed, this fact would seem to undermine Brazil’s allegations of the “fallacy” of the U.S. arguments in this regard.

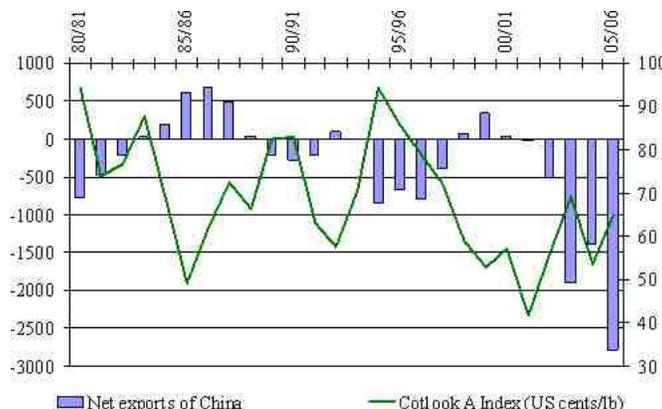
Parallel movements in cotton prices (Cotlook A-Index, US cents/lb) and net exports from China

⁶⁰⁴ Brazil Rebuttal Submission, para. 333.

⁶⁰⁵ Brazil, thus, asserts that “[a]s established by Professor Sumner” and others, a change to the marketing loan and counter-cyclical payment programs would allegedly “trigger” a “reduction in U.S. supply” that “would result in a significant increase in the world market price of upland cotton.” Brazil Rebuttal Submission, para. 332.

⁶⁰⁶ Brazil Rebuttal Submission, para. 337.

⁶⁰⁷ See ICAC “Review of the World Market Situation” for May-June 2006 at p. 8 (Exhibit BRA-485).



Source: UNCTAD secretariat (Data: International Cotton Advisory Committee - ICAC)

394. Similarly, Brazil tries to dismiss as a “technical change” the fact that the calculation of the A-Index has itself been changed to a Far East basis; according to Brazil this “solely” reflects that “the majority of consumers of upland cotton are now located in Asia – and particularly in China.”⁶⁰⁸ The United State reiterates that the fact that the measure of the world market price has had to be changed in order to account for the importance of a particular market – China – to that price can hardly be said to be a “technical change.” Brazil’s arguments to the contrary are not credible.

395. Moreover, in the face of evidence indicating that uncertainty about China’s supply and demand *itself* has price suppressive effects on the market, Brazil simply reiterates its argument that “[u]ncertainty can lead to short-term price volatility, but only during the time when it is unknown what supply and demand will be.”⁶⁰⁹ In doing so, however, Brazil fails to address the evidence submitted by the United States about the pervasive nature of the uncertainty regarding the Chinese market. Indeed, as the United States explained in its first written submission that both USDA and the ICAC have had to significantly revise their estimates of Chinese cotton consumption and stocks in recent years because of lack of reliable initial information.⁶¹⁰ Thus, although Brazil asserts that it is “price is driven primarily by the market fundamentals of supply and demand,” Brazil fails to account for the fact that, in the case of China, reliable facts about these fundamentals do not exist. According to the market reports submitted by Brazil, this is one of the “few issues, mainly related to the rise of China (Mainland) as the dominant buyer in the

⁶⁰⁸ Brazil Rebuttal Submission, para. 341.

⁶⁰⁹ Brazil Rebuttal Submission, para. 343.

⁶¹⁰ For example, see WASDE November 2004, May 2005, July 2005 (US-49).

world cotton market, [that] ha[s] *prevented a significant price increase in 2005/2006.*⁶¹¹

396. Accordingly, Brazil has clearly failed to “ensure that the effects of other factors on prices are not improperly attributed to the challenged subsidies.”⁶¹² Brazil’s efforts to dismiss the evidence submitted by the United States showing the importance of other factors affecting world market prices is both baseless and revealing inasmuch as it confirms that Brazil’s claims of significant price suppression have no support in the empirical evidence. Brazil’s claims are premised almost entirely on the (flawed) assertions of the economist it has retained for purposes of this dispute. As discussed above, those assertions are not reliable and do not support a finding under Articles 5(c) and 6.3(c) of the *SCM Agreement*.

7. Brazil Fails To Provide Any Evidence or Arguments Regarding “Significant” Price Suppression In Its Rebuttal Submission

397. The United States explained in its first written submission that Brazil has not demonstrated either through empirical evidence, or through its modeling exercise, that the marketing loan and counter-cyclical payment programs have had any appreciable impacts on price in MY 2005, let alone caused any “significant” price suppression within the meaning of Article 6.3(c) of the *SCM Agreement*. Brazil does not even address these arguments in its rebuttal submission. Thus, Brazil has yet to prove a critical element of its claims of “significant” price suppression under Articles 5(c) and 6.3(c) of the *SCM Agreement*. This provides yet another basis to reject Brazil claims under these provisions.

8. Conclusion

398. For the reasons above, the United States submits that Brazil has failed to present a *prima facie* case of breach of Articles 5(c) and 6.3(c) of the *SCM Agreement*. The United States has explained above that these claims are also outside the scope of this proceeding. The failure to make a *prima facie* provides, therefore, an additional basis to reject Brazil’s claims.

D. PRESENT SERIOUS PREJUDICE WITHIN THE MEANING OF ARTICLES 5(C) AND 6.3(D) OF THE *SCM AGREEMENT*

399. Brazil had not made a *prima facie* case that the marketing loan and counter-cyclical payment programs breach Articles 5(c) and 6.3(d) of the *SCM Agreement*.⁶¹³ There are two

⁶¹¹ “Cotton: Review of the World Situation”, International Cotton Advisory Committee at 7 (May-June 2006) (BRA-485).

⁶¹² *Upland Cotton (AB)*, para. 437.

⁶¹³ This is an additional basis to reject Brazil’s claims under Articles 5(c) and 6.3(d). As noted above, they are also outside the scope of this proceeding and, further, they fail because Brazil has failed to demonstrate that the marketing loan and counter-cyclical payment programs mandate a breach. For those reasons too, Brazil’s claims

elements of the inquiry under Article 6.3(d) of the *SCM Agreement*.⁶¹⁴ The first relates to the *present* effects of the challenged measure and requires a demonstration of an increase in the world market share of a Member “as compared to the average share it had during the previous period of three years.” The second requires a look backwards over “a period when subsidies have been granted” and a demonstration that the referenced increase – *i.e.*, the increase in world market share “compared to the average share it had during the previous period of three years” – is part of a “consistent trend” over the historical period. Brazil has not shown that either of these elements are met with respect to the marketing loan and counter-cyclical payment programs.

400. As to the first element, Brazil asserts that “the effect” of the marketing loan and counter-cyclical payment programs in MY 2005 was an increase in the U.S. share of world production plus beginning stocks of 0.46 percent over the average for MY 2002-2004 (or 1.53 percent increase looking just at production).⁶¹⁵ Yet Brazil provides no empirical evidence to support its assertion. Indeed, Brazil clarifies in its rebuttal submission that the sole basis for its claim is the flawed and grossly exaggerated modeling results presented by its hired economist. For the reasons discussed above in Section IV.C.5, Brazil’s model does not provide a reliable basis for Brazil’s claim.

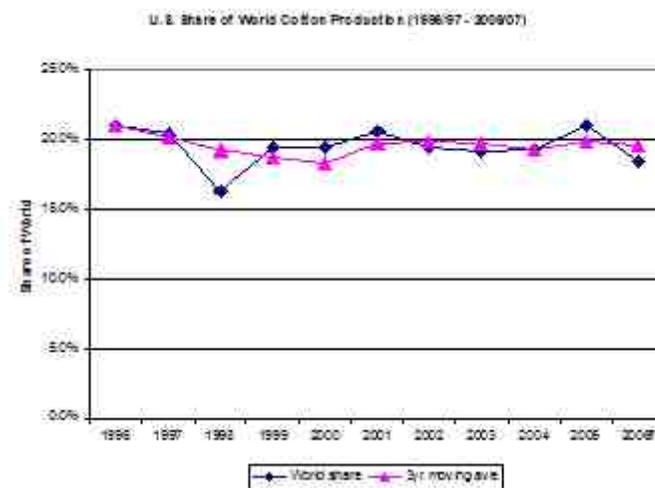
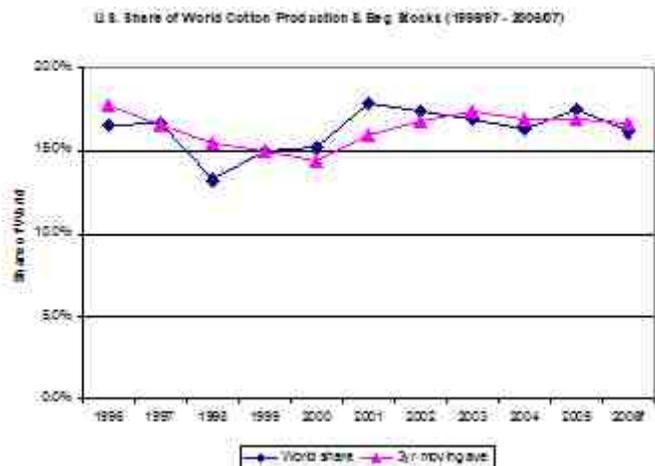
401. More importantly, even the flawed modeling results that Brazil cites are irrelevant to question under Article 6.3(d). Brazil asserts that, according to its model, *removal of the marketing loan and counter-cyclical payment programs* would have resulted in lower U.S. market share in MY 2005. Brazil mistakes the question under Article 6.3(d). Article 6.3(d) is not concerned with absolute market share and whether or not in any given year a Member’s market share would have been lower if subsidies were removed. By its terms, it applies only in those situations where there is an increase from the previous three-year average and it is this *increase* over time that is “the effect” of subsidies. Thus, Brazil’s argument as to the first element – including Figure 12 of its rebuttal submission – are entirely off the mark.

402. Indeed, when one considers the data regarding U.S. market share over the period of the FSRI Act, it is clear that the slight increase of 0.46 percent in the U.S. share of production plus beginning stocks in MY 2005 over the average for MY 2002-2004 (or 1.53 percent increase looking just at production) is simply part of ordinary fluctuation in U.S. market share, not the effect of the marketing loan and counter-cyclical payment programs.

must be rejected.

⁶¹⁴ The question under Article 6.3(d) is whether “the effect of the subsidy is an increase in the world market share of the subsidizing Member in a particular subsidized primary product or commodity as compared to the average share it had during the previous period of three years *and* this increase follows a consistent trend over a period when subsidies have been granted.” (Emphasis added).

⁶¹⁵ Brazil First Written Submission, paras. 222 and 224. Brazil also references increases in the *absolute* volume of U.S. upland cotton production. *See e.g.*, Brazil First Written Submission, para. 229. Absolute production levels are, however, entirely irrelevant to the inquiry under Article 6.3(d) of the *SCM Agreement*.



Source: USDA, PS&D⁶¹⁶

403. Brazil’s arguments with respect to the second element are equally flawed. Here too, Brazil fails to conduct the proper analysis under Article 6.3(d) of the *SCM Agreement*. Brazil’s arguments assume that Article 6.3(d) requires a showing of an *upward trend* in market share. This is what Brazil attempts to show through a flawed end-point-to-end-point comparison from MY 1998 to MY 2005. However, as is clear from the text, this is *not* what Article 6.3(d) requires. Rather, as noted above, Article 6.3(d) requires a showing that “this increase” – *i.e.*, “the increase

⁶¹⁶ U.S. Production Supply and Distribution (Exhibit US-27); World Production Supply and Distribution (Exhibit US-27).

in the world market share of the subsidizing Member . . . as compared to the average share it had during the previous period of three years” – “follows a consistent trend over a period when subsidies have been granted.”⁶¹⁷ In other words, to make a claim under Article 6.3(d), the data must show that a Member’s market share is consistently increasing over the previous three-year average. Brazil does not even provide relevant data in this regard, let alone make the required demonstration. Nor could it. As shown above, there simply is no such “consistent trend.”

404. Brazil has, thus, failed even to submit a proper analysis, let alone established a *prima facie* case of breach under Articles 5(c) and 6.3(d) of the *SCM Agreement*. Under these circumstances, Brazil’s claims should be rejected.

E. BRAZIL FAILS TO MAKE A *PRIMA FACIE* CASE OF THREAT OF SERIOUS PREJUDICE PURSUANT TO ARTICLES 5(C) AND 6.3(C) OF THE *SCM AGREEMENT*

405. Brazil claims on a contingent basis that, if the Panel does *not* find that “the [U.S.] measures taken to comply cause present serious prejudice to the interests of Brazil,”⁶¹⁸ it should find that the measures “are inconsistent with the *SCM Agreement* because they cause a threat of serious prejudice, within the meaning of Articles 5(c) and 6.3(c) as well as footnote 13 of that *Agreement*.”⁶¹⁹ The United States has shown that Brazil’s claims of present serious prejudice fail to withstand scrutiny. Brazil’s contingent claims of “threat” of serious prejudice are equally flawed. They fail not only because they are outside the scope of this proceeding and because Brazil does not show that the measures to which they apply, as such, mandate any breach of U.S. WTO obligations, but also because they are based on a legally erroneous standard and are factually unsubstantiated.

1. Brazil’s Claims of Threat of Serious Prejudice Are Based On An Erroneous Legal Standard

406. Brazil asserts that “the precedent interpreting the terms ‘threat’ and ‘threaten’ suggests that the appropriate standard of threat in Part III [of the *SCM Agreement*] is one in which there is a significant likelihood, based on the nature of subsidies and particular conditions of competition, that serious prejudice will occur in the future.”⁶²⁰ This “significant likelihood” standard, however, is not found in the text of the *SCM Agreement* – in Part III, Part V, or any other part of that agreement. Moreover, even leaving aside that there is no basis to attempt to interpret a treaty in accordance with “precedent” rather than “in accordance with customary rules of interpretation

⁶¹⁷ Indeed, the requirement that there be a “consistent” trend only makes sense when Article 6.3(d) is interpreted in this way. Brazil’s interpretation would read “consistent” out of Article 6.3(d) entirely.

⁶¹⁸ Brazil First Submission, para. 241.

⁶¹⁹ Brazil First Submission, para. 237.

⁶²⁰ Brazil First Submission, para. 253.

of public international law,”⁶²¹ Brazil does not in fact identify any “precedent” that “suggests” that the appropriate standard for “threat” of serious prejudice is “a significant likelihood.” As Brazil’s claims are based on an erroneous legal standard, Brazil fails to make a *prima facie* case of threat of serious prejudice within the meaning of Article 5(c) and footnote 13 of the *SCM Agreement*.⁶²²

407. Footnote 13 to Article 5(c) of the *SCM Agreement* clarifies that “the term ‘serious prejudice to the interests of another Member’ . . . includes threat of serious prejudice.” While footnote 13 clarifies that “serious prejudice” is used in the *SCM Agreement* “in the same sense as in paragraph 1 of Article XVI of GATT 1994,”⁶²³ it does not explain what “threat” of serious prejudice means.⁶²⁴ Useful contextual guidance for interpreting that term can, however, be found in Article 15.7 of the *SCM Agreement*, which sets out obligations for national authorities in determining whether there is a “threat of material injury” in a countervailing duty investigation.⁶²⁵ That provision states that, for a determination of threat of material injury, there must be a finding that “the change in circumstances which would create a situation in which the subsidy would cause injury must be clearly foreseen and imminent.” Accordingly, “threat of material injury” in Article 15.7 of the *SCM Agreement* refers to material injury that does not exist under present circumstances but is, nonetheless, anticipated under other “imminent” (meaning, *inter alia*, “impending, soon to happen”⁶²⁶) circumstances that are “clearly foreseen” (i.e., circumstances that

⁶²¹ DSU Article 3.2.

⁶²² This is analogous to the situation in the original proceeding where Brazil based claims under Article 6.3(d) of the *SCM Agreement* on an incorrect interpretation of the term “world market share.” The Panel explained there that “as Brazil’s evidence and argumentation in this dispute focused exclusively upon a different, and in our view erroneous, legal interpretation of the phrase ‘world market share’ in Article 6.3(d), we find that Brazil has not established a *prima facie* case of violation of Article 6.3(d) or Article 5(c) of the *SCM Agreement*.” Upland Cotton (Panel), para. 7.1465. The same approach is warranted in the present proceeding with respect to Brazil’s claims of threat of serious prejudice.

⁶²³ Article XVI:1 of the GATT 1994 also refers to “threat.”

⁶²⁴ Brazil asserts in parts of its first written submission that, under footnote 13, a *finding* of present serious prejudice also includes a *finding* that there is a threat of serious prejudice with respect to the future and that the original panel not only acknowledged this but indicated that this was true of its own finding of present serious prejudice. *See e.g.*, Brazil First Submission, paras. 239 and 241. Brazil misunderstands footnote 13, which speaks to how “the term ‘serious prejudice to the interests of another Member’ is used in [the *SCM*] Agreement” and clarifies, *inter alia*, that this term “includes threat of serious prejudice.” (Emphasis added). The footnote, thus, clarifies that, where the *SCM Agreement* sets out rights and obligations regarding serious prejudice, the same rights and obligations apply also to the threat of serious prejudice. It does *not* indicate that where a panel *finds* that a Member is causing *present* serious prejudice through the use of a subsidy, the panel automatically also finds that the Member is threatening to cause serious prejudice *in the future* through the use of the same subsidy. And, indeed, the original panel did not so find in the present dispute.

⁶²⁵ An identical provision governing the determination of “threat of material injury” in antidumping investigations is set out in Article 3.7 of the *Agreement on Implementation of Article VI of the GATT 1994* (“*AD Agreement*”). For ease of reference, however, the United States addresses its arguments above to the provision in the *SCM Agreement* alone.

⁶²⁶ *The New Shorter Oxford English Dictionary* at 1316, Volume 1, (1993 Edition) (Exhibit US-101).

one is “distinctly, plainly, manifestly, [or] obviously”⁶²⁷ “aware of beforehand [or] predicts”⁶²⁸).

408. Similarly helpful contextual guidance is provided by Article 4.1(b) of the *Agreement on Safeguards*, which provides that “‘threat of serious injury’ shall be understood to mean serious injury that is clearly imminent . . .” Interpreting this provision in *US – Lamb Safeguards*, the Appellate Body reasoned that:

The word “imminent” relates to the moment in time when the “threat” is likely to materialize. The use of this word implies that the anticipated “serious injury” must be on the very verge of occurring. Moreover, we see the word “clearly”, which qualifies the word “imminent”, as an indication that there must be a high degree of likelihood that the anticipated serious injury will materialize in the very near future.⁶²⁹

409. The fact that both Article 15.7 of the *SCM Agreement* and Article 4.1(b) define “threat” of injurious effects in terms of their close proximity in time and their high probability of occurring is not surprising. These provisions simply elaborate on the ordinary meaning of “threat” – which includes “an indication of the approach of something unwelcome or undesirable”⁶³⁰ and “a person or thing regarded as a likely cause of harm.”⁶³¹ The meaning of “approach,” in turn, is, *inter alia*, “a drawing near in time or circumstances” “be nearly equal to” “[b]e so situated or arranged that the parts lie successively nearer to”⁶³² and, as such, reflects a similar notion of close proximity as the term “imminent.” Thus, the ordinary meaning of “threat” is itself reflected in Article 15.7 of the *SCM Agreement* and Article 4.1(b) of the *Agreement on Safeguards*.

410. By contrast, Brazil’s proposed “significant likelihood” standard injects an entirely new term into the text that (a) is not used by the drafters either in Article 5(c) of the *SCM Agreement* or elsewhere to define “threat,” (b) ignores entirely the timing aspect of the ordinary meaning of the “threat,” and (c) itself requires interpretation (*i.e.*, begging the question of what is a “significant” likelihood of serious prejudice). There is no basis for Brazil’s proposal. Rather, just as the original panel found that there was no reason it should not use the elaboration of “export subsidy” in the *SCM Agreement* as contextual guidance in interpreting the same term in the *Agreement on Agriculture*,⁶³³ there is no reason why the elaboration of the term “threat” in Article

⁶²⁷ *The New Shorter Oxford English Dictionary* at 415, Volume 1, (1993 Edition) (Exhibit US-102).

⁶²⁸ *The New Shorter Oxford English Dictionary* at 1003, Volume 1, (1993 Edition) (Exhibit US-103).

⁶²⁹ *United States – Lamb Safeguards (AB)*, para.

⁶³⁰ *The New Shorter Oxford English Dictionary* at 3290, Volume 2, (1993 Edition) (Exhibit US-104).

Brazil appears to agree that this is ordinary meaning of “threat.” Brazil First Submission, para. 247 (“The term ‘threat’ can refer to ‘an indication of the approach of something unwelcome or undesirable’ . . .”).

⁶³¹ *The New Shorter Oxford English Dictionary* at 3291, Volume 2, (1993 Edition) (Exhibit US-105)

⁶³² *The New Shorter Oxford English Dictionary* at 102, Volume 1, (1993 Edition) (Exhibit US-106)

⁶³³ *Upland Cotton (Panel)*, para. 7.700.

15.7 of the *SCM Agreement* and Article 4.1(b) of the *Agreement on Safeguards* should not be used as contextual guidance in interpreting the same term in footnote 13 of the *SCM Agreement*.

411. Brazil asserts that the Panel should not look to Article 15.7 of the *SCM Agreement* for contextual guidance, because the Panel cannot “import” the requirement in that provision for a “change in circumstances” into an inquiry as to the “threat of serious prejudice” under Article 5(c)/footnote 13 of the *SCM Agreement*. Brazil’s assertion is irrelevant; the United States has not suggested that any of the requirements for making a determination of “threat of serious injury” in Article 15.7⁶³⁴ should be “imported” into an inquiry into the existence of a “threat of serious prejudice” under Article 5(c). The United States simply submits that the ordinary meaning of “threat” of certain injurious effects, as reflected in Article 15.7 of the *SCM Agreement* and Article 4.1(b) of the *Agreement on Safeguards*, provides important contextual guidance in interpreting “threat” of serious prejudice in Article 5(c)/footnote 13 of the *SCM Agreement*.⁶³⁵

412. This is so not only because of the application of customary rules of treaty interpretation,⁶³⁶ but because all three provisions serve a similar purpose – they identify the same narrow circumstance in which it may be appropriate to discipline a Member’s measures *notwithstanding* that the measures are not prohibited *per se* and are not necessarily presently causing any injurious effects or prejudice (and, indeed, as Brazil notes, they are not even *certain* to do so even in the future⁶³⁷). In such situations, the Member’s measure can be subjected to discipline only if there nonetheless a proper “threat” of such injurious effects or serious prejudice sufficient to justify the

⁶³⁴ Including making a finding that a change in circumstances that is expected to cause the “threat of material injury” to materialize into actual “material injury” is “clearly foreseen and imminent.”

⁶³⁵ For this reason, it is also irrelevant that Article 5(c)/footnote 13 of the *SCM Agreement* and Article XVI:1 of the GATT 1994 do not include an express cross-reference to Article 15.7 of the *SCM Agreement*. See Brazil First Written Submission, para. 255. This is not a situation in which a term is given a special meaning in a particular provision or agreement such that it is necessary to clarify when the term is used “in the same sense” elsewhere (this explains the “in the same sense” cross-reference in footnote 11 of the *SCM Agreement* regarding “injury” or in footnote 13 of the *SCM Agreement* regarding “serious prejudice”). A panel may consider the ordinary meaning of a term as reflected in a particular provision to interpret the same term in another provision (especially of the same agreement) without the need for an express cross-reference. Indeed, if a panel could not do so, this Panel would err (as the original panel also would have done) by considering the definition and requirements for an “export subsidy” finding in the *SCM Agreement* as contextual guidance in interpreting the term “export subsidy” in the *Agreement on Agriculture*. There is certainly no “cross-reference” in either agreement that expressly authorizes a panel to consider the former as contextual guidance for the latter, yet Brazil has not argued that this prevents the Panel from doing so.

⁶³⁶ For example, that treaty terms are to be interpreted “in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose.” See *United States – Gasoline (AB)*, p. 17 (noting that “[this] general rule of interpretation [codified in Article 31 of the *Vienna Convention on the Law of Treaties*] has attained the status of a rule of customary or general international law. As such, it forms part of the ‘customary rules of interpretation of public international law’ which the Appellate Body has been directed, by Article 3(2) of the DSU, to apply in seeking to clarify the provisions of the General Agreement and the other ‘covered agreements’ of the Marrakesh Agreement Establishing the World Trade Organization. . . .)

⁶³⁷ Brazil First Written Submission, para. 247-248.

application of a remedy (whether it is multilateral, in the case of a WTO claim based on Article 5(c)/footnote 13, or unilateral, in the case of a countervailing duty or safeguard investigation). The elaboration of “threat” in the latter two contexts – specifically, underscoring the sense of probability and proximity in time, consistent with its ordinary meaning – is undoubtedly important in understanding the use of the same term in the former context.

413. Moreover, although Brazil asserts that “the precedent interpreting the terms ‘threat’ and ‘threaten’ suggests that the appropriate standard of threat in Part III [of the *SCM Agreement*] is one in which there is a significant likelihood . . . that serious prejudice will occur in the future,”⁶³⁸ it in fact identifies no such precedent. Brazil cites to five reports in its discussion of the threat standard – the Appellate Body reports in *United States – Lamb Safeguards*, *United States – Upland Cotton*, *United States – FSC*, and the GATT panel reports in *EC – Sugar I (Australia)* and *EC – Sugar II (Brazil)*.⁶³⁹ None of these reports suggest that the proper interpretation of “threat” in Article 5(c)/footnote 13 of the *SCM Agreement* is “significant likelihood.” To the contrary, the first of these reports – the Appellate Body report in *United States – Lamb Safeguards* interpreted “threat” of serious injury to mean “serious injury that is clearly imminent,” consistent with the elaboration of that term in Article 4.1(b) of the *Agreement on Safeguards*. Moreover, in doing so, the Appellate Body underscored that “in making a determination on either the existence or ‘serious injury,’ or on a ‘threat’ thereof, panels must always be mindful of the very high standard of injury implied by these terms.”⁶⁴⁰

2. Brazil’s Claims of Threat of Serious Prejudice Are Without Factual Basis

414. Brazil fails to demonstrate any threat of serious prejudice for MY 2007 or beyond. Indeed, most of the factual bases it asserts are recycled from the context of its “present” serious prejudice claims, which the United States has addressed and rebutted above and in the U.S. first written submission. Nonetheless, the United States addresses the same points here again in summary.

415. Before turning to Brazil’s arguments, however, the United States notes what is conspicuous in its absence from the allegedly “future-oriented” analysis Brazil purports to provide; namely, any acknowledgment of the fact that both the marketing loan and counter-cyclical payment programs are *scheduled to expire in October of this year*.⁶⁴¹ Therefore, Brazil’s arguments of threat of serious prejudice are *per se* baseless to the extent that they extend to any year beyond MY 2007, the last marketing year for which payments may be made under the current statutory scheme.

⁶³⁸ Brazil First Written Submission, para. 253.

⁶³⁹ Brazil Rebuttal Submission, paras. 246-261.

⁶⁴⁰ *United States – Lamb Safeguards (AB)*, para. 126.

⁶⁴¹ See Section 1201(a) of the FSRI Act of 2002 (Exhibit BRA-29).

416. To the extent that Brazil's claims of threat of serious prejudice pertain to MY 2006, the United States notes that MY 2006 is the *present* marketing year and is the year that is relevant for purposes of Brazil claims of "present" serious prejudice. Indeed, as noted above, both Brazil and the United States appear to agree that, in assessing any effects of the marketing loan and counter-cyclical payment program, it is necessary to examine the *planting* decision. All planting decisions for MY 2006 have already been made – they were made in January to March of 2005⁶⁴² – and any effect that the marketing loan and counter-cyclical payment programs could have had on that decision have already occurred. As discussed above, Brazil has not demonstrates that the marketing loan and counter-cyclical payment programs have had any significant effect on planting decisions in MY 2006. That fact is useful in assessing Brazil's similar failure to demonstrate a "threat" of serious prejudice in respect of future marketing years.

417. Brazil's claims of threat of serious prejudice, thus, appear to pertain to any effects that the marketing loan and counter-cyclical payment program *might* have on planting, production, export, and prices in MY 2007. The United States note in this regard that U.S. producers are currently making their planting decisions with respect to MY 2007. Therefore, current projections regarding future prices levels and other factors provide useful insight as to what producers are deciding and whether marketing loan and counter-cyclical payment are having any significant effect on this process. The United States addresses such evidence in the context of rebutting Brazil's arguments regarding threat of serious prejudice below.

a. Producers are expecting higher prices and low or no marketing loan payments

(i) Producers likely to expect low or no marketing loan payments in MY 2007

418. The average January-present futures price for upland cotton is 59.9 cents/lb.⁶⁴³ These are, in other words, the prices that U.S. producers are expecting, presently, to be able to get on the market at the time of harvest and marketing of the 2007 crop. The NY futures price reflects the expected spot price, NY delivery, for upland cotton. Over the last decade, the A-Index has typically been approximately 8 cents *above* the spot price (i.e., 67.9 cents/lb in this case), and the AWP has typically been 14 cents/lb below the A-Index (i.e., 53.9 cents/lb).⁶⁴⁴ At this expected AWP, U.S. producers are unlikely to plant on the expectation that they will receive marketing loan payments. In other words, marketing loan payments are unlikely to have any significant effects on planting, production, exports, or world market prices in MY 2007.

⁶⁴² See e.g. Cotton Percent Planted, 15 Selected States (Exhibit US-44) showing that planting usually starts in early April. Most planting decisions are, thus, made before this, in January-March.

⁶⁴³ U.S. Rebuttal Submission Data Tables; Futures Prices (Exhibit US-83).

⁶⁴⁴ U.S. Rebuttal Submission Data Tables; Upland Cotton Prices (Exhibit US-83).

419. Price projections for MY 2007 are consistent with this. According to an ICAC market report released on February 1, 2007, the A-index is projected to be 59 cents/lb in MY 2006 and 66 cents/lb in MY 2007. This would be almost the same level achieved in MY 2003, and higher than the 20-year average for upland cotton.⁶⁴⁵ Again, at these price levels, there are unlikely to be any marketing loan payments made. A new baseline projection published by the Congressional Budget Office (“CBO”) confirms that for MY 2007, the expectation is that there will be no more than a 2 cent/lb marketing loan payment (and by MY 2008, the projection is of no marketing loan payment at all).⁶⁴⁶ Under these circumstances, Brazil’s assertions that the marketing loan program is “designed” to provide “consistently large amounts” of payments is demonstrably false.⁶⁴⁷

(ii) Producers likely expect effectively “fixed” counter-cyclical payments in MY 2007

420. With respect to counter-cyclical payments, the new CBO estimates confirm that these payments are expected to remain at approximately 13 cents/lb in MY 2007. According to a recent study of counter-cyclical payments conducted by the same economist whose research the original panel relied upon, in circumstances where expected counter-cyclical payments remain at their statutory maximum, they “become more like ‘fixed’ payments.”⁶⁴⁸ In other words, like the direct payments that the original panel found not to be causing significant price suppression in MY 1999-2002. For this reason, and the reasons discussed above – such as the recent studies showing minimal effects on planting – the United States submits that Brazil has not shown that counter-cyclical payments threaten to cause any serious prejudice in MY 2007.

b. U.S. planting, production, and share of world production are projected to decline in MY 2007

421. Projections for MY 2007 U.S. plantings, production, and exports also undermine Brazil’s claims of “threat of serious prejudice.” The ICAC projects that U.S. cotton area will decline in MY 2007, as will U.S. production (from 4.73 million tons in MY 2006 to 4.41 million tons in MY 2007).⁶⁴⁹ U.S. share of world market production is also projected to decline from 19 percent to 17 percent.⁶⁵⁰ This continues a decline that began in MY 2006. Indeed, for MY 2006, USDA’s December 2006 forecast is 21.3 million bales, which is approximately 11 percent below MY

⁶⁴⁵ Cotton This Month, ICAC, p. 4 (February 1, 2007) (Exhibit US-107).

⁶⁴⁶ CBO January 2007 Baseline for CCC & FCIC (January 22, 2007) (Exhibit US-91).

⁶⁴⁷ It is also entirely irrelevant given that the question is one of *the effect* of payments – in this case, on the planting decisions of U.S. upland cotton farmers – and not merely the size of payments.

⁶⁴⁸ Paul A. Westcott, “Counter-Cyclical Payments Under the 2002 Farm Act: Production Effects Likely to be Limited” (3rd Quarter 2005) (Exhibit US-35).

⁶⁴⁹ Cotton This Month, ICAC, p. 4 (February 1, 2007) (Exhibit US-107).

⁶⁵⁰ Cotton This Month, ICAC, p. 4 (February 1, 2007) (Exhibit US-107).

2005 levels.⁶⁵¹

c. U.S. producers are expected to continue to meet their variable costs and much of their total costs in MY 2007

422. As shown above, cost data for future marketing years show that U.S. producers will likely cover their variable, or operating, costs as well as a large share of total costs in MY 2007. For the Panel’s convenience, the United States replicates, here, the cost analysis discussed above in the context of Brazil’s claims of “present” serious prejudice:

Upland Cotton Lint Costs and Returns, Forecast 2006-2008

| Item | 2006 | 2007 | 2008 |
|-----------------------|-------------------|------|------|
| | Dollars per pound | | |
| Total costs | 0.61 | 0.69 | 0.7 |
| Operating costs | 0.38 | 0.43 | 0.44 |
| Price | 0.46 | 0.53 | 0.55 |
| Yield (lb/harv. acre) | 819 | 763 | 770 |

1/ Adjusts for cottonseed revenue/ginning costs as described below and includes hired labor.
Source: USDA⁶⁵²

423. According to this analysis, in MY 2007, prices are expected to exceed variable costs by more than 10 cents/lb. Therefore, marketing loan and counter-cyclical payments are unlikely to factor into the decision as to whether to plant upland cotton, some other crop, or to put the land to other use in MY 2007.

424. Brazil’s arguments focus solely on the question of long-term production decisions (such as whether to continue or exit cotton farming). However, as the United States has explained above, Brazil’s approach of considering costs and revenue solely from upland cotton production in assessing those types of long-term decisions is flawed. Brazil has, thus, failed to demonstrate on the basis of projected costs that the marketing loan and counter-cyclical payment programs “threaten” to cause significant price suppression within the meaning of Article 6(c) of the *SCM Agreement*.

425. For the reasons above, Brazil’s claims of “threat” of serious prejudice fail. It has not submitted any empirical evidence to support its claims. Brazil’s claims seem to fall again on the econometric modeling performed by the economist it has retained for purposes of this

⁶⁵¹ Cotton and Wool Outlook (December 12, 2006) (Exhibit BRA-576).

⁶⁵² See e.g., Exhibit BRA-575, Exhibit BRA-479. The 2006 yield is from the January 2007 World Agricultural Supply and Demand Estimates (WASDE) Report (Exhibit US-92).

proceeding.⁶⁵³ As discussed above, however, this modeling is deeply flawed and not a reliable basis for a finding regarding either “present” serious prejudice or “threat” of serious prejudice.

3. Brazil’s Argument that the United States Has “Forgone Its Right” to Respond to Brazil’s Contingent Claims of Threat of Serious Prejudice Is Baseless

426. The United States notes Brazil’s argument that the Panel should deny the U.S. “right to respond” to Brazil’s contingent claims of threat of serious prejudice. This argument is baseless and Brazil’s continuing efforts to deny the U.S. the opportunity to present its arguments are regrettable.

427. As the Panel will recall, despite have had many *months* to prepare its own first submission, Brazil “strongly opposed” the provision of any additional time to the United States to respond to Brazil’s claims.⁶⁵⁴ Brazil argued against this on the basis, *inter alia*, that the United States would have “multiple opportunities” in the future – a rebuttal submission, an opening and closing statement in the meeting with the panel, and, possibly, an opportunity to respond to questions from the Panel – to address Brazil’s arguments.⁶⁵⁵

428. Brazil now suggests that the United States has “foregone its right to respond” to Brazil’s contingent claims of threat of serious prejudice, because the United States focused, in its first written submission on rebutting Brazil’s *direct* actionable subsidy claims. As the United States explained,⁶⁵⁶ this was an appropriate approach given (a) the fact that Brazil’s threat claims against the marketing loan and counter-cyclical payment programs are outside scope of this proceeding and that the United States had submitted preliminary ruling requests to that effect (requests to which Brazil required almost 5 weeks to respond), (b) the fact that the “threat” claims were presented as *contingent* claims that rely on many of the same factual arguments made by Brazil in connection with its claims of present serious prejudice; (c) the same factual arguments have been addressed and rebutted by the United States in its first written submission in the context of

⁶⁵³ Brazil Rebuttal Submission, para.304-308. The United States also notes that Brazil argues at length about outlays to crops other than upland cotton. Brazil Rebuttal Submission, para.274-278. These arguments are irrelevant to the issues at hand and do not support Brazil’s claims that the marketing loan and counter-cyclical payment programs are causing significant price suppression of the world market price for upland cotton.

⁶⁵⁴ Brazil filed its panel request on August 18, 2006, 3 months before its first submission was due, and of course Brazil was able to work on preparing its submission well before that.

⁶⁵⁵ 22 November 2006 Letter from Brazil, para. 9 (“In addition to the U.S. First Written Submission due on 8 December 2006, the United States also has an opportunity to file a rebuttal submission on 9 January 2007. Further, the United States has the right to present a detailed oral statement at the hearing on 13 February 2007. The United States also will be given the opportunity to make a closing statement on 13 or 14 February 2007 before the Panel. Further, based on past experience, it is highly likely that United States will be asked a number of questions by the Panel and be given an opportunity to provide written answers to such questions after the panel meeting. These numerous opportunities to address arguments fully protect the U.S. (and Brazil’s) due process rights in these expedited Article 21.5 proceedings.”)

⁶⁵⁶ First Written Submission, para. 11, n. 21.

Brazil’s “present” serious prejudice claims; and (d) the limited time available to respond to Brazil’s lengthy submission. Brazil has no basis to suggest now that the United States has “forgone” any right to respond.

429. Indeed, Brazil attempts to draw support from paragraph 12 of the *Working Procedures of the Panel*. However, that provision says nothing about a “right to respond” to any claims, let alone any condition under which such a right is “foregone.” It speaks, instead, about the submission of factual *information*, clarifying that such information is to be submitted to the Panel in the first written submission (or earlier) unless it is “evidence necessary for purposes of rebuttal and answers to questions.” Thus, even on its face, the provision does not support Brazil’s efforts.

430. In any event, as the U.S. has shown above, Brazil’s claims of “threat of serious prejudice” fail because they are premised on an incorrect legal standard. No factual information is necessary to appreciate that argument. Separately, as shown above, the factual information submitted by Brazil is flawed and does not support its own arguments. And, further, any factual information submitted by the United States to demonstrate the flaws in Brazil’s “evidence” and the arguments in respect thereof are fully within the scope of paragraph 12 of the *Working Procedures of the Panel* (“evidence necessary for purposes of rebuttal and answers to questions.”). This is precisely what the panel noted in *Korea – Ships* in rejecting nearly identical arguments in that dispute.⁶⁵⁷

V. CONCLUSION

431. For the reasons set forth above, the United States requests that the Panel reject Brazil’s claims in their entirety and find that the United States has complied with the DSB’s recommendations and rulings and, further, that the U.S. measures taken to comply are not inconsistent with the *SCM Agreement* or the *Agreement on Agriculture*.

⁶⁵⁷ *Korea – Ships (Panel)*, para. 7.279 (“[i]n paragraphs 113 to 121 of its second written submission, the EC is responding to arguments made by Korea (in its first written submission and during the Panel’s first substantive meeting with the parties) concerning the market benchmark proposed in the EC’s first written submission. As such, we consider that the factual information contained in those paragraphs constitutes “evidence necessary for purposes of rebuttals” within the meaning of paragraph 12 of our Working Procedures. For this reason, we decline Korea’s request to dismiss or disregard this evidence.”)