

**WORLD TRADE  
ORGANIZATION**

**WT/DS267/R**  
8 September 2004

(04-3421)

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Original: English

**UNITED STATES – SUBSIDIES ON UPLAND COTTON**

*Report of the Panel*



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## TABLE OF CASES CITED IN THIS REPORT

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<i>Australia – Automotive Leather II</i>	Panel Report, <i>Australia – Subsidies Provided to Producers and Exporters of Automotive Leather</i> , WT/DS126/R, adopted 16 June 1999, DSR 1999:III, 951
<i>Australia – Automotive Leather II (Article 21.5 – US)</i>	Panel Report, <i>Australia – Subsidies Provided to Producers and Exporters of Automotive Leather – Recourse to Article 21.5 of the DSU by the United States</i> , WT/DS126/RW and Corr.1, adopted 11 February 2000, DSR 2000:III, 1189
<i>Australia – Salmon</i>	Appellate Body Report, <i>Australia – Measures Affecting Importation of Salmon</i> , WT/DS18/AB/R, adopted 6 November 1998, DSR 1998:VIII, 3327
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<i>Brazil – Desiccated Coconut</i>	Appellate Body Report, <i>Brazil – Measures Affecting Desiccated Coconut</i> , WT/DS22/AB/R, adopted 20 March 1997, DSR 1997:I, 167
<i>Canada – Aircraft</i>	Appellate Body Report, <i>Canada – Measures Affecting the Export of Civilian Aircraft</i> , WT/DS70/AB/R, adopted 20 August 1999, DSR 1999:III, 1377
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Short Title	Full Case Title and Citation
<i>Canada – Dairy (Article 21.5 – New Zealand and US II)</i>	Appellate Body Report, <i>Canada – Measures Affecting the Importation of Milk and the Exportation of Dairy Products – Second Recourse to Article 21.5 of the DSU by New Zealand and the United States</i> , WT/DS103/AB/RW2, WT/DS113/AB/RW2, adopted 17 January 2003
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<i>EC – Sardines</i>	Appellate Body Report, <i>European Communities – Trade Description of Sardines</i> , WT/DS231/AB/R, adopted 23 October 2002
<i>EC – Sugar Exports (Australia)</i>	GATT Panel Report, <i>European Communities – Refunds on Exports of Sugar</i> , adopted 6 November 1979, BISD 26S/290.
<i>EC – Sugar Exports (Brazil)</i>	GATT Panel Report, <i>European Communities – Refunds on Exports of Sugar – Complaint by Brazil</i> , adopted 10 November 1980, BISD 27S/69.
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<i>Indonesia – Autos</i>	Panel Report, <i>Indonesia – Certain Measures Affecting the Automobile Industry</i> , WT/DS54/R, WT/DS55/R, WT/DS59/R, WT/DS64/R and Corr.1, 2, 3, and 4, adopted 23 July 1998, DSR 1998:VI, 2201
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<i>US – Export Restraints</i>	Panel Report, <i>United States – Measures Treating Exports Restraints as Subsidies</i> , WT/DS194/R and Corr.2, adopted 23 August 2001
<i>US – FSC</i>	Appellate Body Report, <i>United States – Tax Treatment for "Foreign Sales Corporations"</i> , WT/DS108/AB/R, adopted 20 March 2000, DSR 2000:III, 1619
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Short Title	Full Case Title and Citation
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<i>US – Superfund</i>	GATT Panel Report, <i>United States – Taxes on Petroleum and Certain Imported Substances</i> , adopted 17 June 1987, BISD 34S/136
<i>US – Wool Shirts and Blouses</i>	Appellate Body Report, <i>United States – Measure Affecting Imports of Woven Wool Shirts and Blouses from India</i> , WT/DS33/AB/R and Corr.1, adopted 23 May 1997, DSR 1997:I, 323

### TABLE OF ABBREVIATIONS USED IN THIS REPORT

FACT Act of 1990	Food, Agriculture, Conservation, and Trade Act of 1990
FAIR Act of 1996 or 1996 Farm Act	Federal Agriculture Improvement and Reform Act of 1996
ARP Act of 2000	Agricultural Risk Protection Act of 2000
FSRI Act of 2002 or 2002 Farm Act	Farm Security and Rural Investment Act of 2002
AMS	Aggregate Measurement of Support
AWP	adjusted world price
CCC	U.S. Commodity Credit Corporation
CCP or CCP payment	counter-cyclical payment
CFR	Code of Federal Regulations
CIF	cost, insurance, and freight
DP or DP payment	Direct payment under the FSRI Act of 2002, Title I, Subtitle A
DSB	Dispute Settlement Body
EC	European Communities
ERS	Economic Research Service of the USDA
ETI Act of 2000	FSC Repeal and Extraterritorial Income Act of 2000
EU	European Union
FAPRI	Food and Agricultural Policy Research Institute
FCIC	Federal Crop Insurance Corporation
FSA	USA Farm Services Agency
FSC	Foreign Sales Corporation
FY	fiscal year
GSM 102	General Sales Manager 102
GSM 103	General Sales Manager 103
ICAC	International Cotton Advisory Committee
IMF	International Monetary Fund
LDP	loan deficiency payment
MLG	marketing loan gain
MT	metric ton (equals 2204 pounds)
MY	marketing year
NCC	National Cotton Council of America
OECD	Organisation for Economic Co-operation and Development
PFC payment	production flexibility contract payment
RMA	USDA Risk Management Agency

SCGP	Supplier Credit Guarantee Program
U.S.C.	United States Code
USDA	United States Department of Agriculture



## I. INTRODUCTION

1.1 On 27 September 2002, the Government of Brazil requested consultations with the Government of the United States pursuant to Articles 4.1, 7.1 and 30 of the *Agreement on Subsidies and Countervailing Measures* ("SCM Agreement"), Article 19 of the *Agreement on Agriculture*, Article XXII of the *GATT 1994* and Article 4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU") concerning certain subsidies provided to United States producers, users and exporters of upland cotton<sup>2</sup> as well as legislation, regulations, statutory instruments and amendments thereto providing such subsidies. The United States and Brazil held consultations on 3, 4 and 19 December 2002 and on 17 January 2003, but failed to settle the dispute.

1.2 On 6 February 2003, Brazil requested the establishment of a panel<sup>3</sup> pursuant to Article 6 of the *DSU*, Article XXIII:2 of the *GATT 1994*, Article 19 of the *Agreement on Agriculture* and Articles 4.4, 7.4 and 30 of the *SCM Agreement*. At its meeting on 18 March 2003, the Dispute Settlement Body (the "DSB") established a Panel in accordance with Article 6 of the *DSU* to examine the matter referred to the DSB by Brazil in document WT/DS267/7.<sup>4</sup> At that meeting, the parties to the dispute also agreed that the Panel should have standard terms of reference. The terms of reference are, therefore, the following:

"To examine, in the light of the relevant provisions of the covered agreements cited by Brazil in document WT/DS267/7, the matter referred to the DSB by Brazil in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements".

1.3 In its request for establishment of a panel, Brazil requested that the DSB initiate the procedures provided in Annex V of the *SCM Agreement* pursuant to paragraph 2 of that Annex. At its meetings on 18 and 31 March, 15 April and 19 May 2003, the DSB discussed this request.<sup>5</sup>

1.4 On 9 May 2003<sup>6</sup>, Brazil requested the Director-General to determine the composition of the Panel, pursuant to paragraph 7 of Article 8 of the *DSU*. This paragraph provides:

"If there is no agreement on the panelists within 20 days after the date of the establishment of a Panel, at the request of either party, the Director-General, in consultation with the Chairman of the DSB and the Chairman of the relevant Council or Committee, shall determine the composition of the panel by appointing the panelists whom the Director-General considers most appropriate in accordance with any relevant special or additional rules or procedures of the covered agreement or covered agreements which are at issue in the dispute, after consulting with the parties to the dispute. The Chairman of the DSB shall inform the Members of the composition of the panel thus formed no later than 10 days after the date the Chairman receives such a request".

1.5 On 19 May 2003, the Director-General accordingly composed the Panel as follows:

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<sup>2</sup> Footnote 1 of the request for consultations (WT/DS267/1, G/L/571, G/SCM/D49/1, G/AG/GEN/54), which directly follows the phrase "The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton" reads "[e]xcept with respect to export credit guarantee programs as explained below [in that same document]."

<sup>3</sup> WT/DS267/7.

<sup>4</sup> WT/DS267/15.

<sup>5</sup> See the minutes of those meetings in documents WT/DSB/M/145, item 2(a), M/146, item 1(a), M/147, item 6(a) and M/150, item 5(a).

<sup>6</sup> 52 days after the establishment of the Panel (i.e. 18 March).

Chairman: Mr. Dariusz Rosati

Members: Mr. Mario Matus  
Mr. Daniel Moulis

1.6 Argentina, Australia, Benin, Canada, Chad, China, the European Communities, India, New Zealand, Pakistan, Paraguay, Separate Customs Territory of Taiwan, Penghu, Kinmen and Matsu (hereafter referred to as "Chinese Taipei") and Venezuela reserved their rights to participate in the Panel proceedings as third parties.

1.7 The Panel met with the parties on 22-24 July 2003, at a resumed session of the first substantive meeting on 7-9 October 2003 and at a second substantive meeting on 2, 3 December 2003. It met with the third parties on 24 July 2003 and 8 October 2003.<sup>7</sup>

1.8 The Panel submitted its interim report to the parties on 26 April 2004. The Panel submitted its final report to the parties on 18 June 2004.

## II. FACTUAL ASPECTS

2.1 This dispute concerns various United States domestic support measures and other United States measures which Brazil alleges are export subsidies. Brazil alleges that the measures are inconsistent with certain United States obligations under the *Agreement on Agriculture*, the *SCM Agreement* and the *GATT 1994*.

2.2 The measures as identified in Brazil's request for the establishment of a panel are alleged prohibited and actionable subsidies provided to United States producers, users and/or exporters of upland cotton<sup>8</sup>, as well as legislation, regulations and statutory instruments and amendments thereto providing such subsidies (including export credit guarantees), grants, and any other assistance to United States producers, users and exporters of upland cotton. They include measures referred to as marketing loan programme payments (including marketing loan gains and loan deficiency payments (LDPs)), user marketing (step 2) payments, production flexibility contract payments, market loss assistance payments, direct payments, counter-cyclical payments, crop insurance payments, cottonseed payments and export credit guarantee programmes, which are described below.<sup>9</sup>

## III. PARTIES' REQUESTS FOR FINDINGS AND RECOMMENDATIONS

### A. BRAZIL

3.1 Brazil requests that the Panel make the following findings:

- (i) concerning Article 13 of the *Agreement on Agriculture*:
  - Article 13 of the *Agreement on Agriculture* is in the nature of an affirmative defence;
  - Article 13(b)(ii) of the *Agreement on Agriculture* does not exempt US domestic support measures, including marketing loan/LDP payments, crop insurance payments, production flexibility contract payments, direct

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<sup>7</sup> See, *infra*, Section VII:A of this report for procedural aspects of the Panel proceedings.

<sup>8</sup> Brazil's request for establishment of a panel contains the following footnote: "The term 'upland cotton' means raw upland cotton as well as the primary processed forms of such cotton including upland cotton lint and cottonseed. The focus of Brazil's claims relate to upland cotton with the exception of the US export credit guarantee programs as explained below [in that same document]."

<sup>9</sup> Description of these measures can be found in Section VII:C of the report.

payments, market loss assistance payments, counter-cyclical payments, cottonseed payments, and Step 2 payments made in MY 1999-2002 to upland cotton from actions based on Articles 5 and 6 of the *SCM Agreement* and Article XVI:1 of the *GATT 1994*;

- Article 13(c)(ii) of the *Agreement on Agriculture* does not exempt Step 2 "export" payments, GSM 102, GSM 103 and SCGP export credit guarantees and ETI Act subsidies from actions based on Article 3 of the *SCM Agreement* and Article XVI of the *GATT 1994*;
- (ii) concerning Step 2 "export" payments:
  - Section 1207(a) of the FSRI Act of 2002 mandates Step 2 export payments in violation of Articles 3.3 and 8 of the *Agreement on Agriculture*;
  - Section 1207(a) of the FSRI Act of 2002 mandates Step 2 export payments in violation of Articles 3.1(a) and 3.2 of the *SCM Agreement*;
- (iii) concerning export credit guarantee programmes:
  - GSM 102, GSM 103 and SCGP constitute export subsidies within the meaning of the *Agreement on Agriculture* that violate Article 10.1 of the *Agreement on Agriculture* by circumventing and threatening to circumvent the US export subsidy commitments. The three programmes, therefore, also violate Article 8 of the *Agreement on Agriculture*;
  - GSM 102, GSM 103 and SCGP are prohibited export subsidies within the meaning of item (j) of the Illustrative List of Export Subsidies, and within the meaning of Articles 3.1(a) and 3.2 of the *SCM Agreement*;
- (iv) concerning the FSC Repeal and Extraterritorial Income Act of 2000 ("ETI Act"):
  - the ETI Act is inconsistent with Articles 10.1 and 8 of the *Agreement on Agriculture*;
  - the ETI Act is inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*;
- (v) concerning Step 2 "domestic" payments:
  - Section 1207(a) of the FSRI Act of 2002 mandates the payment of Step 2 "domestic" payments in violation of Articles 3.1(b) and 3.2 of the *SCM Agreement*;
  - Section 1207(a) of the FSRI Act of 2002 mandates the payment of Step 2 "domestic" payments in violation of Article III:4 of the *GATT 1994*;
- (vi) concerning present serious prejudice to the interests of Brazil:
  - the US 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 US, world and Brazilian markets for upland cotton in violation of Articles 5(c) and 6.3(c) of the *SCM Agreement*;

- the US subsidies provided during MY 1999-2001 caused and continue to cause serious prejudice to the interests of Brazil by increasing the US share of the upland cotton world market in violation of Articles 5(c) and 6.3(d) of the *SCM Agreement*;
- the US subsidies provided during MY 1999-2002 caused and continue to cause serious prejudice to the interests of Brazil by resulting in the United States having a more than equitable share of world exports of upland cotton in violation of Articles XVI:1 and XVI:3 of the *GATT 1994*;
- (vii) concerning threat of serious prejudice to the interests of Brazil:
  - the US subsidies mandated to be provided in MY 2003-2007 threaten to cause serious prejudice to the interests of Brazil by suppressing upland cotton prices to an extent that is significant in the US, world and Brazilian markets in violation of Articles 5(c) and 6.3(c) of the *SCM Agreement*;
  - the US subsidies mandated to be provided during MY 2002-2007 threaten to cause serious prejudice to the interests of Brazil by increasing the US share of the upland cotton world market in violation of Article 5(c) and 6.3(d) of the *SCM Agreement*;
  - the US subsidies mandated to be provided during MY 2003-2007 to cause serious prejudice to the interests of Brazil by resulting in the United States having a more than equitable share of world exports of upland cotton in violation of Articles XVI:1 and 3 of the *GATT 1994*;
- (viii) concerning selected provisions of the FSRI Act of 2002 and the ARP Act of 2000:
  - the following sections of the FSRI Act of 2002 and the referenced regulations thereto violate, *as such*, Articles 5(c), 6.3(c), 6.3(d) of the *SCM Agreement* and Articles XVI: 1 and 3 of the *GATT 1994* to the extent that they relate to upland cotton:
    - direct payments: section 1103(a)-(d)(1) and 7 CFR 1412.502;
    - counter-cyclical payments: sections 1104(a)-(f)(1), and 7 CFR 1412.503;
    - marketing loan payments: sections 1201(a)-(b), 1202(a)(6), 1202(b)(6), 1204(b), 1205(a)(1), 1205(b), 1205(c)(1), 1608, and 7 USC. 7286 (Section 166 of the FAIR Act of 1996 as amended), and 7 CFR 1427.22;
    - Step 2 Payments: section 1207(a), and 7 CFR 1427.105(a), 7 CFR 1427.107, and 7 CFR 1427.108(d); and
    - crop insurance payments: ARP Act of 2000: sections 508(a)(8), 508(b)(1), 508(b)(2)(A)(ii), 508(b)(3), 508(c)(1)(A), 508(e), 508(k) and 516.

3.2 Brazil requests that the Panel make the following recommendations in light of the above findings:

- recommend to the United States, pursuant to Article 4.7 of the *SCM Agreement*, to withdraw Step 2 "export" payments, GSM 102, GSM 103 and

SCGP export credit guarantees, and subsidies under the ETI Act without delay;

- recommend to the United States, pursuant to Article 4.7 of the *SCM Agreement*, that it withdraw Step 2 "domestic" payments without delay;
- recommend to the United States, pursuant to Article 19.1 of the *DSU*, that it bring the measures found by the Panel to be inconsistent with the *Agreement on Agriculture* or the *GATT 1994* into conformity with the *Agreement on Agriculture* and the *GATT 1994*;
- recommend to the United States pursuant to Article 7.8 of the *SCM Agreement* to remove the adverse effects caused to the interest of Brazil by virtue of the serious prejudice to the interests of Brazil or to withdraw the subsidies;
- recommend to the United States pursuant to Article 7.8 of the *SCM Agreement* to withdraw the subsidies threatening to cause serious prejudice to the interests of Brazil or remove the threat of serious prejudice to the interests of Brazil; and
- recommend to the United States pursuant to Article 19.1 of the *DSU* that it bring its measures providing subsidies to producers, users and exporters of upland cotton in conformity with Articles XVI:1 and 3 of the *GATT 1994*.

3.3 Brazil further asks the Panel to reject all of the United States' requests for preliminary rulings.

B. UNITED STATES

3.4 The United States requests that the Panel make the following preliminary rulings:

- export credit guarantee measures relating to eligible US agricultural commodities other than upland cotton were not the subject of consultations and are therefore not within the Panel's terms of reference;
- Brazil failed to provide a statement of available evidence with respect to export credit guarantees for commodities other than upland cotton as required by Articles 4.2 and 7.2 of the *SCM Agreement*;
- production flexibility contract payments and market loss assistance payments had terminated prior to Brazil's request for consultations and panel establishment, and are therefore not within the Panel's terms of reference;
- measures under the Agricultural Assistance Act of 2003, including cottonseed payments under that Act, did not exist at the time of Brazil's Panel request, and are therefore not within the Panel's terms of reference;
- cottonseed payments made for the 1999 and 2000 crops were not identified in Brazil's consultation or panel request, and are therefore not within the Panel's terms of reference; and
- Brazil's challenge to storage payments and interest subsidy were not included in Brazil's consultation or panel request, and are therefore not within the Panel's terms of reference.

## 3.5 The United States submits that:

- Article 13 of the *Agreement on Agriculture* (the "Peace Clause") is part of the balance of rights and obligations of Members and is not an affirmative defence;
- pursuant to Article 13(a)(ii) of the *Agreement on Agriculture*, direct payments under the FSRI Act of 2002 and expired production flexibility contract payments under the 1996 FAIR Act (to the extent within the Panel's terms of reference) "conform fully to the provisions of Annex 2 to [the Agriculture] Agreement" and are "exempt from actions based on Article XVI of the *GATT 1994* and Part III of the Subsidies Agreement";
- pursuant to Article 13(b)(ii) of the *Agreement on Agriculture*, US domestic support measures that conform fully to the provisions of Article 6 of the *Agreement on Agriculture*, including the marketing loan programme (including marketing loan gains and loan deficiency payments), user marketing (step 2) payments, direct payments, counter-cyclical payments, and crop insurance payments, for marketing year 2002, as well as payments made during each of marketing years 1999-2001, "do not grant support to a specific commodity in excess of that decided during the 1992 marketing year" and are "exempt from actions based on paragraph 1 of Article XVI of *GATT 1994* and Articles 5 and 6 of the Subsidies Agreement";
- Brazil may not bring or maintain any action against such measures "based on" the provisions specified in the respective Peace Clause provisions;
- Section 1207(a) of the FSRI Act of 2002 does not mandate Step 2 payments that are inconsistent with Articles 3.3 and 8 of the *Agreement on Agriculture*, Articles 3.1(a), 3.1(b), and 3.2 of the *SCM Agreement*, and Article III:4 of the *GATT 1994*;
- US export credit guarantee programmes (GSM 102, GSM 103 and SCGP) for upland cotton and the export credit guarantee programmes for all eligible agricultural commodities (to the extent within the Panel's terms of reference), are not export subsidies within the meaning of the *Agreement on Agriculture*, are not inconsistent with Articles 10.1 and 8 of the *Agreement on Agriculture*, and are not a prohibited export subsidy within the meaning of item (j) of the Illustrative List of Export Subsidies or within the meaning of Articles 3.1(a) and 3.2 of the *SCM Agreement*; and
- Brazil has failed to make a prima facie case that the ETI Act is inconsistent with Articles 10.1 and 8 of the *Agreement on Agriculture* and inconsistent with Articles 3.1(a) and 3.2 of the *SCM Agreement*.

3.6 The United States submits that, in the event the Panel were to find that Brazil has demonstrated that the US measures do not satisfy the conditions of Article 13 of the *Agreement on Agriculture*:

- crop insurance payments are not specific within the meaning of Article 2 of the *SCM Agreement* and are not subject to the provisions of Part III of the *SCM Agreement*;

- US direct payments, expired production flexibility contract payments, counter-cyclical payments, and expired market loss assistance payments are no more than minimally trade- or production-distorting and Brazil's claims under Articles 5(c) and 6.3 of the *SCM Agreement* and Article XVI of the *GATT 1994* fail; and
- with respect to measures properly within the Panel's terms of reference, those measures are fully consistent with the United States' WTO obligations.

#### IV. ARGUMENTS OF THE PARTIES

4.1 The arguments of the parties as submitted, or as summarized in their executive summaries as submitted to the Panel, are attached as Annexes (see Table of Annexes, page ix ff).

4.2 The parties' answers to questions from the Panel, their comments on each other's answers, and other documents submitted at the request of each other are also attached as Annexes.

#### V. ARGUMENTS OF THE THIRD PARTIES

5.1 The arguments of those third parties which have made submissions to the Panel are attached to this Report as Annexes. Third parties' responses to the Panel's questions are also attached as Annexes.

#### VI. INTERIM REVIEW

6.1 On 26 April 2004, the Panel submitted its interim report to the parties. On 17 May 2004, Brazil and the United States submitted written requests for review of precise aspects of the interim report. On 3 June 2004, Brazil and the United States submitted written comments on each other's request for interim review.

6.2 The Panel has modified aspects of its findings in light of the parties' comments where it considered appropriate, as explained below.<sup>10</sup> Moreover, the Panel has made certain technical corrections and revisions as well as other modifications, as described in paragraph 6.59 below.

##### A. CONFIDENTIALITY OF THE PANEL'S INTERIM REPORT

6.3 The **United States** requests that the Panel note in its final report that Brazil had breached the obligation of confidentiality of the Panel's interim report and to note any information that the Panel obtained with respect to those breaches.

6.4 **Brazil** replies that it "regrets the unfounded U.S. accusation that it has breached the confidentiality of the Panel's Interim Report" and provides certain details to support its view that certain press reports which ostensibly attributed content to, for example, "Brazilian diplomats" "speaking on condition of anonymity" could not have and, in fact, had not, obtained information from any Brazilian source. Brazil states that the ostensible sources cited in such press reports could just as easily have been United States officials or other persons not connected with Brazil.

6.5 The **Panel** notes that, when we transmitted our interim report to the parties, we clearly indicated that it was confidential. Indeed, pursuant to Article 18.2 of the *DSU*, all panel proceedings remain confidential until the Panel Report is circulated to WTO Members. Over and above the binding treaty obligation of confidentiality in the *DSU*, the confidentiality of our Panel proceedings

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<sup>10</sup> Unless otherwise indicated, references to paragraph numbers and footnote numbers in this Section are those shown in the final report.

was reflected in our working procedures adopted pursuant to Article 12.1 of the *DSU*. Therefore, we are profoundly concerned to observe that the confidentiality has not been respected and that aspects of the Panel's interim report were disclosed, as evidenced in various press reports brought to our attention by the parties. We consider this lack of respect for confidentiality unacceptable.

#### B. SECTION VII:B - PRELIMINARY RULINGS

6.6 The **United States** requests review of paragraph 7.61 because, in its view, the mere fact that Brazil submitted written questions during consultations does not show that certain measures were the subject of actual consultations; and paragraph 7.179 because storage and interest may be waived in some instances but not all and because these waivers are not unique among covered commodities to upland cotton.

6.7 **Brazil** asks the Panel to reject both the United States' requests. With respect to paragraph 7.61 in its view, the fact that questions were posed proves that consultations were held, despite the fact that the United States refused to answer them. Otherwise, a Member could block dispute settlement procedures simply by refusing to engage during the consultation process. Paragraph 7.179 does not indicate that these waivers are unique, among covered commodities, to upland cotton.

6.8 The **Panel** declines to modify paragraph 7.61 in view of the considerations set out in paragraph 7.67. The Panel considered that paragraph 7.179 of the interim report was consistent with the United States' concerns on interim review but has modified it in the final report for the avoidance of doubt.

#### C. SECTION VII:C - PRELIMINARY ISSUES

6.9 The **United States** requests review of paragraph 7.202 to reflect the fact that some CCC programmes are not administered by the FSA; paragraph 7.209 so as not to imply that user marketing (Step 2) payments were made in 1990; footnote 294 to paragraph 7.213 so as not to suggest that the FACT Act of 1990 set a target price of "72.9 cents per pound"; paragraphs 7.215 and 7.222 so as to clarify further that planting flexibility limitations and exceptions only applied to acreage corresponding in amount to base acres; paragraph 7.216 to note the timing of the enactment of MLA payments each year; footnote 306 to paragraph 7.217 to add a reference to base acres and to alter the amount of MLA payments; paragraphs 7.218, 7.223 and 7.225 to clarify the definition of "producer"; paragraph 7.218 to clarify the coverage of peanuts; paragraph 7.225 to avoid mixing disparate rates calculated according to current and historical production; footnote 456 to paragraph 7.334 and paragraph 7.336 in relation to the mandatory/discretionary distinction; to strike a footnote to paragraph 7.227 which discussed the meaning of "exempt from actions" in relation to non-violation nullification and impairment claims, because it was unnecessary for the purposes of this dispute; paragraph 7.349 for clarity; and to make certain other technical revisions.

6.10 **Brazil** agrees with the United States' requests with respect to paragraph 7.202; footnote 306 to paragraph 7.217 to add a reference to base acres; and paragraph 7.218 and footnote 310 relating to peanuts. Brazil does not object to the United States' request with respect to former footnote 394 to paragraph 7.277 and paragraph 7.349. Brazil agrees that amendments could be made but suggests alternative language in paragraphs 7.209, 7.215, former footnote 303 to paragraph 7.219 (including cross-references to the factual findings in the Attachment to Section VII:D) and paragraph 7.225. Brazil asks the Panel to reject the United States' requests with respect to footnote 294 to paragraph 7.213 as it is factually correct; paragraph 7.216 as the change is unnecessary but, if it is amended, Brazil suggests alternative language that the timing of enactment of MLA payments did not diminish their impact on supporting production of upland cotton; footnote 306 to paragraph 7.217 because the amounts are correct; paragraphs 7.218 and 7.223 with respect to the definition of "producer" as that is the term used in the legislation and is already explained in the interim report but

Brazil also suggests alternative language in paragraph 7.218; paragraph 7.222 as, in its view, the amendment would only complicate the sentence without adding clarity; and paragraph 7.225, fifth sentence because CCP payments should not be seen in isolation and the loan rate is qualified by the words "where applicable".

6.11 The **Panel** takes note of the parties' comments and has modified paragraphs 7.202, 7.209, 7.215 (and added a footnote), 7.222, 7.225; modified footnote 294 to paragraph 7.213 for clarity; modified paragraphs 7.212 (and added a footnote), 7.213 (and modified a footnote), 7.218 (and modified one footnote and added another), 7.219 (deleted a footnote), 7.223 (and added a footnote) and 7.224 to clarify the meaning of "producer" by quoting the applicable definitions and then using the defined term, which is the approach followed in the relevant legislation, and to cross-reference the factual findings in the Attachment to Section VII:D; and modified paragraph 7.217 and footnote 306 to clarify and correct the MLA payment amounts. The Panel has deleted former footnote 394 from paragraph 7.277, having satisfied itself that nothing in Article 13(b)(iii) of the *Agreement on Agriculture* is inconsistent with its findings in that paragraph. The Panel takes note of the parties' comments and declines to modify paragraph 7.216 as it is sufficiently detailed. The Panel further takes note of the parties' comments on footnote 456 to paragraph 7.334 and paragraph 7.336 in relation to the mandatory/discretionary distinction. The Panel declines to modify footnote 456 as it is logically accurate, and has made certain modifications to paragraphs 7.335 and 7.336, including inserting footnotes for greater clarity. The Panel has also deleted a footnote from paragraph 7.211 and made certain other technical revisions as suggested by the parties, including footnote 453 to paragraph 7.331.

D. SECTION VII:D - DOMESTIC SUPPORT MEASURES AND ARTICLE 13 OF THE *AGREEMENT ON AGRICULTURE*

1. **General**

6.12 **Brazil** requests review of footnote 469 to paragraph 7.345 to correct the date on which it submitted that the peace clause expired; paragraph 7.450 to correct a reference to the target price in the first line; paragraphs 7.453-7.456 for consistency with the inclusion of crop insurance payments in the peace clause tabulation; paragraphs 7.561-7.567 to cross-reference the calculation of CCP payments; paragraph 7.566 to clarify that the producers in question are upland cotton producers; and paragraph 7.594 for clarity. It also suggests technical revisions to paragraphs 7.640 and footnote 595.

6.13 In response, the **United States** agrees that paragraph 7.450 should be corrected but suggests an alternative term. The United States does not agree to refer in paragraph 7.566 to "upland cotton producers" because the evidence cited does not necessarily mean that any policy holders is a producer, and it suggests alternative language.

6.14 The **United States** requests review of paragraph 7.386 for consistency; paragraph 7.387 to be deleted since it is not necessary to resolve the matter before the Panel; paragraph 7.403 to reflect additional arguments presented by the United States; footnote 579 to paragraph 7.437 because the meaning of "crop year" or "crop" could vary depending on the context; paragraph 7.446 with regard to the role of the OBRA Act of 1990; paragraph 7.488 with respect to the relevance of the quotation; paragraph 7.517 to distinguish between types of covered losses and separate plans of insurance; paragraph 7.562 with respect to the authorizing statutes for MLA payments and the term "successor" programmes; paragraph 7.574 and footnote 740 to reflect Brazil's explanation of its 14/16ths methodology and for clarity; footnote 748 to paragraph 7.577 to correspond to the contents of the Attachment; paragraph 7.600 to treat A.R.P. and flex acres in the same way; and paragraphs 7.602 and 7.603 to reflect the way in which CCP payments are calculated; and certain technical revisions.

6.15 In response, **Brazil** agrees to the United States' requested amendment of paragraph 7.562 with respect to the authorizing statutes for MLA payments. Brazil does not object to the clarification of

former paragraph 7.490 or to the deletion of the footnote to Brazil's Annex IV methodologies, but suggests that the Panel make additional findings on those methodologies, including that Brazil's use of them was appropriate. Brazil agrees that amendments could be made but suggests alternative language in paragraphs 7.386, 7.446 and 7.513. Brazil strongly disagrees with the deletion of paragraph 7.387 as it may be of relevance on appeal. Brazil asks the Panel to reject the following United States' requests: with respect to paragraph 7.403 as the additional arguments contradict a USDA statement submitted by Brazil referred to in the preceding paragraph and because the lack of base updates during the term of the FSRI Act of 2002 is already mentioned; with respect to the footnote to paragraph 7.437 because the United States did not dispute that the upland cotton crop year and upland cotton marketing year are identical in response to a question from the Panel and both parties had used these terms interchangeably in submissions; with respect to paragraph 7.517 because the Panel's description is factually correct and the United States has not proved its assertion that these coverage for the relevant types of losses were ever offered to other crops; paragraph 7.562 because these programmes are "successors" in the ordinary sense of that word; and paragraph 7.574 because the reasoning for Brazil's 14/16ths methodology in its response to Panel Question No. 60 is narrowly limited. Brazil stated that it developed that methodology as a proxy amount and made the reasonable assumption that each acre of upland cotton planted would receive support equivalent to the support that an upland cotton base acre would receive since the United States had "misrepresented" the fact that it did not have data on the amount of contract payments made to current producers of upland cotton; footnote 740 to paragraph 7.574 because it is necessary to understand the relationship of the 14/16ths ratio to payments; paragraph 7.602 because deficiency payments were also calculated in respect of base acreage; paragraph 7.603 because, on the facts, it is accurate to state that upland cotton producers receive CCP payments and unnecessary to make the change requested by the United States. Brazil asks the Panel to reject the United States' request with respect to the A.R.P. in paragraph 7.600 but proposes a different amendment to reflect programme non-participation rates in order to show that the percentage of upland cotton acreage ineligible for support from the marketing loan programme was 11.8 per cent, which is much higher than the 7.5 per cent found by the Panel.

6.16 The **Panel** takes note of the parties' comments and has made modifications to footnote 469 to paragraph 7.345, as suggested by Brazil, to correct the date on which it submitted that the peace clause expired (i.e. 31 December 2003); paragraph 7.349; paragraphs 7.386, 7.403 (and added a footnote), footnote 579 to paragraph 7.437, paragraph 7.446, paragraph 7.450 consistently with the language of preceding paragraphs; paragraphs 7.453 (and modified, deleted and added footnotes), 7.456, 7.490 (former paragraph), 7.504, 7.513 (and added a footnote), 7.516, 7.561, 7.562, 7.574 (and added additional footnotes) and footnote 740; paragraph 7.579 by moving footnote 748 to the correct position; paragraph 7.584; paragraph 7.602, although the Panel declines to state that deficiency payments were calculated in respect of current production because they were also calculated in respect of base acreage; and paragraph 7.603 for greater clarity although the Panel uses the term "producer" which appears in the legislation and description of measures. The Panel has also amended paragraphs 7.593 and 7.594 to clarify the separate issues dealt with in each and to remove unnecessary references to "marketing" years. The Panel has also made certain technical revisions, as suggested by the parties, including revision to paragraph 7.380, footnote 508 to paragraph 7.384, footnote 522 to paragraph 7.395, footnote 595 to paragraph 7.447, footnote 664 to paragraph 7.512 and paragraph 7.642, as well as editing the terminology in paragraphs 7.385 to 7.387 and 7.413 for consistency and adding a footnote to paragraph 7.518 and editing footnote 515 to paragraph 7.386, paragraphs 7.399, 7.481, 7.498 and 7.559(ix), footnote 727 to paragraph 7.565 and paragraph 7.570 for clarity and accuracy. The Panel takes note of the parties' comments and declines to modify paragraph 7.387 since it refers to an argument raised by a third party and silence could be misconstrued as implying a view on that argument; paragraph 7.600 as requested by the United States for the reasons already given in footnote 779, eighth sentence, and paragraph 7.600 as requested by Brazil because, in order to be consistent with the United States' approach, decisions by producers on participation should not be taken into account and also because Brazil's proposed amendment is not strictly limited to responding to the United States' request for review as required by paragraph 16 of the Panel's Working Procedures.

## 2. Section VII:D.5(g) - Brazil's requests that the Panel draw adverse inferences

6.17 The **United States** requests that the Panel review paragraph 7.621 because the FSA does not track total expenditures on a farm-specific basis with respect to planted acres for payments calculated with respect to base acres; and paragraph 7.631(ii) because "the United States preliminarily advised Brazil and the Panel at the second meeting that the release of planted acreage information is confidential information that cannot be released under U.S. domestic law" and Brazil did not suggest substitute farm numbers in Exhibit BRA-369.

6.18 **Brazil** strongly opposes the United States' requests with respect to paragraphs 7.621 and 7.631(ii) as the Panel's analysis accurately reflects the United States' conduct in this dispute and its description reflects the actual sequence of events. Brazil agrees only that the reference to Exhibit BRA-369 should be deleted.

6.19 The **Panel** takes note of the parties' comments and has modified paragraph 7.621 for accuracy to state that the FSA tracks both total expenditures and planting information on a farm-specific basis. The Panel has modified paragraph 7.631(ii) (and modified and added additional footnotes) to remove the statement that substitute farm identifiers had been suggested by Brazil prior to the second substantive meeting and to set out the facts surrounding Brazil's approach to the format of data at the second substantive meeting, which the United States alleged was responsible for its later inability to provide the requested data.

## 3. Factual findings

6.20 The **United States** requests that the Panel delete its factual findings in paragraphs 7.583, the final sentence of paragraph 7.600 and paragraphs 7.634-7.647 because these findings are not necessary to resolve the matter before the Panel.

6.21 **Brazil** strongly disagrees with the United States' requests. In Brazil's view, these factual findings are important, or may be important. The United States has already indicated that it would appeal the Panel's report. In the event that the Appellate Body should modify the Panel's interpretation, these factual findings may be highly relevant for the Appellate Body to "complete the analysis". If so, then these findings may significantly assist the parties in resolving their dispute. Without them, the Appellate Body might be prevented from completing the analysis, which is immensely frustrating for complaining parties who have gone to great expense to develop the evidence necessary to establish their claims.

6.22 The **Panel** takes note of the parties' comments and declines to delete these factual findings. The Panel's function is to assist the DSB in discharging its responsibilities under the *DSU* and covered agreements including, specifically, to make an objective assessment of the facts of the case.<sup>11</sup> The Panel makes the factual findings in this report in order to carry out that function. Certain of these factual findings, notably in the Attachment to Section VII:D, provide support for findings in Section VII:G. The Panel has added a sentence to that effect in paragraph 7.6314. Certain other factual findings are not necessary to resolve the matter according to the Panel's legal interpretations, but we observe that the aim of the WTO dispute settlement system is to secure a positive solution *to a dispute*.<sup>12</sup> In this dispute, the Panel is the sole tribunal of fact<sup>13</sup> and these additional factual findings may ultimately be essential in order to secure a positive solution to it. In this regard, we note that the United States indicates in its request for review that it intends to appeal the Panel's final report.<sup>14</sup>

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<sup>11</sup> Article 11 of the *DSU*.

<sup>12</sup> Article 3.7 of the *DSU*.

<sup>13</sup> Article 17.6 of the *DSU*.

<sup>14</sup> United States' request for interim review, paragraph 2.

E. SECTION VII:E - EXPORT SUBSIDIES

**1. Overview of parties' export subsidy claims and arguments under the *Agreement on Agriculture*, the *SCM Agreement* and the *GATT 1994***

6.23 The **Panel** has made the technical clarification suggested by Brazil in paragraph 7.651(iii).

**2. Relationship between the export subsidy provisions of the *Agreement on Agriculture* and the *SCM Agreement* and the *GATT 1994***

6.24 The **United States** requests that the Panel modify paragraph 7.657 to clarify that Article 21.1 of the *Agreement on Agriculture* is not limited in its application only in the event of a conflict. **Brazil** opposes this request, asserting that the rights and obligations arising from Annex 1A apply cumulatively, unless there is a conflict. **The Panel** has modified paragraph 7.657 in light of the parties' comments, noting that the last sentence commences with the proposition "[i]n the event of a conflict...".

**3. Section 1207(a) of the FSRI Act of 2002: user marketing (Step 2) payments to exporters**

6.25 In connection with our treatment of the parties' comments on the mandatory/discretionary distinction, outlined above in paragraph 6.11, we have modified paragraphs 7.742, 7.746 and 7.747.

6.26 The Panel has made the technical corrections identified by the United States in footnotes 894 and 912, and has supplemented footnote 895 in light of paragraph 6.45 *infra*.

**4. Export credit guarantee programmes**

(a) Brazil

6.27 **Brazil** submits that, in paragraph 7.842, we should place quotation marks around the term "subsidy" - in the sentence beginning "[a]ccording to the United States government, a positive net present value means that the United States government is extending a subsidy..." - to clarify that the term is not used there within the meaning of Article 1.1 of the *SCM Agreement*, but rather in the sense of the United States Federal Credit Reform Act of 1990. The latter defines the term "subsidy" with reference to cost and relates to cost to the United States government. The **United States** expresses no view on this request. Noting that the surrounding paragraph deals with the United States net present value methodology under the FCR Act, and that the sentence begins with the phrase "according to the United States government", the **Panel** has inserted quotation marks around the term "subsidy" in the sentence concerned in paragraph 7.842 and has also inserted a footnote.

6.28 **Brazil** requests that we incorporate our finding in paragraph 7.843 about the consistently positive numbers in the United States budget guaranteed loan subsidy line into Section VII:E.5(d)(i)iii.g. relating to the structure, design and operation of the programmes. The **United States** does not agree with this suggestion. The United States submits that this did not coincide with the analytical approach or conclusions of the Panel. According to the United States, such incorporation would "conflate the conceptual distinction" which the Panel made between past performance of the programmes and structure operation and design of the programmes. The **Panel** has inserted footnote 1052. This does not conflate the conceptual distinction we have drawn in our analysis. Our examination of the past performance of the programme and our findings relating to the structure, operation and design of the measure are mutually reinforcing. As we have already indicated (for example, in paragraphs 7.808 and 7.867), our findings on the United States export credit guarantee programmes are based upon the evidence as a whole.

6.29 **Brazil** requests that we insert, in footnote 1011, a reference to the percentage of rescheduled guarantees (1992-2003) that remain outstanding.<sup>15</sup> The **United States** submits that it would be inappropriate to include the percentage share Brazil proposes as it is derived from figures not constituting part of the discussion in the footnote and accompanying text. In light of the record evidence indicating that approximately \$1.6 billion of defaulted guarantees have been re-scheduled 1992-2003 (Column F of Exhibit US-147), and that approximately \$1.5 billion in principal on rescheduled debt remained outstanding as of 30 November 2003, while \$205 million in principal may have been collected on reschedulings (Column F of Exhibit US-148) and some interest has been collected on reschedulings (Column M in Exhibits US-128 and US-147), the **Panel** does not believe that it is necessary to make the additional percentage finding requested by Brazil.

6.30 **Brazil** requests, in respect of paragraph 7.858 and footnote 1033, that we note that CCC authority to extend export credit guarantees is not limited by the budget appropriations process. The **United States** believes that Brazil's suggestion would distort otherwise fuller and more precise statements of the Panel. The **Panel** has included a reference to 2 USC 661c(c)(2) in footnote 1033.

6.31 **Brazil** requests the Panel to make certain additional "factual" findings regarding the parties' evidence and argumentation relating to Brazil's allegation that the CCC export credit guarantee programmes at issue constitute prohibited export subsidies under the elements of Articles 1 and 3.1(a) of the *SCM Agreement*. Brazil asserts that, in the event one of the parties appeals and the Appellate Body reverses the Panel's conclusion on item (j), it might not have the necessary facts at its disposal to "complete the analysis" with respect to Brazil's claims under Articles 1 and 3.1(a) of the *SCM Agreement*. In the **United States'** view, the Panel has already made findings on the claims cited by Brazil, in paragraphs 7.946-7.948. According to the United States, Brazil improperly requests us to make unnecessary and unsupported additional factual findings with respect to its *SCM Agreement* claims, and to reverse the applicable burden of proof. The United States asserts that Article 10.3 of the *Agreement on Agriculture* applies only in respect of claims of export subsidies in excess of applicable reduction commitment levels under the *Agreement on Agriculture*, and does not apply to export subsidy claims or factual findings under the *SCM Agreement*. The **Panel** declines to make the additional findings requested by Brazil. We are of the view that Brazil's allegation invoking the elements of Articles 1 and 3.1(a) of the *SCM Agreement* is not a separate claim, but merely another argument, on a different factual basis, as to how the United States export credit guarantee programmes would meet the definition of an export subsidy in Article 3.1(a) of the *SCM Agreement*. Given our finding in paragraphs 7.946-7.948, we do not believe that it is necessary to address Brazil's additional arguments about how the Article 3.1(a) definitional elements would be fulfilled on another factual basis in order to resolve this dispute. For greater clarity, we have inserted footnote 1125.

6.32 **Brazil** requests that, in paragraph 7.875 and footnote 1056, we make reference to Exhibit BRA-298, which contains a list of all agricultural products that are eligible for CCC export credit guarantees. The **United States** submits that we should reject Brazil's request, noting that Brazil's own description of Exhibit BRA-298 is that it identifies "all agricultural products that are eligible for CCC export credit guarantees", and that eligibility is not the relevant test under the Panel's approach. The **Panel** declines to make the addition requested by Brazil. Our finding in the paragraph concerned relate to exports of upland cotton and other unscheduled agricultural products *supported* under the programme, and not to all products eligible for such support. We recall that we have already referred to Exhibit BRA-298 in footnote 851, in describing the products subject to Brazil's claim. In the interests of comprehensiveness, we have, however, also inserted a reference to Exhibit BRA-299 in footnote 851.

6.33 **Brazil** requests that the Panel review its statement, in paragraph 7.880, relating to the time period of the United States' actual circumvention of export subsidy commitments for rice. The

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<sup>15</sup> Brazil refers to its 18 February 2004 comments on United States 11 February 2004 responses, para. 38.

**United States'** view is that we should reject Brazil's request. According to the United States, Brazil prepared and presented the data in Exhibit BRA-300 solely as a comment in response to a Panel question which was oriented to the issue of "threaten[ing] to lead to circumvention". Having satisfied ourselves of the record, including the United States' statement in footnote 150 of its further rebuttal submission that "[t]he only commodity with respect to which the United States did not provide [uncontroverted] evidence that the respective quantities of exports under the export credit guarantee programmes did not exceed the applicable quantitative reduction commitment] is rice", the **Panel** has made certain modifications to paragraph 7.880 and footnote 1060 in light of these comments. We also refer to paragraph 6.34 in respect of our treatment of "threatening to lead to circumvention" in respect of rice and to unscheduled products supported under the programmes.

6.34 In respect of paragraphs 7.882-7.896, **Brazil** requests that the Panel address Brazil's "separate claims" that the CCC export credit guarantee programmes, with respect to rice and to unscheduled agricultural products supported under the programmes, threaten to lead to circumvention of the United States export subsidy commitments. The **United States'** view is that we should reject this request. The **Panel** declines to make any additional findings in this respect. We have, however, inserted footnote 1061 for greater clarity.

6.35 We have also made the clarifications and/or modifications suggested by the parties in paragraphs 7.793, 7.821, 7.895, 7.896, 7.940 and 7.1305 and footnotes 1028, 1047, 1067, and have inserted footnote 1080.

(b) United States

6.36 In light of the **United States'** request, with which **Brazil** does not disagree, the **Panel** has made modifications in paragraph 7.803 to more accurately reflect the United States' argument and to clarify that even if an export credit guarantee programme for agricultural products meets the elements of item (j) it would not be a "prohibited" export subsidy under the *SCM Agreement* as long as agricultural export subsidies during the implementation period were within reduction commitments.

6.37 The **United States** requests that we clarify that our reference in paragraph 7.875 (and paragraph 8.1(d)(ii)) to Exhibit BRA-73 as relevant record evidence refers to those unscheduled products that are within the scope of the *Agreement on Agriculture* and our terms of reference. **Brazil** requests us to conclude that GSM 102, GSM 103 and SCGP also constitute prohibited export subsidies within the meaning of item (j) and Article 3.1(a) of the *SCM Agreement*, for all products not covered by the *Agreement on Agriculture*. Recalling that: interim review is not the time to raise new arguments; our terms of reference include export credit guarantees to facilitate the export of United States upland cotton and other eligible *agricultural* commodities as addressed in document WT/DS267/7 (see also *supra*, paras. 7.69 and 7.103); Article 2 and Annex I of the *Agreement on Agriculture* set out the product coverage of that agreement; the core distinction between "scheduled" and "unscheduled" products is rooted in the scheduled commitments under the *Agreement on Agriculture*; and the scope of the products within our terms of reference does not materially affect the programme-wide analytical approach that we have taken, and the evidence we have considered, under item (j), the **Panel** has made the clarifications requested by the United States. This would, of course, affect the cross-reference in paragraph 8.1(d)(ii).

#### F. SECTION VII:F - IMPORT SUBSTITUTION SUBSIDY

6.38 The **United States** suggests that the Panel should omit paragraphs 7.1046-7.1052 as the parties agree that Article 13 of the *Agreement on Agriculture* would not be applicable to the import substitution subsidies at issue and the Panel need not reach further issues concerning the relationship between Article 13 of the *Agreement on Agriculture* and Article 3.1(b) of the *SCM Agreement*. **Brazil** disagrees with the United States' request. According to Brazil, although both parties agreed that Article 13 of the *Agreement on Agriculture* does not exempt actions under Article 3.1(b) of the *SCM*

*Agreement*, Articles 13(b) and (c) of the *Agreement on Agriculture* may still provide context for interpreting Article 3.1(b) of the *SCM Agreement* and Article 6.3 of the *Agreement on Agriculture*. Brazil submits that the Panel correctly explains the relevance of the omission of any reference to Article 3 of the *SCM Agreement* in Article 13(b)(ii) and the importance of its inclusion in paragraph 13(c)(ii) of the *Agreement on Agriculture*. The **Panel** declines to make the deletion requested by the United States. As we have noted, we endorse the shared view of the parties that Article 13 of the *Agreement on Agriculture* does not affect a claim under Article 3.1(b) of the *SCM Agreement*. We believe that our examination of the terms of Articles 13(b) and (c) of the *Agreement on Agriculture* provide relevant context and support for our examination.

6.39 The **United States** requests that we delete footnote 1217 to paragraph 7.1074, as the examples therein are not necessary to resolve the dispute. **Brazil** disagrees with the United States' request. The **Panel** declines to make the deletion requested by the United States. We believe that the considerations in this footnote support our examination.

6.40 The **United States** requests that the Panel strike the second sentence of paragraph 7.1085 as it was not aware of any record evidence relating to the "ease of use" of domestic cotton. **Brazil** submits that the second sentence is not necessary for the Panel's conclusions in the first and third sentences of paragraph 7.1085, but it provides a useful comparison. According to Brazil, evidence suggesting that United States upland cotton is easier to use than imported cotton is reflected in the extremely low import figures for upland cotton into the United States as shown in Exhibit BRA-4, and by the fact that there are far smaller freight and delivery charges for United States mill owners to use United States upland cotton, and because domestic users are paid under the user marketing (Step 2) subsidy. The **Panel** points out that the sentence actually addresses the issue of ease of meeting the conditions of eligibility for the subsidy, as opposed to ease of use of domestic cotton. The rationale behind the sentence is that use of domestically produced cotton does not merely improve the chances of obtaining the subsidy. Rather, as we note in the following sentence, use of such cotton is a pre-condition for receipt of the payments. The Panel therefore declines to make any modification.

6.41 With reference to the United States requests relating to the mandatory/discretionary distinction, the Panel has made certain modifications to paragraphs 7.1089, 7.1094 and 7.1096. The Panel has also made requested modifications to the description of the United States' argument in paragraph 7.1024, as well as modifications, in light of the parties' comments, in paragraphs 7.1148 and 7.1150. We have also made requested technical revisions in footnote 1234.

#### G. SECTION VII:G - ACTIONABLE SUBSIDIES: CLAIMS OF "PRESENT" SERIOUS PREJUDICE

##### (a) Brazil

6.42 **Brazil** requests modifications in respect of footnote 1323 concerning the participation of certain experts as members of its delegation, and suggested that we insert a reference in paragraph 7.1248 to certain expert testimony and statements. The **Panel** has made modifications to footnotes 1323 and 1343, and has inserted footnote 1361 to paragraph 7.1245.

6.43 **Brazil** requests that we refer to Exhibit BRA-302 in support of figures we cite in paragraph 7.1283 relating to United States' share of world exports, and include the level in MY 2002. Brazil also requests that we include figures relating to United States' share of world exports in footnote 1534 or in paragraph 7.1283 so that, in the event of an appeal, the Appellate Body could draw a legal conclusion on the existence of a "consistent trend" within the meaning of Article 6.3(d) of the *SCM Agreement* and could complete the analysis, if necessary. The **United States'** view is that such a finding would appear to be irrelevant in light of the Panel's interpretation of "world market share" in Article 6.3(d), and that the data in Exhibit BRA-302 has been revised as evidenced in Exhibits US-119 and -120 and thus Brazil's requested findings overstate the United States' share of world exports. In light of the parties' comments, our role as the sole tribunal of fact and the fact that

these additional factual findings may ultimately be essential in order to secure a positive solution to this dispute, the **Panel** has modified paragraph 7.1283, including through the insertion of footnote referencing Exhibit BRA-302 and other relevant record evidence. The Panel has inserted cross-references in footnote 1534. The Panel has made further consequent modifications in its report.

6.44 **Brazil** requests that we add references to Exhibits BRA-224, -275 and -276 in footnote 1400 as further USDA studies addressing the effect of the marketing loan programme. The **United States** submits that we should reject Brazil's request. Recalling that the footnote concerned includes the term "e.g." and is therefore not intended to be exhaustive of relevant record evidence, the **Panel** declines to insert the additional references requested by Brazil in footnote 1400. However, the Panel has ensured that these studies are referred to in footnote 1329. The considerations set out in paragraph 7.1215 therefore apply.

6.45 **Brazil** requests that we include, either in the main body of the text or in a footnote, the total amount of user marketing (Step 2) payments to domestic users and exporters. The **Panel** has supplemented footnote 895 and cross-referenced this in footnote 1408.

6.46 **Brazil** requests that we refer to specific evidence in support of our finding in paragraph 7.1313. The **United States** indicates that this is not necessary as, in its view, the Panel has indicated the evidence that it considered in making this finding. The **Panel** has inserted footnote 1428.

6.47 **Brazil** requests the insertion of further cross-references in Section VII.G.3(k). The **United States** does not believe this would add any clarity to the Panel's analysis. In light of the existing cross-references in Section VII.G.3(k), for example in footnotes 1455 and 1458, the **Panel** does not believe it is necessary to insert the further cross-references to Section VII:G.3(j)(iii)ii and iii.

6.48 **Brazil** submits that it would be useful and appropriate for the Panel to make specific findings, in paragraph 7.1415, that it has relied on evidence produced by Benin and Chad. The **United States** does not agree with Brazil that the Panel should alter its detailed analysis and conclusions relating to "other Members". Recalling paragraphs 7.54 and footnote 1323, and underlining the constructive role the participation of experts have played in these proceedings, the **Panel** does not find it necessary to add such a specific reference in the paragraph concerned.

(b) United States

6.49 We have made modifications in paragraphs 7.1148 and 7.1150 in light of the requests of the **United States**, and comments by **Brazil**. The **United States** requests that we delete footnote 1276 and modify paragraph 7.1150 concerning the specificity of crop insurance subsidies, particularly in respect of our discussion of livestock. **Brazil** opposes this request for deletion. In light of the parties' comments, the **Panel** has modified paragraphs 7.1138, 7.1148 and 7.1152 and footnote 1276 for clarity and accuracy.

6.50 The **United States** requests certain modifications to the first sentence of paragraph 7.1168 concerning our characterization of the aim of a countervailing duty investigation. **Brazil** has no objection to these changes. The **Panel** has made the requested changes.

6.51 The **Panel** has declined to modify the description of the A-Index in paragraph 7.1264 as suggested by the **United States**, and opposed by **Brazil**, but the Panel has added to footnote 1374 for accuracy.

6.52 The **United States** requests that we delete footnote 1374. **Brazil** requests that the Panel retain the footnote. The **Panel** has retained the footnote. The Panel derives contextual guidance from the now-lapsed Article 6.1(a) of the *SCM Agreement*. The last sentence of the footnote refers to our

view that while a rate of subsidization may, where available, constitute relevant evidence in a given case, in the particular facts and circumstances of this case, it is not necessary to establish with any precision a rate of subsidization in order to resolve the dispute.

6.53 The **United States** requests clarifications in the third sentence of paragraph 7.1360 relating to the United States share in world production and exports. **Brazil** suggests that we reject the United States request and make a technical modification. In light of the parties' comments, the **Panel** has made certain modifications in the paragraph concerned.

6.54 The **United States** requests that we delete the term "evidentiary" in paragraph 7.1415. Although the United States generally agrees that third party submissions can help provide additional context and support in panel proceedings, the United States submits that the term "evidentiary" could be read as going further than this to imply that third parties can help sustaining Brazil's burden of proof. **Brazil** asserts that the United States' argument that evidence provided by third parties cannot provide "evidentiary support" conflicts with Article 10 of the *DSU*. According to **Brazil**, while a third party cannot alleviate a complainant's burden to present a prima facie case of inconsistency of a measure, the evidence presented by a third party can nevertheless provide "evidentiary" support that can be relied upon by the Panel. The **Panel** has retained the term "evidentiary" in the paragraph concerned. Neither party suggests that evidence provided by a third party may alleviate the complainant's burden to establish a prima facie case. We agree entirely. Information supplied by third parties in support of their allegations may constitute evidence, in terms of additional context and support, that we may take into account in conducting an objective assessment of the matter before us.

6.55 The **United States** requests modifications and/or deletions of paragraphs 7.1425, 7.1451, 7.1452 and 7.1453. **Brazil** opposes these requested modifications, asserting that the United States is trying to introduce a new argument at the interim review stage. Having reviewed the record, the **Panel** has declined to make the precise deletions and modifications requested by the United States. The Panel has, however, made certain modifications, including to paragraphs 7.1425 (also added a footnote), 7.1451 and 7.1453 and has modified footnotes 1519 and 1527 in light of the parties' comments.

6.56 The Panel has also made certain technical and other revisions in respect of suggestions by Brazil in paragraphs 7.1107, 7.1229, 7.1305 (also added a footnote and made a related revision in paragraph 7.214) and footnotes 1185, 1327, 1336, 1375 and 1409, and certain suggestions by the United States in paragraphs 7.1305, 7.1307, 7.1447, 7.1449, 7.1501, footnote 1417 to paragraph 7.1305, footnote 1544 to paragraph 7.1477 and footnote 1561 to paragraph 7.1502. We have also made certain modifications in footnote 1410.

#### H. SECTION VII:H - ACTIONABLE SUBSIDIES: CLAIMS OF "THREAT OF" SERIOUS PREJUDICE

6.57 The **Panel** has modified paragraph 7.1480 and footnote 1544 in light of the parties' comments.

#### I. SECTION VIII - CONCLUSIONS AND RECOMMENDATIONS

6.58 **Brazil** suggested that the language of paragraph 8.3(c) mirror that of paragraph 8.3(b). The **United States** does not object to this, but also wishes to avoid any mistaken impression that the six month period referred to for withdrawal is "required by" Article 4.7. In light of the parties' comments, the **Panel** has modified paragraph 8.3(c). We have, however, retained certain language, as the measures subject to paragraph 8.3(b) are also subject to the recommendation in paragraph 8.3(a). This is not the case for the measure subject to the recommendation in paragraph 8.3(c).

## J. OTHER

6.59 As stated in paragraph 6.2 above, the Panel has also made technical corrections and revisions, as well as other modifications, including the following: paragraphs 7.54 (bullet 5), 7.178, 7.260, 7.261, 7.274, 7.285, 7.330, 7.337(ix), 7.338, 7.340, 7.351, 7.357, 7.365-7.370, 7.375, 7.376, 7.379, 7.387, 7.388, 7.390, 7.392, 7.396, 7.397, 7.412, 7.413, 7.417, 7.418, 7.422, 7.424, 7.436, 7.443, 7.446, 7.447, 7.448, 7.460, 7.464, 7.476 (by adding a footnote), 7.479, 7.480, 7.481, 7.495 (by adding a footnote), 7.499 (by adding a footnote), 7.515, 7.520, 7.526 (by modifying the footnote), 7.528 (by deleting a footnote), 7.551, 7.554 (also added two footnotes), 7.559 (by inserting a new paragraph consistent with paragraph 7.286), 7.584, 7.586, 7.606 (for clarity with paragraph 7.607), 7.628(iii) and (iv) (by adding a footnote to each, respectively), 7.633 (by adding a footnote), 7.636 (also modified a footnote), 7.637, 7.646, 7.665, 7.689, 7.695, 7.704, 7.707, 7.708, 7.713 (by adding a footnote), 7.736, 7.754, 7.826, 7.864 (by quoting an excerpt from an Exhibit), 7.866 (by adding a footnote), 7.883, 7.947 (also added a footnote), 7.1004, 7.1007 (by inserting a new paragraph), 7.1011 (also added a footnote), 7.1014, 7.1037 (also added a footnote), 7.1039, 7.1097, 7.1140, 7.1142, 7.1155 (by moving the paragraph), 7.1161, 7.1165, 7.1192, 7.1200, 7.1213, 7.1222 (by deleting a footnote), 7.1281 (also added a footnote), 7.1282, 7.1284 (also modified a footnote and deleted another), 7.1285, 7.1307, 7.1311, 7.1314, 7.1332, 7.1351 (by adding a footnote to bullet 5), 7.1360, 7.1361, 7.1449, 7.1458, 7.1459 (by inserting a new paragraph and a footnote), 7.1460, 7.1469 (by inserting a new paragraph and five footnotes), 7.1478, 7.1484, 8.1 and footnotes 43, 44, 63, 197, 261, 383, 427, 442, 477, 522, 523, 850, 937, 999, 1011, 1056, 1060, 1076, 1215, 1234, 1294, 1330, 1334, 1337, 1338, 1401, 1456, 1414, 1465, 1496, 1510, 1534 and 1544.

## VII. FINDINGS

### A. PROCEDURAL MATTERS

#### 1. Organization of the Panel's Procedures

7.1 On 21 May 2003, prior to the Panel's adoption of its working procedures, the United States sent a communication to the Panel in which it "propose[d] that the Panel organize its procedures to deal with the threshold Peace Clause issue at the outset of this dispute". It stated, *inter alia*, as follows:

"We would suggest that the Panel first receive written submissions from both parties on the applicability of the Peace Clause, to be followed by a meeting of the Panel with the parties on this issue, and then rebuttal submissions. The Panel would then make findings on whether any US measure is in breach of the Peace Clause. If the Panel agrees that Brazil has failed to establish that the US measures are inconsistent with the Peace Clause, then that would dispose of those claims. If the Panel finds that the US measures are inconsistent with the Peace Clause, then Brazil could have recourse to the Annex V procedures with respect to its Subsidies Agreement claims on these measures. In either event, briefing and meetings of the Panel with the parties could then proceed on any claims not disposed of by the Peace Clause findings.

This procedure would satisfy the legal requirement that certain claims not be maintained while the Peace Clause is applicable and provide the Panel with a fair and orderly means of addressing the issues in this dispute. The United States notes that the Panel has broad discretion to determine its working procedures under Article 12.1 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* ("DSU"), and, under DSU Article 12.2, the Panel is charged with establishing panel procedures with "sufficient flexibility so as to ensure high-quality panel reports." Because in this dispute Brazil has made claims under 17 different provisions of the WTO Multilateral Agreements with respect to numerous US programs under at least

12 US statutes, we believe the Panel's consideration of the critical Peace Clause issue would be aided by briefing and argumentation focused on this threshold issue."<sup>16</sup>

7.2 On 23 May 2003, after the Panel asked Brazil to communicate its views, if any, on the United States' letter<sup>17</sup>, Brazil sent a communication opposing the United States' proposal. It stated, *inter alia*, as follows:

"The United States has singled out AoA [Agreement on Agriculture] Article 13 as a "special" provision which allegedly requires special and unprecedented procedural treatment. Yet DSU Appendix 2, the closed list of "special and additional" rules and procedures that trump the normal rules of dispute settlement, does not include Article 13 or any other AoA provision, nor does it include the cross-references to the AoA in Articles 3.1 and 7.1 of the Agreement on Subsidies and Countervailing Measures (ASCM). There is no support in the DSU, in the Agreement on Agriculture, or elsewhere in the WTO Agreement for the proposition that a separate "mini-trial" on peace clause issues is required before any claim can be made against subsidies under the Agreement on Agriculture. Acceptance of this proposition would invent a substantial new obstacle to future claims by any government against agricultural subsidy programs, altering the rights of Brazil and many other Members, in contradiction to Article 3.2 of the DSU.

The US notion that two rounds of submissions and a special meeting are required before the parties perform any further work on the case is unprecedented. As the Panel is aware, the concept of preliminary objections is not new. [ ... ]

The threshold issues posed by AoA Article 13 are no more or less significant than other threshold issues in many WTO Agreements."<sup>18</sup>

7.3 On 28 May 2003, after having heard the views of the parties in the organizational meeting, the Panel adopted its timetable and working procedures in accordance with Article 12.1 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU").<sup>19</sup> At the same time, the Panel indicated that it intended to make a ruling on certain issues on 20 June 2003, prior to the submission by the parties of their first written submissions. The Panel requested the parties and invited third parties to address the issues related to the proposed ruling. More specifically, the communication relating to the proposed ruling stated as follows:

"As indicated in the attached<sup>20</sup> timetable, prior to the submission by the parties of their first written submissions, the Panel requests the parties to address, in their initial briefs to the Panel (to be submitted on 5 June 2003), the following:

- whether Article 13 of the *Agreement on Agriculture* precludes the Panel from considering Brazil's claims under the *Agreement on Subsidies and Countervailing Measures* in these proceedings in the absence of a prior conclusion by the Panel that certain conditions of Article 13 remain unfulfilled. In particular, the Panel invites the parties to explain their interpretation of the words 'exempt from actions' as used in Article 13 of the *Agreement on Agriculture*, as well as bringing to the Panel's attention any other relevant provisions of the covered agreements and any other relevant

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<sup>16</sup> Excerpt from the United States' letter dated 21 May 2003. See Annex K item 1 for full communication.

<sup>17</sup> Communication from the Panel dated 21 May 2003. (see Annex L-1 item 1).

<sup>18</sup> Excerpt from Brazil's letter dated 23 May 2003. See Annex K item 2 for full communication.

<sup>19</sup> See Annex M.

<sup>20</sup> Attachment omitted. See Annex M item 2 for the evolution of the timetable of this dispute.

considerations which the parties consider should guide the Panel's consideration of this issue. For greater clarity, the Panel invites the parties, during this initial stage of the proceedings, to focus on matters of legal interpretation, rather than upon the submission of any factual evidence that might be associated with the substantive elements of Article 13.

As also indicated in the attached timetable, the Panel will invite the parties to submit any written comments on each other's comments on this issue (i.e. on 13 June 2003). The Panel intends to rule on these issues on 20 June 2003, prior to the parties' submission of their first written submissions.

As has been indicated, the Panel recognizes that it may need to revisit certain aspects of its timetable and working procedures in light of developments during the course of the Panel procedures, including the nature of the Panel's ruling that is scheduled for 20 June 2003. In particular, in the event that the Panel were to rule that Article 13 precludes the Panel from considering certain claims raised by Brazil prior to a conclusion that certain conditions of Article 13 remain unfulfilled, we may decide to adjust the timetable to permit the parties to make further submission(s) after the second substantive meeting and to schedule further substantive meeting(s), as necessary, with the parties. Related amendments to the working procedures may also be made, if necessary.

With respect to the participation of third parties in these Panel proceedings, we have carefully considered the parties' comments at this morning's organizational meeting. In exercise of our discretion to manage these Panel proceedings, we continue to believe that it would be appropriate in this case for the third parties to have access to the parties' initial written comments (and any written comments the parties may make on each others' comments) as well as to have the ability to submit any written comments they themselves may have on the issue that we have identified above. The Panel considers that such third party participation in this initial stage of the Panel proceedings is appropriate for the following reasons.

The Panel is aware of the provisions of Article 10.3 of the *DSU*, which states that third parties shall receive the submissions of the parties to the dispute to the first meeting of the Panel. We would also observe that the factual circumstance that presents itself here is not itself specifically addressed by the *DSU*. In our view, the legal issue that the Panel has asked the parties to address in their initial briefs will necessarily have ramifications for the remainder of the Panel proceedings, including the scope of the first substantive meeting, at which third parties will participate.

We therefore invite the parties to serve also on the third parties their initial briefs and any responding comments. The Panel will also invite third parties to submit any written comments they might have concerning the initial phase of these proceedings. The deadline for any third party comments is 10 June 2003. The parties' comments to be submitted on 13 June may, of course, also address comments made by third parties.<sup>21</sup>

7.4 On 5 June 2003, in line with the schedule set out in paragraph 7.3 *supra*, the parties submitted their initial briefs on this question.<sup>22</sup> On 10 June 2003, the following six third parties submitted initial

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<sup>21</sup> Excerpt from the communication from the Panel dated 28 May 2003. (See Annex L-1 item 3 for the full communication). A corresponding communication was sent to the third parties. (See also Annex L2 item 1.)

<sup>22</sup> See Annex A items 1 and 2.

briefs: Argentina, Australia, European Communities, India, New Zealand and Paraguay.<sup>23</sup> On 13 June 2003, the parties submitted further comments.<sup>24</sup>

7.5 On 20 June 2003, after carefully considering all these initial briefs, the Panel issued the following communication to the parties and third parties:

"Article 13(a)(ii) of the *Agreement on Agriculture* states that domestic support measures that conform fully to the provisions of Annex 2 of the *Agreement on Agriculture* shall be exempt from actions based on Article XVI of *GATT 1994* and Part III of the *Agreement on Subsidies and Countervailing Measures* (the '*SCM Agreement*'). Article 13(b)(ii) of the *Agreement on Agriculture* states that domestic support measures that conform fully to certain conditions shall be 'exempt from actions based on paragraph 1 of Article XVI of *GATT 1994* or Articles 5 and 6 of the *Subsidies Agreement*, provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year.'" Articles 5 and 6 of the *SCM Agreement* are each qualified by the proviso that "[t]his Article does not apply to subsidies maintained on agricultural products as provided in Article 13 of the *Agreement on Agriculture*." Article 13(c)(ii) of the *Agreement on Agriculture* provides that export subsidies that conform fully to the provisions of Part V of that Agreement, as reflected in each Member's Schedule, shall be 'exempt from actions based on Article XVI of *GATT 1994* or Articles 3, 5 and 6 of the *Subsidies Agreement*'. Article 3.1 of the *SCM Agreement*, which prohibits export subsidies, is qualified by the proviso: "Except as provided in the *Agreement on Agriculture*...". These provisions of Article 13 afford a conditional exemption from certain obligations relating to certain actionable and prohibited subsidies under the provisions of the *SCM Agreement* and Article XVI of the *GATT 1994*. This conditionality requires, *inter alia*, a comparison of facts with the applicable exemption requirements.

Briefly, Brazil asserts that the Panel can simultaneously consider all of the arguments and evidence on the substance of its claims under the *SCM* and *Agriculture Agreements*, while the United States asserts that the Panel is precluded from examining the *SCM* claims concerning prohibited and actionable subsidies in the absence of a prior ruling that the conditions of Article 13 of the *Agreement on Agriculture* are not satisfied, and, even if not, the Panel should exercise its discretion to order its proceedings in this way. All of the six third parties that made submissions support the view that the Panel is not precluded from simultaneously considering all of the arguments and evidence on the substance of Brazil's claims under the *SCM* and *Agriculture Agreements*, or, putting this another way, that conclusions on the applicability of the Article 13 exemptions do not have to be made before consideration of *SCM* claims in relation to the measures concerned.

We are faced with two questions:

- first, whether we are *required* to defer any examination of certain of Brazil's claims based on Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* until after making a ruling or expressing views on the issue of fulfilment of *Agreement on Agriculture* Article 13 conditions; and
- second, if not, then *how* we should exercise our discretion to best structure our examination of the matter before us.

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<sup>23</sup> See Annex A items 3-8.

<sup>24</sup> See Annex A items 9 and 10.

These questions concern the manner in which we should or must treat the claims of Brazil based on Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* having regard to the provisions of Article 13 of the *Agreement on Agriculture*.

We therefore look first to the dispute settlement procedures governing disputes under the *SCM Agreement*. Article 30 of the *SCM Agreement* states: "The provisions of Articles XXII and XXIII of GATT 1994 as elaborated and applied by the Dispute Settlement Understanding shall apply to consultations and the settlement of disputes under this Agreement, except as otherwise specifically provided herein."

We thus turn next to the *Understanding on Rules and Procedures Governing the Settlement of Disputes* (the "DSU") and to the terms of the *SCM Agreement* itself (in order to see whether or not there is anything otherwise specifically provided therein). Article 1.1 of the *DSU* is entitled "Coverage and Application". It states that "[t]he rules and procedures of this Understanding shall apply to disputes brought pursuant to the consultation and dispute settlement provisions of the agreements listed in Appendix 1 to this Understanding (referred to in this Understanding as the "covered agreements")."

As the Appellate Body has observed, "[a]rticle 1.1 of the DSU establishes an integrated dispute settlement system which applies to all of the agreements listed in Appendix 1 to the *DSU* (the "covered agreements"). The DSU is a coherent system of rules and procedures for dispute settlement which applies to "disputes brought pursuant to the consultation and dispute settlement provisions of" the covered agreements.<sup>25</sup> The *SCM Agreement* and the *GATT 1994* are Multilateral Agreements on Trade in Goods in Annex 1A of the *WTO Agreement* and are therefore "covered agreements" listed in Appendix 1 of the *DSU*. The general *DSU* rules and procedures do not set forth any specific distinct way to deal with claims under the *SCM Agreement* and the *GATT 1994* having regard to the provisions of Article 13 of the *Agreement on Agriculture*.

Article 1.2 of the *DSU* provides, in relevant part, that the rules and procedures of the *DSU* shall apply subject to such special or additional rules and procedures on dispute settlement contained in the covered agreements as are identified in Appendix 2 to the *DSU*.

We therefore examine whether Appendix 2 to the *DSU* identifies any special or additional dispute settlement rules or procedures relating to the *SCM Agreement* or to Article XVI of the *GATT 1994*.

Appendix 2 of the *DSU* does not identify Article XVI of the *GATT 1994* as a special or additional rule. It does identify Articles 4.2-4.12 and Articles 7.2-7.10 of the *SCM Agreement* as "special or additional rules and procedures". These provisions contain special procedures and remedies for disputes involving prohibited and actionable subsidies governed by the *SCM Agreement*. However, none of these provisions purports to confer any sort of precedence or priority for considering SCM remedies in a dispute involving claims under the *Agreement on Agriculture*. Furthermore, Article 7.1 of the *SCM Agreement*, which is not identified as a special or additional rule or procedure in Appendix 2 of the *DSU*, indicates that it applies: "Except as

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<sup>25</sup> Original footnote: Appellate Body Report, *Guatemala – Anti-Dumping Investigation Regarding Portland Cement from Mexico* ("Guatemala – Cement I"), WT/DS60/AB/R, adopted 25 November 1998, DSR 1998:IX, 3767, para. 64.

provided in Article 13 of the Agreement on Agriculture...". This clearly indicates to us that this provision must be read in the light of the provisions of Article 13 of the *Agreement on Agriculture*. Moreover, as noted in para. 5 above, the substantive provisions to which these remedial articles are linked – Articles 3, 5 and 6 – stipulate either that they apply "except as provided in the Agreement on Agriculture" (Article 3 relating to prohibited subsidies), or that they do "not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture" (Articles 5 and 6.9 of the *SCM Agreement*, entitled "Adverse Effects" and "Serious Prejudice", respectively).

The cited provisions of the *SCM Agreement* refer, as just indicated, to the *Agreement on Agriculture*, and some specify more precisely Article 13 of the *Agreement on Agriculture*. We therefore examine the rules applicable to dispute settlement under the *Agreement on Agriculture*, which is also a Multilateral Agreement on Trade in Goods in Annex 1A of the *WTO Agreement* and is, therefore, a "covered agreement" listed in Appendix 1 of the *DSU*. Article 19 of the *Agreement on Agriculture* is entitled "Consultation and Dispute Settlement". It states that the provisions of Articles XXII and XXIII of *GATT 1994*, as elaborated and applied by the *DSU*, shall apply to consultations and the settlement of disputes under that Agreement.

Appendix 2 to the *DSU* does not identify any special or additional dispute settlement rules or procedures relating to Article 13 of the *Agreement on Agriculture*.

Consequently, consistent with our consideration of the relevant provisions, there is no special dispute settlement requirement foreseen in the covered agreements in respect of a panel's consideration of the fulfilment of Article 13 conditions. The issue of fulfilment of the conditions of Article 13 of the *Agreement on Agriculture* is to be resolved using generally applicable *DSU* rules and procedures. The fact that certain very specific provisions are included in Appendix 2 of the *DSU* as special or additional rules indicates that, when the drafters intended to make a particular provision applicable as a special or additional dispute settlement rule, they did so explicitly. Therefore, their failure to include a reference to any provision of the *Agreement on Agriculture* in the text of Appendix 2 demonstrates that they did not intend to make any provision of that Agreement a special or additional dispute settlement rule. It is not necessary for us to look for any further interpretive guidance on this issue.

We next turn to the issue of how we should structure our procedures to consider the matter before us. As we have concluded above, this issue is subject to the *DSU* but not otherwise affected by the covered agreements. In this regard, within the overall parameters set by the *DSU* of prompt and efficient dispute resolution<sup>26</sup>, we must exercise our discretion as to how best to organize our procedures. Our discretion must be guided by the instructions given to us by the *DSU*. Pursuant to Article 12.1 of the *DSU*, "[p]anels shall follow the Working Procedures in Appendix 3 unless the panel decides otherwise after consulting the parties to the dispute". Moreover, Article 12.2 provides: "Panel procedures should provide sufficient flexibility so as to ensure high-quality panel reports, while not unduly delaying the panel process."

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<sup>26</sup> *Original footnote*: Article 3.3 of the *DSU* provides: "The prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members."

Article 11 of the *DSU*, entitled "Function of Panels" provides that the function of panels is to assist the DSB in discharging its responsibilities under the *DSU* and the covered agreements. Accordingly, a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements. Article 11 contemplates that a panel must make an "objective assessment of the facts of the case and the applicability of and conformity with the relevant covered agreements." It does not require that a panel must conduct its proceedings in any particular way, provided that its requirements are fulfilled. It is within our discretion to manage our procedures so as to best fulfil the requirements of Article 11.

Given the potential complexity of the claims before us, the conditional nature of certain of these claims and the volume of evidence which may be introduced by the parties in support of their claims and arguments, and in order to organize our proceedings in an orderly, effective and efficient manner which serves to facilitate an objective assessment of the matter before us, and optimizes use of our resources, we have adopted the following modifications to our procedures (as indicated in the attached<sup>27</sup> timetable):

- The Panel intends to express its views on whether measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*, to the extent that it is able to do so, by 1 September 2003,<sup>28</sup> and will defer its consideration of claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* as those provisions are referred to in Article 13 of the *Agreement on Agriculture* until after it has expressed those views. The Panel's views may be expressed in the form of rulings which could affect the Panel's further consideration of this dispute.
- In order that third parties may participate effectively at the first meeting at which the claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* as referred to in Article 13 of the *Agreement on Agriculture* are examined (as necessary), the Panel intends to divide its first meeting into two sessions, each of which will include a third party session.
- Accordingly, for the purposes of the first session of the first substantive meeting on 22-24 July 2003, the Panel does not require the parties to address claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* as referred to in Article 13 of the *Agreement on Agriculture*. Having said this, the Panel notes that this does not preclude the parties from addressing such matters in their first submissions.
- All other claims of Brazil in relation to measures which Brazil maintains do not involve a consideration of Article 13 of the *Agreement on Agriculture* should also be addressed in first submissions, in order for the other party and third parties to have an opportunity to express their views on any such claims.

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<sup>27</sup> Attachment omitted. See Annex M item 2 for the evolution of the timetable of this dispute.

<sup>28</sup> This date was changed to 5 September by the communication from the Panel dated 30 July 2003. (See Annex L-1 item 6 and L-2 item 3 for full communication. See Annex M item 2 for the evolution of the timetable of this dispute.)

- For the purposes of allowing the Panel to express its views on the exemption conditions of Article 13 of the *Agreement on Agriculture* by 1 September 2003, in relation to those measures which may be affected by Article 13, full and complete submissions on factual and legal issues related to Article 13 in this dispute will need to be provided, at the latest, in the parties' rebuttal submissions (to be submitted on 22 August 2003).

We recognize that we may need to revisit certain aspects of our timetable and working procedures in light of developments during the course of the Panel procedures. Related amendments to the working procedures may also be made, if necessary. We have been mindful of due process considerations in revising our timetable and will continue to ensure that the parties have reasonable time to prepare for any subsequent stages of the dispute, as appropriate."<sup>29</sup>

7.6 On 27 August 2003, the United States sent a letter requesting that the Panel's views of 5 September be presented in an "interim form". It stated, *inter alia*, as follows:

"The United States notes that the Panel intends to express its views on the issue of the Peace Clause by September 5, 2003. No prior panel nor the Appellate Body has made findings on the Peace Clause. The submissions and material provided to the Panel to date have demonstrated that the issues involved in the Panel's findings on the Peace Clause are fact-intensive, complex and sensitive.

While prior panels have made preliminary rulings on procedural issues, no prior panel has been confronted with the situation presented in this dispute. Here, the Panel will be making substantive findings on key provisions of the covered agreements. In this connection, the United States takes note of the Panel's observation that the fairness of panel proceedings may require ensuring that the parties receive sufficient opportunity to comment on new material. The United States also takes note of the provisions of paragraph 2 of Article 15 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* in which Members have agreed that parties should have an opportunity to comment on a panel's findings before they are final.

In this dispute, the Panel's findings on the Peace Clause are presumably intended to be dispositive of substantive claims and arguments of the parties for the remainder of the panel proceedings. Because of the substantive nature of those findings, the Panel's findings on September 5 will need to provide the factual basis and basic rationale underlying the findings. Both parties have a significant interest in those findings, in terms not just of the ultimate conclusion reached, but also in terms of the factual findings, rationale underlying those findings, and an understanding of the scope of those findings. Accordingly, in keeping with Article 15.2 of the DSU, and in order to be fair to both parties, the United States respectfully requests that the Panel provide Brazil and the United States with the Panel's September 5 Peace Clause findings in an interim form and provide the parties an opportunity to comment on the Panel's findings. The United States suggests that, in keeping with the practice in other panel proceedings and this Panel's timetable for the interim review in this dispute, two weeks should be sufficient time to comment."<sup>30</sup>

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<sup>29</sup> Excerpt from the 20 June 2003 communication from the Panel. (See Annex L1 item 4 for full communication.)

<sup>30</sup> Excerpt from the United States' letter dated 27 August 2003, footnotes omitted. (See Annex K item 15 for full communication.)

7.7 On 28 August 2003, Brazil sent a letter opposing the United States' request. It argued, *inter alia*, as follows:

"The US letter argues that the Panel must set forth its complete and full reasoning and factual findings in its 5 September decision. Brazil notes that paragraph 20 of the Panel's 20 June Decision stated that it would 'express its views on whether measures raised in this dispute satisfy the conditions in Article 13 of the Agreement on Agriculture' and would 'express its views in the form of ruling...'. Brazil does not and would not presume or suggest what form the Panel's "ruling" will or should take. However, it is within the Panel's discretion, as with many previous panels, to provide the basic rulings on the preliminary issue and then to further elaborate such rulings in the final determination.

As the United States recognizes, there will be an opportunity for the parties to comment on the interim report that the Panel will issue following the second meeting of the Panel with the Parties. Brazil believes that its procedural rights will be fully protected by the existing procedural safeguards provided by the interim review process. The United States has provided no legitimate reasons why its rights would not also be protected. Both parties will have an equal opportunity to comment on any decision by the Panel regarding the peace clause at that time.

In sum, Brazil requests that the Panel reject the United States request to establish an interim review process to the Panel's 5 September ruling."<sup>31</sup>

7.8 On 29 August 2003, the United States and Brazil each sent a further letter<sup>32</sup> reiterating their positions.

7.9 On 5 September 2003, in line with the established schedule, the Panel sent the following communication to the parties and third parties:

"[ ... ]

4. The Panel takes note of the correspondence from the parties dated 27, 28 and 29 August 2003 and declines to make findings at this stage as to whether measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*, for the reasons given in its communication dated 20 June 2003. The Panel's findings on that issue will be included in its interim report, on which the parties will have the right to comment in accordance with Article 15.2 of the *DSU*.

5. The Panel has now had the opportunity to consider the parties' and third parties' evidence and arguments to date. At this stage, the Panel cannot conclude its assessment of the matter before it on the basis that the measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*. The expression by the Panel of this view is without prejudice to the Panel's eventual findings, and is subject to paragraph 6 below. In this context, the Panel is of the view that consideration, as appropriate, of Brazil's claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994*, as those provisions are referred to in Article 13 of the *Agreement on Agriculture*, is warranted in order for the Panel properly to discharge its responsibilities under the *DSU* and the relevant covered agreements. Therefore, the Panel will consider those claims at a second session of the first substantive meeting.

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<sup>31</sup> Excerpt from Brazil's letter dated 28 August 2003. (See Annex K item 16 for full communication.)

<sup>32</sup> See Annex K items 18 and 19.

6. The Panel also wishes to inform the parties that, on the basis of the evidence and arguments presented to date, it is unable to form any view on whether the ETI Act satisfies the relevant provisions of the *Agreement on Agriculture*.

7. Regarding the Panel's procedures:

- (a) the Panel invites the parties to address in further submissions, due on 9 and 23 September respectively, the claims referred to in paragraph 5 above;
- (b) the Panel also invites the parties to address further the issue whether the export credit guarantee programs at issue constitute export subsidies for the purposes of the *Agreement on Agriculture*;
- (c) the Panel confirms that items (o), (p) and (q) of its timetable will be necessary, and confirms the following dates:

Further submissions of the third parties: 29 September 2003;

First substantive meeting with the parties  
(resumed second session): 7, 8 and (as  
necessary)  
9 October 2003;

Third party session: 8 October 2003;

- (d) the Panel invites the third parties to address in their further submissions the claims referred to in paragraph 5 above;
- (e) the Panel intends to postpone the second substantive meeting; and
- (f) the Panel invites the parties to comment on the attached<sup>33</sup> draft further revised timetable. Such comments should be submitted no later than close of business on Tuesday, 9 September 2003."<sup>34</sup>

7.10 On 12 and 18 September 2003, after having received comments from the parties<sup>35</sup>, the Panel issued further communications revising its timetable.<sup>36</sup>

## 2. Rights of third parties in the proceedings

7.11 On 31 July 2003, the European Communities sent a communication to the Panel<sup>37</sup> in which it requested: (a) to have sight of the oral statements of the main parties at the first substantive meeting, (b) that the Panel ask the parties to provide third parties with copies of their oral statements and responses to the Panel's questions, and (c) that the Panel confirm that it would make the 5 September 2003 views of the Panel available to the third parties.

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<sup>33</sup> Attachment omitted. See Annex M item 2 for the evolution of the timetable of this dispute.

<sup>34</sup> Excerpt from the communication from the Panel dated 5 September 2003. Footnote omitted. (See Annex L-1 item 11 for full communication.)

<sup>35</sup> United States' letters dated 9, 11, 16 and 17 September 2003 (See Annex K items 20, 22, 24 and 26) and Brazil's letters dated 9, 10, 16 and 17 September 2003. (See Annex K items 19, 21, 23 and 25.)

<sup>36</sup> See Annex L-1 items 12 and 13. See Annex M item 2 for the evolution of the timetable.

<sup>37</sup> See Annex K item 6.

7.12 On 1 August 2003, Brazil and the United States each communicated their views on this issue<sup>38</sup> to the Panel, and the European Communities commented on these communications on 4 August 2003.<sup>39</sup>

7.13 On 5 August 2003, the Panel issued a communication to the parties and third parties in which:

- (i) it informed them that it would communicate its 5 September 2003 views to third parties, as well as to the parties to the dispute, in order to enable them to participate, as necessary and appropriate, in any second session of the first substantive meeting in a full and meaningful fashion; and
- (ii) it denied both the European Communities' requests for additional third party rights. Nonetheless, in view of the phased nature of the first meeting, the Panel directed the parties to the dispute to make best efforts to ensure that their submissions to any second session of the first meeting were understandable either on their own or in conjunction with the submissions to the first session of the meeting. In particular, such submissions should not refer to any document to which the third parties did not have access without, at the very least, a summary, explanation or description of the contents of that document (or a citation indicating where that document may be found on the public record).<sup>40</sup>

### 3. Results of econometric model(s) used by Brazil and related communications

7.14 On 9 September 2003, in its further submission, Brazil submitted a quantitative simulation in conjunction with its initial "serious prejudice" arguments under Articles 5(c) and 6.3 of the *SCM Agreement*.<sup>41</sup> On 7 October 2003, during the resumed session of the first substantive meeting, the United States requested Brazil to provide information relating to the underlying econometric model (the "FAPRI"<sup>42</sup> model"), as well as any modifications made thereto by Dr. Sumner<sup>43</sup>, for the purposes of this dispute. The United States asserted that:

"[T]he report provided by Brazil as Annex I to its further submission does *not* provide the model itself, including detailed specifications of the equations used therein. As a result, Brazil is essentially asking the Panel and the United States to accept Dr. Sumner's results on faith alone. Dr. Glauber<sup>44</sup> has pointed out why Dr. Sumner's approach is inappropriate for a retrospective analysis of the effect of US subsidies. Even were Dr. Sumner's approach appropriate, however, Brazil has failed to this point to provide sufficient evidence to allow the Panel to fully understand and evaluate that model. Thus, quite apart from the flaws identified by Dr. Glauber, Brazil's reliance

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<sup>38</sup> See Annex K items 7 and 8.

<sup>39</sup> See Annex K item 9.

<sup>40</sup> Communication from the Panel dated 5 August 2003. See Annex L-1 item 7.

<sup>41</sup> "A Quantitative Simulation Analysis of the Impacts of US Cotton Subsidies on Cotton Prices and Quantities" by Professor Daniel Sumner, reproduced in Annex I to Brazil's further submission of 9 September 2003.

<sup>42</sup> "FAPRI" is an acronym for the Food and Agricultural Policy Research Institute.

<sup>43</sup> Dr. Daniel Sumner is an expert economist with the Brazilian delegation. See also *infra*, Section VII:G, footnote 1323, relating to the involvement of experts as members of party and third party delegations in these Panel proceedings

<sup>44</sup> Dr. Joseph Glauber is the Deputy Chief Economist, Office of the Chief Economist of the USDA. Dr. Glauber participated in the resumed session of the first substantive meeting and the second substantive meeting with the Panel as a member of the United States delegation. See also *infra*, Section VII:G, footnote 1323, relating to the involvement of experts as members of party and third party delegations in these Panel proceedings

on Dr. Sumner's inadequately explained results, evident throughout Brazil's latest submission, further demonstrates that Brazil has *not* established a *prima facie* case that US subsidies have the effects complained of."<sup>45</sup>

7.15 On 14 October 2003, in response to a request by Brazil to provide a precise description of the information sought, the United States identified the information it requested.<sup>46</sup>

7.16 On 5 November 2003<sup>47</sup>, Brazil indicated that it would provide the written information requested by the United States "early in the week of 10 November", and that it understood that the "electronic version" of the model was available for use by the United States Government upon coordination with FAPRI staff. On 11 November 2003<sup>48</sup>, the United States expressed disappointment that Brazil claimed not to be able to provide an electronic version of the model and indicated that the "the offer by FAPRI to run simulations at the United States request for a fee is not an acceptable substitute". The United States also requested an extension of the timetable in light of Brazil's delay in providing the requested written information. On 12 November 2003<sup>49</sup>, Brazil submitted certain written information about the model<sup>50</sup> and asked the Panel to reject the request of the United States for an extension of the timetable. The United States sent a further letter, dated 13 November 2003<sup>51</sup>, reiterating its position.

7.17 On 14 November 2003, the Panel issued the following communication to the parties:

"The Panel takes note of the United States' written request of 14 October 2003 for certain information relating to the quantitative simulation model used by Dr. Sumner in his analysis presented in Annex I to Brazil's 9 September 2003 further written submission. The Panel also takes note of the parties' related communications dated 5, 11, 12 and 13 November 2003, and the submissions by Brazil on 12 and 13 November 2003.

The Panel confirms the dates in its existing timetable, subject to the following.

The Panel does not require the parties' 18 November further rebuttal submissions, nor their oral statements during the second Panel meeting, to address the methodology, equations or parameters underlying the quantitative modelling simulation in Annex I

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<sup>45</sup> United States' oral statement at the resumed session of the first substantive meeting, para. 56. (Emphasis in original)

<sup>46</sup> United States' letter dated 14 October 2003 (See Annex K item 31). The attachment to the letter reads as follows:

"Please provide the following information relating to the model used by Dr. Sumner in his analysis presented in Annex I to Brazil's further submission:

- (a) Electronic copies of the actual models used for the baseline and each of the seven scenarios described in Annex I.
- (b) Printed copies of the exact equation specifications used for the baseline and for each of the seven scenarios described in Annex I, including all parameter estimates. (If no such printed copies currently exist, please develop and provide.)
- (c) Documentation of all adaptations to the original FAPRI modeling system made or used by Dr. Sumner for his analysis presented in Annex I. (If no such documentation currently exists, please develop and provide.)"

<sup>47</sup> See Annex K item 32.

<sup>48</sup> See Annex K item 33.

<sup>49</sup> See Annex K item 34.

<sup>50</sup> Exhibits BRA-313, -314.

<sup>51</sup> See Annex K item 35.

to Brazil's further written submission which are directly linked to the information requested by the United States on 14 October 2003 and the submissions by Brazil on 12-13 November 2003. Having said this, the parties are not precluded from doing so.

Mindful of the requirements of Article 12.4 of the *Understanding on Rules and Procedures Governing the Settlement of Disputes* and in keeping with its duty to conduct an objective assessment of the matter before it, the Panel invites the United States to submit, on 22 December, in conjunction with its responses to any questions following the second Panel meeting, any comments that it may have on Brazil's submissions of 12-13 November 2003. Brazil may submit any comments on any such US comments by 12 January 2004, and the United States may submit any further comments by 19 January 2004. If necessary, at the discretion of the Panel, a further Panel meeting with the parties may be held to address this specific material.

This decision is without prejudice to the relevance and significance which the Panel may ascribe to the quantitative simulation model and related evidence and argumentation in its report.

Finally, the Panel wishes to ask the United States to respond, by 22 December, to the following:

Is the Panel correct in understanding that the US government (including the United States Department of Agriculture) does not have a license or any other form of permission (standing or otherwise; free of charge or otherwise) to run, electronically, the FAPRI/CARD model and/or Professor Sumner's adaptations thereto?"<sup>52</sup>

7.18 On 8 December 2003, after having heard the views of both parties at the second substantive meeting, the Panel communicated the following to the parties:

"1. The Panel has been advised by Brazil that, to the best of Brazil's knowledge and belief, all of the information used by FAPRI to generate the various results presented in Brazil's submissions concerning the effects of the subsidies, and their removal, has been provided to the US in an electronic format. Conceptually speaking, the information is in two parts: (a) the model used as the basis for generating the results ('the FAPRI model'), and (b) adaptations to the model and other specific pieces of information which affect the calculations made by the model ('the Brazil information'). FAPRI has possession of the FAPRI model and the Brazil information. Brazil only has possession of the Brazil information. Brazil instructed FAPRI as to the use of the Brazil information that FAPRI then used to generate the various results presented by Brazil to the Panel.

2. We say that the US has all of the information (ie both the FAPRI model and Brazil's information) 'to the best of Brazil's knowledge and belief' because Brazil itself has never had access to all of the data comprising the FAPRI model, which is voluminous. FAPRI considers the model to be its own work product. At the request of Brazil, FAPRI has made all of the information available to the US. Why it has done this in the case of the US, but not Brazil, relates to the relationship (commercial or otherwise) between FAPRI (which receives US funding for its work) and the US Government. FAPRI has provided all of the information to the US on the express stipulation that the model not be provided to the Panel or Brazil ("the FAPRI stipulation").

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<sup>52</sup> Communication from the Panel dated 14 November 2003, reproduced in full.

3. At para 74 of its Opening Statement at the Second Panel Meeting, the US asks this of the Panel:

'[W]hether it intends the United States to comment on this new model, documentation, and results by the original 22 December deadline to file comments on the methodology underlying the Annex I model.'

4. During the Second Panel Meeting, Brazil advised the Panel that it had no objection, then, to the US looking at the information provided to it by FAPRI, notwithstanding the FAPRI stipulation.<sup>53</sup> The Panel acknowledges this, but also notes that it would be open to Brazil to reconsider its position depending on anything that the US may wish to present to the Panel about the FAPRI model.

5. The Panel's view in these circumstances is that the US should comment on the FAPRI model, if it believes that it needs to do so in the interests of presenting its case to the Panel, by **22 December**. The FAPRI stipulation does not, in the Panel's view, affect the Panel's ability to make an objective assessment of the matter before it in the terms of Article 11 of the DSU. The Panel will assess the reliability and relevance of the FAPRI model on the basis of the evidence presented to it by the parties.

6. Brazil will be given until **12 January 2004**, to comment on the above US comments.<sup>54</sup>

7.19 On 22 December 2003, in line with the above timetable, the United States submitted "Comments of the United States of America concerning Brazil's Econometric Model"<sup>55</sup>. On 20 January 2004<sup>56</sup>, Brazil submitted "Brazil's Comments on the 22 December US Comments Concerning Brazil's Econometric Model".<sup>57</sup> On 28 January 2004, the United States submitted further views on this issue<sup>58</sup> as "Comments of the United States of America on Comments by Brazil on US Comments Concerning Brazil's Econometric Model".<sup>59</sup>

#### **4. Requests for information under Article 13.1 of the DSU**

7.20 In its further rebuttal submission submitted on 18 November 2003, Brazil, in response to the assertion of the United States that it had not provided precise calculations of the amount of contract payments to current producers of upland cotton, observed, after explaining Brazil's methodology, that the Panel had the discretion to request the United States, pursuant to Article 13.1 of the *DSU*, to

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<sup>53</sup> The "FAPRI stipulation" refers to the fact that Dr. Babcock of FAPRI stated in his e-mail to Dr. Glauber of the USDA that: "I am sending you this material with the understanding that it is for use by the United States and should not be shared with Brazil or other parties." (Brazil submitted a copy of this e-mail in Exhibit BRA-346.)

<sup>54</sup> Second attachment to the communication from the Panel dated 8 December 2003. See Annex L-1 item 18 for full communication.

<sup>55</sup> See Annex I item 9.

<sup>56</sup> The original deadline of 12 January 2004 was extended, at the request of Brazil, to 20 January 2004 by the Panel's communication dated 24 December 2003. (See Annex L-1 item 20.)

<sup>57</sup> See Annex I item 12.

<sup>58</sup> The Panel's communication dated 8 December 2003 provided that "[t]he parties may submit any further comments on each other's comments by 19 January". This deadline was extended, at the request of Brazil, to 28 January 2004 by the Panel's communication dated 24 December 2003. (See Annex L-1 item 20 for full communication)

<sup>59</sup> See Annex I item 16.

produce information on contract payments made in respect of base acreage in the 1999-2002 marketing years.<sup>60</sup>

7.21 On 2 December 2003, during the second substantive meeting, Brazil requested that the United States submit information that would permit the calculation of the precise amount of these contract payments made to current producers of upland cotton.<sup>61</sup> More specifically, it requested farm-specific planting and base acreage data to determine the amount of upland cotton planted on contract base acreage during the 1999-2002 marketing years. Brazil took note of information that the United States Department of Agriculture's (USDA) Kansas City Administrative Office had provided under the Freedom of Information Act ("FOIA") to a private citizen assisting the Brazilian delegation concerning another programme crop, (i.e. rice)<sup>62</sup>, and sought information in a similar format, according to standard USDA practice.<sup>63</sup>

7.22 On 8 December 2003, the Panel communicated to the parties that the United States would be given until 18 December to respond to Brazil's request and Brazil would be given until 12 January 2004 to comment on the United States' response.<sup>64</sup>

7.23 On 18 December 2003<sup>65</sup>, the United States informed the Panel that the release of planted acreage information associated with a particular farm, county, and state number was confidential information that could not be released under United States domestic law, in particular the Privacy Act of 1974. This was consistent with the position of the United States in Freedom of Information Act appeals that had considered this issue.<sup>66</sup> Nevertheless, the United States provided, for all programme crops and for each marketing year: (1) planted acreage data aggregated for all cotton farms; and (2) farm-level planted acreage data without any fields that could identify the particular farm.<sup>67</sup> The United States further advised the Panel that the USDA had released the information concerning rice in error and asked that Brazil and its agents return all copies of the erroneous rice release.

7.24 On 22 December 2003, in its responses to the Panel's questions following the second substantive meeting, Brazil submitted that the United States had confirmed that it had collected complete planted acreage, contract base acreage, contract yields, and payment data that would allow it to calculate with relative precision the amount of direct and counter-cyclical payments made to current producers of upland cotton in the 2002 marketing year. Brazil also indicated that it could not calculate direct payment and counter-cyclical payment figures because the United States had refused to provide farm-specific identifying numbers, thus rendering any matching of farm-level information on contract payments with information on farm-specific plantings impossible.<sup>68</sup>

7.25 On 12 January 2004, the Panel made certain observations to the parties on the material submitted by the United States concerning the Privacy Act of 1974 and made the following request:

"Pursuant to Article 13 of the DSU, the Panel requests the United States to provide the same data that it agreed to provide in its letters dated 18 and 22 December 2003

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<sup>60</sup> Brazil's further rebuttal submission, para. 48.

<sup>61</sup> Exhibit BRA-369.

<sup>62</sup> Exhibit BRA-368.

<sup>63</sup> Brazil referred to documents in FOIA cases 03-117, 03-302, 03-103 and 03-082, attached to a statement by Mr. Christopher Campbell of the "Environmental Working Group" (EWG), reproduced in Exhibit BRA-316. See also *infra*, Section VII:G, footnote 1323, relating to the involvement of experts as members of party and third party delegations in these Panel proceedings.

<sup>64</sup> See Annex L-1 item 18 for full communication.

<sup>65</sup> See Annex K item 37.

<sup>66</sup> The United States submitted Exhibits US-103 through US-107 in support of its arguments.

<sup>67</sup> The delivery was made, at the request of Brazil, to the Embassy of Brazil in Washington D.C. The CD-ROM with the data was delivered to the Panel on 23 December 2003.

<sup>68</sup> See Brazil's response to Panel Question No. 196. (See Annex I item 7.)

but in a format which permits matching of farm-specific information on contract payments with farm-specific information on plantings. The Panel considers it both necessary and appropriate to seek this information in a suitable format in order to undertake its mandate to assist the DSB in discharging its responsibilities under the DSU and the covered agreements. Disclosure is sought to permit an assessment of the total expenditures of PFC, MLA, CCP and direct payments by the US Federal Government to upland cotton producers in the relevant marketing years.

The United States may again designate the data as confidential in accordance with paragraph 3 of the Panel's working procedures. Disclosure can be limited to Brazil's delegation, the Panel and Secretariat staff assisting the Panel. The United States may also protect the identity of individual producers by, for example, using substitute farm numbers which still permit data-matching.

A refusal by the United States to provide the information as requested without an adequate explanation may lead to adverse inferences being drawn.

The Panel reminds Brazil that it may not disclose the above information outside its delegation in this proceeding if it is designated by the United States as confidential.<sup>69</sup>

7.26 The Panel also posed the following additional question to Brazil:

"Please submit a detailed explanation of the method by which one could calculate total expenditures to producers of upland cotton under the four relevant programmes on the basis of the data which it seeks."<sup>70</sup>

7.27 On 20 January 2004<sup>71</sup>, the United States noted that it had previously provided data that permitted calculation of "total expenditures" for all decoupled payments made to "farms planting upland cotton" with respect to historical base acres (whether upland cotton base acres or otherwise). Thus, the data already provided by the United States to Brazil and the Panel would permit an assessment of total expenditures of decoupled payments to "farms planting upland cotton". It also informed the Panel that it was not possible to protect the identity of individual producers while providing the requested data in a format that permitted data-matching because it had already provided, by farm number, farm-specific contract information. Even in the absence of farm numbers, disclosing the farm-specific plantings would allow each farm's confidential plantings to be connected to the USDA farm numbers through the farm-by-farm files previously provided. It submitted that it had provided the original data with Farm Service Agency (FSA) farm numbers as a result of Brazil's refusal to consider any alternative that would respect the privacy interests of United States' producers. The United States responded to certain of the Panel's observations on confidentiality under its domestic law and submitted that there was no basis for an 'inference' of any kind, adverse or otherwise, because the United States did not have the authority to provide the farm-specific planting information in the format requested and, further, it had provided both farm-specific and aggregated contract data that would permit the Panel to make the assessment it identified, i.e. an assessment of total expenditures of decoupled payments to farms planting upland cotton. The United States also recalled that panels must take care not to use the information gathered under this authority to relieve a complaining party from its burden of establishing a prima facie case of WTO inconsistency based on specific legal claims asserted by it, such that the Panel could not relieve Brazil of its burden of

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<sup>69</sup> Excerpt from the communication from the Panel dated 12 January 2004. (See Annex L-1 item 21 for full text).

<sup>70</sup> Panel Question No. 258 posed in a communication from the Panel dated 12 January 2004. (See Annex L-1 item 21).

<sup>71</sup> See Annex K item 42.

advancing and establishing claims and arguments relating to the key issue in the serious prejudice claim of the value of decoupled payments benefiting upland cotton.

7.28 On 28 January 2004, Brazil submitted certain documents in accordance with the Panel's timetable for "any further comments on each other's comments". One of the documents submitted by Brazil was entitled "Brazil's Comments and Requests Regarding Data Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-Scrambled Data on 20 January 2004".<sup>72</sup> In it, Brazil submitted that the United States had refused to provide the information concerning the amount of contract payments made to current producers of upland cotton, that there were no legitimate confidentiality concerns that would prevent the United States from producing the data and, even if there were, confidentiality procedures under Article 13.1 of the *DSU* and/or the Panel's working procedures could have addressed these concerns. Brazil asked the Panel to draw adverse inferences (listed in Section 6 of that document) and conclude that the withheld information would have been adverse to the United States' defence in this case. Furthermore, Brazil asked the Panel to use the best information available, including the adverse inferences, to find that the figures Brazil had estimated under its so-called 14/16<sup>th</sup> methodology were supported by the evidence on the record.<sup>73</sup>

7.29 On 28 January 2004<sup>74</sup>, the United States submitted revised data on a new CD-ROM<sup>75</sup> to correct for errors it had detected in the data submitted in December.<sup>76</sup>

7.30 On 30 January 2004, the United States requested that the Panel give it an opportunity to comment on Brazil's comments of 28 January 2004.<sup>77</sup> On 2 February 2004, Brazil replied, outlining the limits within which it deemed appropriate for the Panel to grant such opportunity.<sup>78</sup> On 3 February 2004, the United States replied, refuting Brazil's arguments.<sup>79</sup>

7.31 On 3 February 2004, after carefully reviewing these letters and the data, the Panel informed the parties as follows:

"The Panel has noted the US letter dated 30 January, Brazil's response dated 2 February, and a further letter from the US dated 3 February 2004. Keeping in mind the dictates of due process and relevant provisions of the covered agreements -- including Article 12.2 of the *DSU* which requires Panel procedures to provide sufficient flexibility so as to ensure high-quality panel reports while not unduly delaying the panel process -- the Panel is of the view that the above revisions to the timetable [omitted] provide the United States and Brazil sufficient opportunity to comment on each other's comments. Accordingly, the US is free to submit its comments on Brazil's above mentioned submission by 11 February (but no later).

This is without prejudice to any definitive view of the Panel on the characterization of any of the above communications by the parties and, in particular, of the document submitted by Brazil entitled 'Brazil's Comments and Requests Regarding Data

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<sup>72</sup> See Annex I item 15.

<sup>73</sup> See paragraphs 107 and 108 of "Brazil's Comments and Requests Regarding Data Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-scrambled data on 20 January 2004". (See Annex I item 15.)

<sup>74</sup> See Annex K item 43.

<sup>75</sup> The content of this CD-ROM is described in Exhibit US-145.

<sup>76</sup> See *supra*, footnote 67.

<sup>77</sup> See Annex K item 44.

<sup>78</sup> See Annex K item 45.

<sup>79</sup> See Annex K item 46.

Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-scrambled Data on 20 January 2004'.<sup>80</sup>

7.32 In the same communication, the Panel also made a supplementary request pursuant to Article 13 of the *DSU* for the United States to provide:

- (i) such of the information requested on 12 January 2004 in the format requested, as regards payment recipients who did not have interests protected under the Privacy Act of 1974, if any; and
- (ii) planting information for farms enrolled in each of the PFC, MLA, DP and CCP payments programmes for each of the 1999, 2000, 2001 and 2002 marketing years, grouped into three broad categories, according to whether they had greater or less upland cotton base acreage than upland cotton planted acreage or upland cotton planted acreage but no upland cotton base acreage. The category for farms which overplanted their upland cotton base acres was divided into three sub-categories according to their base acreage for all covered commodities.<sup>81</sup>

7.33 Also in the same communication, the Panel advised the parties as follows:

"The Panel considers it both necessary and appropriate to seek this information to undertake its mandate to assist the DSB in discharging its responsibilities under the *DSU* and the covered agreements. However, the Panel reserves its views as to the extent to which any methodology might be appropriate to determine support provided to upland cotton in the circumstances of this case.

A refusal by the United States to provide the information as requested without an adequate explanation may lead to adverse inferences being drawn."

7.34 Also in the same communication, the Panel posed additional questions to both parties, including several questions to the United States related to the Privacy Act of 1974.

7.35 On 11 February 2004, the United States responded to the Panel's questions<sup>82</sup>, explaining *inter alia* that the USDA was obligated under United States domestic law to protect farm-specific planting data. It also submitted comments<sup>83</sup> on the comments of Brazil<sup>84</sup> to the United States' data submitted on 18 and 19 December 2003.

7.36 On 11 February 2004, the United States also requested a time extension to respond to the supplementary request for information due to its very extensive nature and sought specific clarification of item (b) of the Panel's request.<sup>85</sup> It also requested an opportunity to comment on any reply which the Panel might permit Brazil to file to the United States comments filed on that day.

7.37 On 13 February 2004, Brazil responded, asking the Panel to reject the requests of the United States.<sup>86</sup> On 16 February 2004, the United States reiterated its position.<sup>87</sup>

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<sup>80</sup> Excerpt from the communication from the Panel dated 3 February 2004 (See Annex L-1 item 22 for full communication.)

<sup>81</sup> The full text of the supplementary request is set out in Annex L-1 item 22.

<sup>82</sup> See Annex I item 18.

<sup>83</sup> See Annex I item 19.

<sup>84</sup> See *supra*, paragraph 7.28.

<sup>85</sup> This Panel's request is reproduced as (ii) in paragraph 7.32 *supra*.

<sup>86</sup> See Annex K item 48.

7.38 On 16 February 2004, the Panel provided clarification of its supplementary requests for information, as requested by the United States<sup>88</sup>, and indicated that it would consider at a later stage the United States' request for an opportunity to comment.<sup>89</sup> It also granted the United States an extension of time until 3 March 2004 to submit all remaining data as requested.<sup>90</sup>

7.39 On 18 February 2004, Brazil submitted a communication entitled "Brazil's Comments on US 11 February 2004 Comments on Brazil's 28 January Comments and Requests Regarding Data Provided by the United States on 18/19 December 2003 and the US Refusal to Provide Non-Scrambled data on 20 January 2004".<sup>91</sup> It provided extensive comments on the Privacy Act of 1974 and argued that WTO Members' domestic laws do not provide a basis for not complying with obligations to cooperate in a WTO dispute settlement proceeding and to provide, if requested by a Panel under Article 13 of the *DSU*, any information, if necessary using special confidentiality procedures.

7.40 On 3 March 2004, the United States submitted<sup>92</sup> the data requested by the Panel on 3 February 2004, as well as its comments<sup>93</sup> on Brazil's 18 February 2004 comments.

7.41 On 10 March 2004, Brazil submitted its comments to the data submitted by the United States on 3 March 2004.<sup>94</sup> In this comment, Brazil stated, *inter alia*, that the data provided by the United States on 3 March 2004 was the best information available before the Panel, and that Brazil no longer considered that relying on its "14/16<sup>th</sup> methodology" would be appropriate.

7.42 On 15 March 2004, the United States submitted its comments on Brazil's comments, reiterating its criticism of the various calculation methodologies recently advanced by Brazil, and noting Brazil's statement in its last submission that it "no longer considers that relying on its 14/16<sup>th</sup> methodology would be appropriate", observed that this meant that the only methodology that Brazil had brought forward from August 2003 until January 2004 to allegedly demonstrate a breach of the Peace Clause was irrelevant to this dispute.

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<sup>87</sup> See Annex K item 49.

<sup>88</sup> See *supra*, paragraph 7.36.

<sup>89</sup> The Panel, after reviewing Brazil's submission subsequently submitted on 18 February 2004, granted, by the communication dated 20 February 2004, the United States until 25 February 2004 to comment on this Brazil's submission. (See Annex L-1 item 24.) On 23 February, the United States sent a letter requesting an extension of this deadline, and on 24 February, the Panel issued a communication to inform parties that the deadline would be extended until 3 March 2004. (See Annex K item 50 for the letter and Annex L-1 item 25 for the communication from the Panel.)

<sup>90</sup> The Panel's communication dated 16 February 2004 is set out in Annex L-1 item 23 in full.

<sup>91</sup> See Annex I item 22.

<sup>92</sup> By a document entitled "Response of the United States of America to the Panel's February 3, 2004 Data Request, as Clarified on February 16, 2004" (See Annex I item 24), submitted together with a CD-ROM. The United States designated the data submitted as confidential pursuant to paragraph 3 of the Panel's working procedures. (Paragraph 31 of the document.)

<sup>93</sup> Entitled "Comments of the United States of America on the February 18, 2004, Comments of Brazil". (See Annex I item 23)

<sup>94</sup> Brazil requested (in a letter dated 13 February 2004) that in the event the Panel would allow the extension of the deadline for the United States to submit the data requested by the Panel, Brazil should be given the opportunity to comment on the data. The Panel granted this opportunity in its communication dated 4 March 2004. (See Annex K item 48 for Brazil's letter and Annex L-1 item 26 for the communication from the Panel.)

## 5. Other procedural issues

### (a) Timing of the service of documents

7.43 On 14 July 2003, Brazil sent a letter<sup>95</sup> complaining about the late timing of delivery of documents by the United States. On 14 August 2003, Brazil sent another letter stating, *inter alia*, as follows:

"As it had already done on two previous occasions, the US did not deliver its answers to the Panel's questions following the first substantive meeting with the parties by the time established in paragraphs 17(b) and (d) of the "Working Procedures". Brazil recalls that the deadline for submitting the parties' answers to the Panel was expressly confirmed by the Panel on its communication dated 30 July 2003 informing about the extension of the deadline for the submission of the parties' responses.

As a matter of fact, the electronic version of the US answers, which was due on 11 August, 5:30 pm, was delivered around 11:30 pm, more than 6 hours after the deadline, more than 6 hours after Brazil delivered both its electronic version and hard copies to the Secretariat and the US. Brazil further notes that no hard copy of the US answers was made available either to the Secretariat or to Brazil by the deadline. [ ... ]

Brazil respectfully asks the Panel to take note of this new delay and to encourage, again, the US to respect the deadlines, with a view to ensuring procedural fairness in these proceedings."<sup>96</sup>

7.44 On 19 August 2003, the Panel informed the parties as follows in its communication:

"The Panel has received a communication from Brazil dated 14 August 2003 in which Brazil draws attention to the timing and format of service of the United States' responses to the Panel's questions, in light of paragraphs 17(b) and (d) of our Working Procedures, and in which it raises issues of procedural fairness.

The Panel has taken note of the matters raised in the communication from Brazil and draws them to the United States' attention. The Panel recalls that, at its meeting with the parties on 22 July 2003, it also drew the attention of the United States to these issues as raised by Brazil in connection with the filing of the United States' first written submission and comments on Brazil's initial brief."<sup>97</sup>

7.45 On 2 October 2003, Brazil sent another letter<sup>98</sup> complaining about the timing of the United States' delivery of documents.<sup>99</sup> On 13 October 2003, after having heard the views of parties at the resumed session of the first substantive meeting, the Panel communicated the following to the parties:

"The Panel takes note of Brazil's request in its letter dated 2 October 2003 regarding the late receipt of submissions, and the US response in its letter dated 6 October 2003. In accordance with paragraph 17(b) of the Panel's working procedures, the Panel sets the following time for the provision of submissions by the parties: 11:59 pm, Geneva time on the dates concerned. This time refers to *receipt* of submissions by the other

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<sup>95</sup> See Annex K item 3.

<sup>96</sup> Excerpt from Brazil's letter dated 14 August 2003. (See Annex K item 10 for full communication.)

<sup>97</sup> Excerpt from the communication from the Panel dated 19 August 2003. (See Annex L-1 item 8 for full communication.)

<sup>98</sup> See Annex K item 29.

<sup>99</sup> The United States sent a letter on 6 October 2003 responding to Brazil's letter. (See Annex K item 30.)

party and the Secretariat and not to commencement of transmission. For greater clarity, this time for receipt of submissions also refers to the time of completion of receipt of any Exhibits and service of all Exhibits (if necessary, electronically) to the other party and to the Secretariat as envisaged in paragraphs 17(a)-(d) of the Panel's working procedures. All other provisions of the Working Procedures remain unchanged. The Panel confirms the dates in the revised timetable, as revised in its communication of 18 September 2003.

The Panel has set this time in light of the repeated service of submissions by the United States after 5.30 p.m. and in order to ensure due process and secure a balance between the two parties. The Panel stresses its expectation that the parties will respect all of the rules and procedures set out in the *DSU* and in the working procedures, including the new time set by the Panel above for the dates in question."<sup>100 101</sup>

7.46 On 23 December 2003, Brazil sent another letter on this issue.<sup>102</sup>

(b) Other extensions of deadlines

7.47 On 29 July 2003, the United States sent a communication to the Panel requesting an extension of the deadline to respond to the questions posed by the Panel<sup>103</sup>, citing the number and complexity of the questions. After reviewing Brazil's comment<sup>104</sup> on this request, the Panel notified, in its communication dated 30 July 2003<sup>105</sup>, certain modifications to its timetable.

7.48 On 14 August 2003, Brazil sent a written communication to the Panel requesting that it be provided additional time to comment on certain responses to the Panel's questions submitted by the United States on 11 August, on grounds that the United States did not provide complete answers or documentation that would have allowed Brazil the opportunity to comment and rebut in its rebuttal submission which was due on 22 August 2003.

7.49 In a communication dated 19 August 2003, the Panel notified the parties as follows:

"[W]hen each party receives the other party's rebuttal submission, it is invited, without delay, to draw the Panel's attention to any specific material on which it has not had an opportunity to comment and to show cause why it needs such an opportunity. Upon a showing of good cause, the Panel will permit that party to comment in writing by 27 August 2003. The Panel is willing to grant such permission on Saturday, 23 August 2003, if necessary."<sup>106</sup>

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<sup>100</sup> Excerpt from the communication from the Panel dated 13 October 2003. (See Annex L-1 item 15 for full communication.)

<sup>101</sup> The Panel notes that the United States' submissions due on 22 December 2003, 28 January 2004, 18 February 2004 and 3 March 2004 were received after the deadline of 23:59, regarding both the paper version and the electronic version.

<sup>102</sup> See Annex K item 40.

<sup>103</sup> Posed on 25 July 2003. This was the first of the series of questions subsequently posed by the Panel.

<sup>104</sup> Letter dated 29 July 2003. (See Annex K item 5.)

<sup>105</sup> See Annex L-1 item 6 and L-2 item 3.

<sup>106</sup> Excerpt from the communication from the Panel dated 19 August 2003. (See Annex L-1 item 8 for full communication.)

7.50 On 23 August 2003, in response to this communication by the Panel, Brazil identified specific issues on which it deemed that additional time for comment was necessary.<sup>107</sup> On the same day, the Panel permitted Brazil to comment on such new material by 27 August 2003.<sup>108</sup>

7.51 On 25 August 2003, the Panel received a communication from the United States in which it also identified specific issues on which it deemed additional time for comment necessary.<sup>109</sup> On the same day, in conjunction with transmitting additional question 67*bis*, the Panel permitted the United States to comment on new material by 27 August 2003.<sup>110</sup>

7.52 On 23 September 2003, the United States sent a letter to the Panel requesting extension of the deadline for submitting its further submissions as well as extension of other related deadlines. After hearing Brazil's views<sup>111</sup>, the Panel, on 24 September 2003, notified the parties and third parties of certain modifications to its timetable.<sup>112</sup>

7.53 On 23 December 2003, in relation to additional questions posed by the Panel on 23 December<sup>113</sup>, Brazil requested an extension of certain deadlines including the deadline for responses to the specific Panel's questions.<sup>114</sup> After reviewing the United States response<sup>115</sup> to this request, the Panel notified the parties of further modifications to its timetable.<sup>116</sup>

## 6. Least-developed country Members

7.54 Benin and Chad, two least-developed country Members, are involved in these proceedings as third parties. In accordance with Article 24.1 of the *DSU*, particular consideration was given to the special situation of these two Members. In this respect, the Panel notes:

- Benin provided a detailed written submission and presented an oral statement at the first session of the first meeting of the Panel. It provided written responses to the Panel's questions following that session;
- Benin and Chad made a detailed joint written submission, and presented separate oral statements, at the resumed session of the first meeting of the Panel. They provided joint written responses to the Panel's questions following that session<sup>117</sup>;
- in their joint submission, Benin and Chad extensively explained the situation of the cotton sector in their respective countries;
- Benin, which has a permanent mission in Geneva, was represented by a delegation headed by its Ambassador, which included a research fellow<sup>118</sup> of the International

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<sup>107</sup> See Annex K item 12.

<sup>108</sup> Panel's communication dated 23 August 2003. (See Annex L-1 item 9.)

<sup>109</sup> The United States sent a communication to the Panel on 20 August 2003 foreshadowing that it would make such request. Brazil sent a communication on 25 August 2003 requesting the Panel to reject the United States' request. (See Annex K items 11 and 14.)

<sup>110</sup> By the Panel's communication dated 25 August 2003. (See Annex L-1 item 10.)

<sup>111</sup> Letter dated 23 September 2003. (See Annex K item 28.)

<sup>112</sup> Communication from the Panel dated 24 September 2003. (See Annex L-1 item 14.)

<sup>113</sup> Communication from the Panel dated 23 December 2003. (See Annex L-1 item 19.)

<sup>114</sup> Letter dated 23 December 2003. (See Annex K item 40.)

<sup>115</sup> Letter dated 23 December 2003. (See Annex K item 41.)

<sup>116</sup> Communication from the Panel dated 24 December 2003. (See Annex L-1 item 20.)

<sup>117</sup> The further submission submitted on 3 October 2003, and responses to certain of the Panel's Questions, submitted on 27 October 2003. ( See Annex E item 4 and Annex J item 14.)

<sup>118</sup> Mr. Nicholas Minot. See also *infra*, Section VII:G, footnote 1501 and footnote 1323, relating to the involvement of experts as members of party and third party delegations in these Panel proceedings.

Food Policy Research Institute, who presented the results of a study entitled "Effect of falling cotton prices on rural poverty in Benin"<sup>119</sup>;

- Chad, which does not have a permanent mission in Geneva, was represented at the resumed session of the first substantive meeting by a delegation headed by its Brussels-based Ambassador, who presented a detailed statement by the Chairman of the *Société Cotonnière du Tchad* ("*Cotontchad*") and the *Association Cotonnière Africaine*, Mr. Ibrahim Malloum;
- Benin and Chad had legal advisers from a private law firm;
- the parties and other third parties referred to the special situation of Benin and Chad in various places<sup>120</sup>; and
- the Panel referred to the arguments of Benin and Chad at paragraphs 7.267, 7.990, 7.1211, 7.1233 and 7.1400 of this report.

## B. PRELIMINARY RULINGS

### 1. Export credit guarantees for agricultural commodities other than upland cotton

#### (a) Terms of reference

7.55 The **United States** requests the Panel to rule that export credit guarantee measures relating to eligible United States agricultural commodities (other than upland cotton) are not within its terms of reference because this "measure" was not the subject of Brazil's request for consultations.<sup>121</sup>

7.56 The Panel notes that the United States did not address export credit guarantee measures relating to agricultural commodities other than upland cotton in terms of substance in its first written submission.

7.57 **Brazil** asks the Panel to reject the United States' request, submitting that both its request for consultations and the accompanying statement of available evidence, as well as the questions it posed to the United States during consultations, revealed that they covered export credit guarantee measures relating to all eligible United States agricultural commodities.<sup>122</sup>

7.58 **New Zealand** also considers that the Panel should reject the United States' request because Brazil had had little choice but to look at a broader commodity coverage in relation to export credits as the information specific to upland cotton alone was not available.<sup>123</sup>

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<sup>119</sup> Brazil also submitted a report by Mr. Nicholas Minot and Ms. Lisa Daniels as Exhibit BRA-244.

<sup>120</sup> For example, Brazil has explained the situation in Benin and/or Chad in its further submission dated 9 September 2003 (executive summary included as Annex E item 1) at paragraph 1; in its answers dated 27 October 2003 to questions from the Panel at paragraphs 61, 121, 159 (see Annex I item 5); in Exhibit BRA-294, and in its further rebuttal submission dated 18 November 2003 (executive summary included as Annex G item 1) at paragraph 87. Numerous exhibits also pertain to the cotton sectors in Benin and/or Chad, in particular, Exhibit BRA-15, an OXFAM briefing paper, Exhibits BRA-264 through BRA-268 and BRA-294. The United States referred to the submission of Benin in its response dated 11 August 2003 to the Panel's Questions at paragraph 26 (see Annex I item 2).

<sup>121</sup> United States' first written submission, para. 206. For the record, we note that the United States raised this issue at both meetings of the DSB at which Brazil's request for establishment of a panel was considered. See the minutes of the DSB meetings in WT/DSB/M/143, para. 27 and WT/DSB/M/145, para. 24.

<sup>122</sup> Brazil's oral statement at the first session of the first substantive meeting, para. 94.

<sup>123</sup> New Zealand's written submission to the first session of the first substantive meeting, para. 5.02.

7.59 The Panel was established with standard terms of reference<sup>124</sup> that are set out in Brazil's request for establishment of a panel. That request states that "the measures that are the subject of this request" include:

"Export subsidies, exporter assistance, export credit guarantees, export and market access enhancement to facilitate the export of US upland cotton, and other eligible agricultural commodities as addressed herein, provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, and the Step 1 and Step 2 certificate programs, among others;"<sup>125</sup>

7.60 It is agreed that this document specifically mentions other eligible agricultural commodities. However, Article 6.2 of the *DSU* provides that a request for establishment of a panel:

"... shall indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly. ..."

7.61 The United States accepts that consultations were held in respect of export credit guarantee measures for upland cotton, but contends that consultations were not held for other eligible agricultural commodities. The United States acknowledges that Brazil posed questions in consultations which extended beyond upland cotton.<sup>126</sup> The Panel notes that during the consultations Brazil submitted 21 questions in writing to the United States regarding export credit guarantee measures, seeking information on the total volume and value of exports of United States agricultural goods guaranteed by these programmes, the same information for exports of United States upland cotton only, the total costs of the programmes and the legal basis for the programmes, among other issues.<sup>127</sup> This shows that the *actual* consultations did include export credit guarantee measures relating to all eligible agricultural commodities.

7.62 The United States takes the view that the consultations could only cover upland cotton because the other products were not included in Brazil's request for consultations.<sup>128</sup> Assuming *arguendo* that the scope of the written request for consultations is determinative, rather than the scope of the actual consultations, the Panel notes that Brazil's request included the following paragraph:

"The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton,<sup>1</sup> as well as legislation, regulations, statutory instruments and amendments thereto providing such subsidies (including export credits), grants, and any other assistance to the US producers, users and exporters of upland cotton ("US upland cotton industry")."

7.63 Footnote 1 to this paragraph read "Except with respect to export credit guarantee programs as explained below." This should have indicated to the careful reader that the subject of the request for consultations, with respect to export credit guarantee measures only, was different from those "provided to US producers, users and/or exporters of upland cotton". Looking below, there were two references to export credit guarantee measures, which read as follows:

"Export subsidies, exporter assistance, export credit guarantees, export and market access enhancement to facilitate the export of US upland cotton provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the

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<sup>124</sup> Document WT/DS267/15.

<sup>125</sup> Document WT/DS267/7.

<sup>126</sup> United States' first written submission, para. 198.

<sup>127</sup> Exhibit BRA-101. The United States confirmed that these questions were posed to it during consultations and that it immediately objected to them – see its response to Panel Question No. 8.

<sup>128</sup> United States' first written submission, para. 198.

GSM-102, GSM-103, and SCGP programs, and the Step 1 and Step 2 certificate programs, among others;" (on page 2); and

"Regarding export credit guarantees, export and market access enhancement provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, Brazil is of the view that these programs, as applied and as such, violate Articles 3.3, 8, 9.1, and 10.1 of the Agreement on Agriculture and are prohibited export subsidies under Article 3.1(a) and item (j) of the Illustrative List of Export Subsidies included as Annex I to the SCM Agreement. Subsidies provided under these programs are also actionable subsidies for the purpose of Brazil's claims under Article 6.3 of the SCM Agreement." (on page 4).<sup>129</sup>

7.64 The second of these paragraphs referred to the three export credit guarantee programmes at issue "as applied and as such" and made no specific reference to upland cotton, yet almost every other substantive paragraph and *tiret* of the request made such a specific reference. Therefore, a plain reading of that paragraph includes all eligible agricultural commodities.<sup>130</sup> Any uncertainty on the part of the United States should have been dispelled by the questions which Brazil posed during the consultations.<sup>131</sup>

7.65 Therefore, the Panel concludes that export credit guarantee measures relating to all eligible agricultural commodities were included in Brazil's request for consultations, based on its reading of the text of the request itself. Accordingly, the Panel rejects the United States' contention that they were not so included and that export credit guarantee measures relating to eligible agricultural commodities other than upland cotton are not properly before the Panel.

7.66 The Panel asked the United States whether it had suffered any actual prejudice as a result of the alleged omission of products other than upland cotton from the request for consultations. The United States replied that the issue of prejudice was not relevant to the question whether a measure not consulted upon may be the subject of panel proceedings. Nevertheless, it submitted that it had suffered an inability to prepare, respond and consult with respect to allegations on measures never presented in accordance with the *DSU*. If export credit guarantees with respect to other eligible commodities were included in the dispute, it would suffer prejudice of having to prepare and defend its actions in a severely compressed time frame without the benefit of any consultations whatsoever.<sup>132</sup>

7.67 We note the fact that the United States declined to respond to the questions posed by Brazil during consultations concerning export credit guarantees relating to eligible commodities other than upland cotton. On a plain reading of the request for consultations, export credit guarantee measures were challenged by Brazil in relation to all eligible agricultural commodities. If a Member is uncertain as to the scope of the measures referred to by another Member in a request for consultations, and chooses not to seek clarification, it cannot rely on its own uncertainty as a jurisdictional bar to a Panel finding on the measures. Members have an obligation under Article 3.10 of the *DSU* to engage in WTO dispute settlement procedures in good faith in an effort to resolve the dispute.

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<sup>129</sup> Document WT/DS267/1.

<sup>130</sup> The United States does not disagree that the request for establishment of a panel can be understood to indicate that Brazil's claim related to products other than upland cotton, although it submits that Brazil was not entitled to add the words "other eligible agricultural commodities" to its request for establishment of a panel to broaden the scope of the challenged measures. See the United States' response to Panel Question No. 11.

<sup>131</sup> The title "United States – Subsidies on Upland Cotton" was added by the Secretariat when it circulated a copy of the request for consultations to Members. The title did not appear in the original communication sent from the Permanent Mission of Brazil to the Permanent Mission of the United States and is therefore not a legally relevant consideration here.

<sup>132</sup> United States' response to Panel Question No. 10.

7.68 Given the Panel's finding on the scope of the two requests, it is not strictly necessary to examine the relationship between them. However, the Panel takes note of the United States' concern that the request for establishment of a panel included the words "and other eligible agricultural commodities as addressed herein" which did not appear in the request for consultations. There is no requirement in the *DSU* that the language in the request for establishment of a panel should be a duplicate of the request for consultations. Rather, the difference in language between Article 4.4, which requires a request for consultations to identify the measures at issue, and Article 6.2, which requires a request for establishment of a panel to identify the "specific" measures at issue, suggests that the measures will be identified in sharper focus in the latter request.<sup>133</sup> Indeed, one of the purposes of consultations is that each party should gain a better understanding of the other's position, which may often lead to differences between the two requests.

7.69 Therefore, the Panel rules that export credit guarantees to facilitate the export of United States upland cotton, and other eligible agricultural commodities as addressed in document WT/DS267/7, are within its terms of reference.<sup>134</sup>

(b) Statement of available evidence

7.70 The **United States** also requests the Panel to rule that Brazil could not advance claims under either Article 4 or Article 7 of the *SCM Agreement* with respect to export credit guarantee measures on eligible agricultural commodities other than upland cotton because it did not include a statement of available evidence with respect to such export credit guarantees in accordance with Articles 4.2 and 7.2 of that Agreement.<sup>135</sup>

7.71 In its first written submission, the United States argued that the statement of evidence attached to Brazil's request for consultations provided further proof that the request for consultations did not extend beyond export credit guarantees for upland cotton.<sup>136</sup> After the Panel's 25 July 2003 communication relating to its intended ruling that export credit guarantee measures in respect of other eligible agricultural commodities were within its terms of reference, the United States foreshadowed a request for a preliminary ruling in its responses to Panel questions following the first session of the first Panel meeting.<sup>137</sup> The United States first clearly requested a ruling on the adequacy of Brazil's statement of available evidence with respect to export credit guarantees on eligible agricultural commodities other than upland cotton in its 30 September 2003 further submission.<sup>138</sup>

7.72 **Brazil** asks the Panel to reject the United States' request. Brazil asserts that the United States' request is not new and is untimely, groundless and "mooted by" the Panel's communication of 25 July 2003 indicating that the Panel intended to rule that export credit guarantees to facilitate the export of United States upland cotton and other eligible agricultural commodities are within the Panel's terms of reference.<sup>139</sup>

7.73 The Panel first recalls that the United States has made allegations of inadequacy in Brazil's statement of available evidence under *both* Articles 4.2 and 7.2 of the *SCM Agreement*.

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<sup>133</sup> We note that the Panel in *Canada – Wheat Exports and Grain Imports* was also of this view: see para. 15 of the preliminary ruling set out at para. 6.10 of that Panel Report (circulated to Members, currently on appeal).

<sup>134</sup> The Panel communicated to the parties and third parties in a letter dated 25 July 2003 that it intended to make this ruling in this report, in order to assist them in deciding what argumentation and evidence to submit in their answers to questions and rebuttals.

<sup>135</sup> United States' further written submission, para. 9.

<sup>136</sup> United States' first written submission, para. 197.

<sup>137</sup> United States' response to Panel Question No. 3, footnote 3.

<sup>138</sup> United States' further written submission, paras. 9 *ff.*

<sup>139</sup> Brazil's oral statement at the resumed session of the first substantive meeting, paras. 73-78.

7.74 Article 4.2 of the *SCM Agreement*, in Part II of that Agreement, deals with requests for consultations relating to alleged *prohibited* subsidies. With respect to such alleged prohibited subsidies, it requires that: "A request for consultations ... shall include a statement of available evidence with regard to the existence and nature of the subsidy in question."

7.75 With respect to the United States' request pertaining to Article 4.2 of the *SCM Agreement*, during the course of the Panel proceedings, Brazil clarified that its export subsidy claims under Part II of the *SCM Agreement* included export credit guarantees under the GSM 102, GSM 103 and SCGP programmes as they relate to upland cotton and other eligible agricultural commodities. It is clear to us that our terms of reference include Brazil's prohibited subsidies claims under Article 3 of the *SCM Agreement* in relation to cotton and other eligible agricultural commodities.<sup>140</sup> It is therefore appropriate for us to address here the United States' allegations of inadequacy in Brazil's statement of available evidence under Article 4.2 of the *SCM Agreement*.

7.76 By contrast, Article 7.2 of the *SCM Agreement*, in Part III of that Agreement, deals with requests for consultations relating to alleged *actionable* subsidies. With respect to such alleged actionable subsidies, it requires that: "A request for consultations ... shall include a statement of available evidence with regard to (a) the existence and nature of the subsidy in question, and (b) the injury caused to the domestic industry, or the nullification or impairment, or serious prejudice caused to the interests of the Member requesting consultations." (footnote omitted)

7.77 In our 3 November 2003 communication, we indicated an intention to rule that Brazil had provided a statement of available evidence with respect to export credit guarantee measures relating to eligible United States agricultural commodities other than upland cotton under Article 7.2 of the *SCM Agreement*.<sup>141</sup> As we indicated there, our intention at that time was to assist the parties in deciding what evidence and argumentation to submit in the course of the Panel proceedings. In light of the particular circumstances of this dispute and, more specifically, the long-standing issue of the product scope of Brazil's claims pertaining to United States export credit guarantee measures, we made it clear that neither party should consider it was justified in withholding any relevant evidence from the Panel for any reason.

7.78 In relation to the United States' allegations of inadequacy under Article 7.2 of the *SCM Agreement*, it is now clear that Brazil's allegations of "serious prejudice" under Part III of the *SCM Agreement* are in respect of export credit guarantees under only one of the United States export credit guarantee programmes – GSM 102 – and *only* as that programme applies to upland cotton.<sup>142</sup> In light of Brazil's limitation of the product scope of its actionable subsidy claims to upland cotton, and of our exercise of judicial economy in respect of that claim<sup>143</sup>, it is no longer necessary for us to make nor

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<sup>140</sup> We recall our ruling *supra*, para. 7.69.

<sup>141</sup> See Annex L to this report.

<sup>142</sup> It is clear that Brazil's actionable subsidy claims relating to export credit guarantees under the GSM 102 programme do *not* relate to agricultural products other than upland cotton from, *inter alia*, Brazil's statement that "the only CCC export credit guarantee program that significantly contributed to the upland cotton-related serious prejudice suffered by Brazil was the GSM-102 program...". See Brazil's response to Panel Question No. 139(a), para. 77. Moreover, Brazil stated:

"[e]ven if the United States were to make this request for a preliminary ruling and the Panel were to grant it, it would not affect Brazil's claims. Brazil's compliance with Article 7.2 of the *SCM Agreement* can have no effect on its claims under the Agreement on Agriculture, or on its prohibited subsidy claims under the *SCM Agreement*, or on its actionable subsidy claims with respect to upland cotton." See Brazil's 22 August comments on United States' response to Panel Question No. 3, para. 5.

<sup>143</sup> See *infra*, Section VII:G.

substantiate that intended ruling in respect of the adequacy of Brazil's statement of available evidence under Article 7.2 of the *SCM Agreement*.<sup>144</sup>

7.79 Accordingly, we limit our examination here to whether Brazil included a statement of available evidence with respect to export credit guarantees on other eligible agricultural products in accordance with the requirement pertaining to its *export* subsidy allegations in Article 4.2 of the *SCM Agreement*.

7.80 As we have already mentioned, in respect of claims concerning alleged prohibited subsidies, Article 4.2 of the *SCM Agreement* provides:

"A request for consultations under paragraph 1 shall include a statement of available evidence with regard to the existence and nature of the subsidy in question."

7.81 Appendix 2 of the *DSU* identifies this provision as a "special or additional rule or procedure". In respect of such special or additional rules, Article 1.2 of the *DSU* provides:

"The rules and procedures of this Understanding shall apply subject to such special or additional rules and procedures on dispute settlement contained in the covered agreements as are identified in Appendix 2 to this Understanding. To the extent that there is a difference between the rules and procedures of this Understanding and the special or additional rules and procedures set forth in Appendix 2, the special or additional rules and procedures in Appendix 2 shall prevail."

7.82 To the extent that there is a difference between the rules and procedures of the *DSU* and the special or additional rules, the latter will prevail. A request for consultations relating to prohibited subsidies must therefore satisfy the requirements in Article 4.2 of the *SCM Agreement* as well as the standard requirements set out in Article 4.4 of the *DSU*.<sup>145</sup>

7.83 Brazil's "statement of available evidence" annexed to its request for consultations contains multiple references to alleged United States prohibited (and actionable) subsidies to upland cotton. It also contains two points specifically referring to United States export credit guarantee programmes. These read:

"US export credit guarantee programs have caused serious prejudice to Brazilian upland cotton producers by providing below-market financing benefits for the export of competing US upland cotton;

US export credit guarantee programs, since their origin in 1980 and up the present, provide premium rates that are inadequate to cover the long-term operating costs and losses of the programs; in particular there were losses caused by large-scale defaults totalling billions of dollars that have not been reflected in increased premiums to cover such losses [...]"

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<sup>144</sup> The evidence properly before the Panel is a separate issue from the adequacy of the statement of available evidence. Thus, this does not affect the evidence which we may take into account when examining Brazil's actionable subsidy claims relating to the export credit guarantee measures at issue.

<sup>145</sup> See for example, Appellate Body Report, *US – FSC*, paras. 159-161. Article 4.4 of the *DSU* provides:

"All such requests for consultations shall be notified to the DSB and the relevant Councils and Committees by the Member which requests consultations. Any request for consultations shall be submitted in writing and shall give the reasons for the request, including identification of the measures at issue and an indication of the legal basis for the complaint."

7.84 The first of these paragraphs -- which refers to "serious prejudice" -- is textually limited to upland cotton. The second -- which refers to United States' export credit guarantee "programmes" and contains language reflecting certain elements set out in item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*<sup>146</sup> -- is not so limited. The United States contends that this non-limitation "does nothing to expand" the scope of the statement of available evidence.<sup>147</sup>

7.85 We disagree. Particularly when this paragraph is read in light of footnote 1<sup>148</sup> of the request for consultations, a careful reader should have been alerted to the fact that this paragraph referred to alleged subsidies arising from export credit guarantees under the challenged programmes, without any limitation to upland cotton or any other particular product or products. Brazil referred to the three export credit guarantee programmes by name -- GSM 102, GSM 103 and SCGP -- elsewhere in its consultation request, thereby clarifying the particular United States export credit guarantee programmes at issue.

7.86 We read Brazil's statement of available evidence, insofar as Brazil's export subsidy claims are concerned, to refer to each of the three challenged United States export subsidy programmes as they relate to upland cotton and other eligible agricultural products.

7.87 It is not entirely clear to us that the United States challenges the *adequacy* of the statement of available evidence in terms of evidence with respect to the "existence" or "nature" of these alleged subsidies with respect to any product other than upland cotton. However, to the extent that the United States makes this challenge, we see nothing in the text of Article 4.2 of the *SCM Agreement* that would *necessarily* require Brazil to identify specifically or explicitly the products for which the programmes were provided, the amounts provided, or indicate that they existed beyond upland cotton, as the United States contends.<sup>149</sup> This would have fallen within the scope of the export credit guarantee "programmes" already identified by Brazil.

7.88 Article 4.2, by its terms, requires that the complaining party include an expression in words of the facts available at the time of the consultation request concerning the "existence" and "nature" of the subsidy in question. It would be illogical to expect that this was meant to refer to the universe of all "available" evidence. Rather, this must be taken to refer to evidence available to the complaining

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<sup>146</sup> Brazil's statement of available evidence alleges that the US export credit guarantee programmes at issue "provide premium rates that are inadequate to cover the long-term operating costs and losses of the programs; in particular there were losses caused by large-scale defaults totalling billions of dollars that have not been reflected in increased premiums to cover such losses." Item (j) similarly focuses on a comparison of premium rates of export credit guarantee programmes and long-term operating costs and losses in order to discern whether the former are inadequate to cover the latter. Item (j) reads as follows: "The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes." While it may not be appropriate to limit a statement of available evidence to the text of the relevant legal provisions, we note that Brazil refers elsewhere in its statement to evidence on which it relies. The similarity of the language used by Brazil in its statement of available evidence and the language in item (j) provides an insight into aspects of the alleged prohibited export subsidy forming the subject of Brazil's statement of available evidence.

<sup>147</sup> United States' further written submission, para. 11.

<sup>148</sup> As already indicated, Brazil's request for consultations states:

"The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton,<sup>1</sup> as well as legislation, regulations, statutory instruments and amendments thereto providing such subsidies (including export credits), grants, and any other assistance to the US producers, users and exporters of upland cotton ('US upland cotton industry')."

<sup>1</sup>Except with respect to export credit guarantee programs as explained below. [*original footnote*].

<sup>149</sup> United States' further written submission, para. 11.

Member. This evidence available to the complaining Member goes towards identifying the "existence" and "nature" of the subsidy in question, including available evidence of the character of the measure as a "subsidy".<sup>150</sup>

7.89 Brazil's statement of available evidence indicates Brazil's view that the character of the alleged subsidy lay in the provision of export credit guarantees under programmes "at premium rates that are inadequate to cover the long-term operating costs and losses of the programs; in particular there were losses caused by large-scale defaults totalling billions of dollars that have not been reflected in increased premiums to cover such losses."

7.90 Brazil therefore had evidence available to it at that time which led it to conclude that the United States was providing a prohibited export subsidy of this nature and character under the three identified export subsidy programmes, without any limitation to a particular product or products.

7.91 In this context, we note that Brazil's "statement of available evidence" indicates that:

"2. The evidence set out below is evidence available to Brazil at this time regarding the existence and nature of those subsidies, and the adverse effects caused by them to the interests of Brazil. It reflects the presently available evidence regarding the claims reflected in Brazil's request for consultations and is supported by documents that are described and set out in United States Department of Agriculture (USDA) and non-governmental internet locations set out in paragraph 4 below. Brazil reserves the right to supplement or alter this list in the future, as required."<sup>151</sup>

7.92 We further note that, among the various websites and documents that Brazil identifies in order to substantiate its statement that United States export credit guarantee programmes are run at "premium rates that are inadequate to cover the long-term operating costs and losses of the programmes" is a website maintained by the United States "Congressional Budget Office", concerning "Current Budget Projection". That website contains CBO projections for United States government mandatory and discretionary spending. In a table entitled "CBO's Baseline Projections of Mandatory Spending, Including Offsetting Receipts", there is an entry for the "Commodity Credit Corporation" – the entity administering the United States' export credit guarantee programmes – accompanied by certain data pertaining to spending and offsetting receipts.

7.93 Neither this entry, nor the related data, contain any indication of limitation of Brazil's allegations concerning the export credit guarantee programmes to any specific product, such as, for example, upland cotton. This budgetary projection evidence could reasonably be taken as evidence available to Brazil that led it to conclude that the United States' export credit guarantee programmes are run at "premium rates that are inadequate to cover the long-term operating costs and losses of the programmes."

7.94 The United States further contends that the statement did not contain *all* of the evidence available to Brazil at the time of the request for consultations, and that Brazil deliberately withheld certain evidence that was available to it.<sup>152</sup>

7.95 While objective confirmation by a panel of the totality of evidence available to Brazil at the time that it made its consultation request would be difficult, Brazil has submitted to us that its request for consultations and statement of available evidence submitted on 27 September 2002 "offer[ed] the quite limited information it knew at the time about the CCC export credit guarantee programs. It

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<sup>150</sup> See Appellate Body Report, *US – FSC*, paras. 159-161.

<sup>151</sup> WT/DS267/1, p.5, para. 2. The electronic version of the document contains hyperlinks to the identified websites.

<sup>152</sup> United States' further written submission, paras. 11-12.

sought to use the consultation process to gather information that was readily available to the United States."<sup>153</sup>

7.96 It is clear to us that Article 4.2 of the *SCM Agreement* requires a complaining Member to include more information about its case in its request for consultations than is otherwise required under the *DSU*.

7.97 As we have already mentioned, by virtue of Article 1.2 of the *DSU*, to the extent that there is a difference between Article 4.2 of the *SCM Agreement* and the rules and procedures in the *DSU*, Article 4.2 would prevail.<sup>154</sup> Article 4.4 of the *DSU* requires that: "Any request for consultations shall be submitted in writing and shall give the reasons for the request, including identification of the measures at issue and an indication of the legal basis for the complaint." Thus, Article 4.4 of the *DSU* merely requires "identification" of the measures at issue and an "indication" of the legal basis for the complaint. This is a different requirement to that of Article 4.2 of the *SCM Agreement*.

7.98 This additional requirement in Article 4.2 of the *SCM Agreement* serves to provide a responding Member with a better understanding of the matter in dispute and serves as the basis for consultations. The statement of available evidence informs the responding Member of facts at the disposal of the complaining Member at the time it requests consultations about the prohibited subsidy it alleges is being granted or maintained.<sup>155</sup>

7.99 However, Article 4.2 does not require disclosure of *all* facts and evidence upon which the complaining Member will ultimately rely in the course of the dispute settlement proceedings.<sup>156</sup> Article 4.3 explicitly states that one of the purposes of consultations shall be to "clarify the facts of the situation". This implies that additional facts and evidence will be developed during the consultations.<sup>157</sup> This is consistent with the view that a central purpose of consultation in general, and of consultations under Article 4 of the *SCM Agreement* in particular, is to clarify and develop the facts of the situation.

7.100 The statement of available evidence directs attention to the measures concerned. It is the starting point for consultations, and for the emergence of more evidence concerning the measures by reason of the clarification of the "situation". If the dispute proceeds to the panel stage, additional evidence may well come to light by reason of the parties' participation in the panel procedures, including in response to the panel's questions and requests for information.

7.101 It is therefore credible that Brazil's statement of available evidence indicated the evidence that was available to Brazil at the time that led it to conclude that the United States was providing a prohibited subsidy. As we have observed in paragraph 7.92 above, at least one of the website links cited in the "statement of available evidence" contained evidence that would reasonably be relevant to substantiate such an allegation.<sup>158</sup>

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<sup>153</sup> Brazil's oral statement at the resumed session of the first substantive meeting, para. 78.

<sup>154</sup> See *supra*, paragraph 7.81.

<sup>155</sup> See Panel Report, *Australia – Automotive Leather II*, para. 9.29.

<sup>156</sup> We find support for this proposition in Panel Report, *Australia – Automotive Leather II*, paras. 9.27-9.29.

<sup>157</sup> Indeed, consultations may play a significant role in developing the facts in a dispute settlement proceeding. For example, the Appellate Body has observed that "[...] the claims that are made and the facts that are established during consultations do much to shape the substance and the scope of the subsequent panel proceedings." See Appellate Body Report, *India – Patents (US)*, para. 94.

<sup>158</sup> We refer to the particular circumstances of this case. We do not mean to imply that mere reference in a complaining Member's statement of available evidence to a list of websites would invariably be appropriate or sufficient for the purposes of Article 4.2 of the *SCM Agreement*. It is clear to us, however, that there is no

7.102 The United States has not demonstrated that Brazil actually had at its disposal any additional evidence that it failed to include in its statement of available evidence. Even if this had been established (and this might arguably not have been difficult, in light of the large volume of evidence that was subsequently submitted), it is not the Panel's view that the statement of available evidence must be absolutely comprehensive and exhaustive of the entire universe of all available evidence. To rule otherwise would go well beyond the purpose of consultations, to which such a statement is directed, and create a jurisdictional obstacle which would run counter to an underlying rationale of the procedural rules of WTO dispute settlement, which are designed to promote, not the development of litigation techniques, but the fair, prompt and effective resolution of trade disputes.<sup>159</sup>

7.103 For all of these reasons, assuming *arguendo* that the United States' request was timely<sup>160</sup>, the Panel rules that Brazil provided a statement of available evidence with respect to export credit guarantee measures relating to upland cotton and eligible United States agricultural products other than upland cotton, as required by Article 4.2 of the *SCM Agreement*.<sup>161</sup>

## 2. PFC and MLA payments

### (a) Expired programmes

7.104 The **United States** requests the Panel to rule that production flexibility contract ("PFC") payments and market loss assistance ("MLA") payments are not within its terms of reference because they expired prior to Brazil's request for consultations. Consultations under Article 4.2 of the *DSU* cannot cover expired measures, and measures not the subject of consultations cannot fall within a panel's terms of reference.<sup>162</sup> The United States did not address these payments in terms of substance in its first written submission.

7.105 **Brazil** asks the Panel to reject the United States' request, submitting that a panel is required to examine the effects flowing from expired measures in order to conduct an objective assessment of a serious prejudice claim. Otherwise, the actionable subsidies provisions of the *SCM Agreement* would be redundant, as a Member could easily tailor its measures in a fashion which effectively circumvented these disciplines.<sup>163</sup>

7.106 **New Zealand** considers that these measures should be within the scope of the Panel's consideration, particularly when the programmes in question in fact continue in a slightly different form, and given that serious prejudice claims may necessitate consideration of trends over a number of years.<sup>164</sup>

7.107 The parties agree that PFC and MLA payments were made under legislation that no longer exists. PFC payments constituted a programme under the FAIR Act of 1996 which no longer

requirement under Article 4.2 of the *SCM Agreement* for a complaining Member to establish a *prima facie* case in its statement of available evidence.

<sup>159</sup> Article 3.10 of the *DSU*. See Appellate Body Report, *US – FSC*, para. 166.

<sup>160</sup> In light of our ruling, it is not necessary for us to address the issue of timeliness here.

<sup>161</sup> The Panel communicated to the parties on 3 November 2003 that it intended to make this ruling in this report, in order to assist them in deciding what argumentation and evidence to submit in their further rebuttal submissions.

This ruling is, of course, without prejudice to the issue of whether or not a panel would be required to dismiss claims under Article 3 of the *SCM Agreement* because the complaining Member did not include a sufficient statement of available evidence in its request for consultations within the meaning of Article 4.2 of the *SCM Agreement*.

<sup>162</sup> United States' first written submission, para. 211.

<sup>163</sup> Brazil's oral statement at the first session of the first substantive meeting, para. 144; its response to Panel Question No. 15 and its closing statement at the first session of the first substantive meeting, para. 4.

<sup>164</sup> New Zealand's written submission to the first session of the first substantive meeting, para. 5.01.

authorizes payments.<sup>165</sup> MLA payments were made under four separate annual Acts in 1998, 1999, 2000 and 2001, discussed below. The authorizing legislation allocated these payments to a particular crop year (in the case of PFC payments) or fiscal year (in the case of MLA payments). All those measures and years of allocation expired prior to the date of Brazil's request for establishment of a panel. This is a different situation from that confronting some previous panels, where measures expired during their proceedings.

7.108 The Panel notes that Brazil pursues claims only in respect of the subsidies and domestic support provided under the expired programmes and authorizing legislation, in other words, the payments themselves.<sup>166</sup> Brazil does not seek any relief in respect of the PFC and MLA programmes or authorizing legislation "as such". Therefore, the Panel only considers whether the payments are within its terms of reference.

7.109 Brazil does not seek any recommendation that PFC and MLA payments be brought into conformity with the *Agreement on Agriculture* or the *GATT 1994* but only requests findings that those made during the 1999-2001 marketing years are not exempted from actions by Article 13 and that they caused and continue to cause serious prejudice to the interests of Brazil in violation of Articles 5(c) and 6.3(c) and (d) of the *SCM Agreement* and Articles XVI:1 and XVI:3 of the *GATT 1994*.<sup>167</sup>

7.110 PFC and MLA payments had already been made at the date of the establishment of the Panel. In that sense, they had not expired, but simply occurred in the past, which will be true of most subsidies challenged in a claim of actual serious prejudice. We agree with the following statement of the Panel in *Indonesia – Autos*:

"We note that at any given moment in time some payments of subsidies have occurred in the past while others have yet to occur in the future. If we were to consider that past subsidies were not relevant to our serious prejudice analysis as they were "expired measures" while future measures could not yet have caused actual serious prejudice, it is hard to imagine any situation where a panel would be able to determine the existence of actual serious prejudice."<sup>168</sup>

7.111 However, 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.

7.112 The United States argues that for this reason these measures do not fall within the Panel's terms of reference. It cites Article 4.2 of the *DSU* which provides:

"2. Each Member undertakes to accord sympathetic consideration to and afford adequate opportunity for consultation regarding any representations made by another Member concerning measures affecting the operation of any covered agreement taken within the territory of the former."(footnote omitted)

7.113 The United States argues that measures that are no longer in effect at the time of consultations cannot be "affecting the operation of any covered agreement" at that time within the meaning of Article 4.2 of the *DSU* and therefore cannot be "measures at issue" within the meaning of Article 6.2 of the *DSU*.<sup>169</sup> Brazil argues that Article 4.2 has no temporal connotation.<sup>170</sup>

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<sup>165</sup> Nevertheless, the PFC programme was basically continued with modifications in the FSRI Act of 2002, as discussed in Section VII:D of this report.

<sup>166</sup> See Brazil's first written submission, para. 352 and Brazil's further written submission, para. 471.

<sup>167</sup> See Brazil's further written submission, para. 471 and its response to Panel Question No. 250.

<sup>168</sup> See the Panel Report, *Indonesia – Autos*, para. 14.206.

<sup>169</sup> See United States' response to Panel Question No. 15.

7.114 Article 4.2 of the *DSU* was applicable to Brazil's request for consultations in this dispute. The rules and procedures in the *DSU* are applicable to disputes under all the covered agreements, subject to any special rules and procedures listed in Appendix 2.<sup>171</sup> There are no special rules concerning requests for consultations that would prevail over Article 4.2 in this dispute.

7.115 Article 4.2 of the *DSU* contains the word "affecting" which, in the English and French versions, is a participle that refers not to the status of measures but rather to the way in which they relate to a covered agreement. This is consistent with the Spanish version which does not use a participle but rather a subjunctive verb in the phrase "*medidas que afecten*" which simply indicates measures of the type which may affect the operation of any covered agreement.

7.116 This is consistent with Article 3.3 of the *DSU* which states that:

"The prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members."

7.117 This provision is phrased in the present tense in all three authentic texts. It refers to situations in which a Member "considers" (present tense) that any benefits accruing to that Member under the covered agreements "are being impaired", (present continuous tense) by measures "taken" (past participle) by another Member. This provision focuses on the present nature of the alleged impairment of benefits but does not address whether or not measures themselves must still be in effect.

7.118 In light of the above, the Panel does not consider that Article 4.2 supports an interpretation that a request for consultations cannot concern measures that have expired, or payments made under programmes that are no longer in effect, where the Member requesting consultations represents that benefits accruing to it directly or indirectly under the covered agreements are being impaired by those measures.

7.119 Brazil's request for consultations alleges that the use of the measures specified in the request "causes adverse effects, i.e. serious prejudice" to its interests. We note the present tense of this allegation. The request concerns the way in which measures were affecting the operation of a covered agreement at the time of consultations, and it states that Brazil had reason to believe that these subsidies were resulting in serious prejudice at that time. As such, it satisfies the requirements of Article 4.2 of the *DSU*.

7.120 The United States also distinguishes between non-recurring subsidies and recurring subsidies and the period of time for which they are allocated to production, in support of an argument that recurring subsidies may not be actionable subsidies after they have expired.<sup>172</sup> Given our view that expired measures may be the subject of a request for consultations, it is not necessary for us to address this argument here. However, the Panel notes that the text of Part III of the *SCM Agreement* does not indicate that requests for consultations are to be governed in the way in which subsidies are expended. Rather, the conformity of expired recurring subsidies to the provisions of Part III is an issue of substance and remedies and does not go to the scope of the terms of reference.

7.121 In any event, the Panel's terms of reference refer to Brazil's request for establishment of a panel, not its request for consultations. Article 6.2 of the *DSU* provides that a request for

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<sup>170</sup> Brazil's oral statement at the first session of the first substantive meeting, para. 142.

<sup>171</sup> Article 1.1 and 1.2 of the *DSU*.

<sup>172</sup> See United States' response to Panel Question No. 15.

establishment of a panel should identify the "specific measures at issue" and does not address the issue of the status of the measures at all.

7.122 For all of the above reasons, the Panel does not believe that Article 4.2, and hence Article 6.2, of the *DSU* excludes expired measures from the potential scope of a request for establishment of a panel.

(b) Identification as specific measures

7.123 The **United States** also notes that the request for establishment of a panel did not identify MLA payments by name and submits that it "raises concerns under Article 6.2 of the *DSU*".<sup>173</sup> The United States mentioned this in a footnote in its first written submission, and did not formally indicate that it was raising an objection. Objections should be clearly raised. However, for the record, the Panel wishes to explain its approach to this issue.

7.124 The request for establishment of a panel identified the pieces of legislation under which the MLA payments were authorized in the marketing years 1999-2001 in the following paragraph:

"Subsidies provided under the Agricultural Assistance Act of 2003; Subsidies provided under the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriation Act of 2002 (November 2001), the Crop Year 2001 Agricultural Economic Assistance Act (August 2001), the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2001 (October 2000), the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2000 (October 1999), and the Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 1999 (October 1998);"<sup>174</sup>

7.125 Brazil submits that the four Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriation Acts in this list authorized MLA payments.<sup>175</sup> The United States indicated that these are the names and dates of the relevant legislation.<sup>176</sup> Elsewhere, the United States indicated that the last market loss assistance payment was authorized under Public Law 107-25, which is the third Act in the above list.<sup>177</sup> The Panel also notes that the Agricultural Risk Protection

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<sup>173</sup> United States first written submission, para. 210, footnote 190. There is no dispute that the request for establishment of a panel identified PFC payments by name and by authorizing statute. It read, relevantly, as follows: "*Subsidies and domestic support provided under the Federal Agricultural Improvement and Reform Act (FAIR Act) of 1996, and programs under the FAIR Act or amendments thereto relating to marketing loans, loan deficiency payments, commodity certificates, production flexibility contract payments, conservation payments, Step 2 certificate programme payments, export credit guarantees, crop insurance, and any other FAIR Act provisions providing direct or indirect support to the US upland cotton industry; [emphasis added]*" (document WT/DS267/7, page 2).

<sup>174</sup> This paragraph also appeared in the request for consultations, minus the phrase "Subsidies provided under the Agricultural Assistance Act of 2003;".

<sup>175</sup> See Brazil's first written submission para. 60, footnote 129. The United States, in its first written submission, para. 209, footnote 188, agrees with the titles of the relevant legislation, and para. 210, footnote 190, it agrees that they were set out in the request for establishment of a panel. Compare Exhibit BRA-105, Annex 2, footnote 16, which lists all five Acts in this paragraph besides the Agricultural Assistance Act of 2003.

<sup>176</sup> United States' first written submission, para. 209, footnote 188. In para. 210, footnote 190, the United States indicates that the MLA payments were authorized within these pieces of appropriations legislation.

<sup>177</sup> See section 1 of the law which is reproduced in Exhibit BRA-138. See United States' response to Panel Question No. 15. The title of this Public Law is discussed below in paragraph 7.142.

Act of 2000, which is cited elsewhere in the request for establishment of a panel, contained provisions relevant to MLA payments.<sup>178</sup>

7.126 The word "Agriculture" is missing from the title of the 1999 Act. This appears to have been a typographical error as it was correctly stated in the request for consultations and the rest of the title, which is lengthy, is correctly cited in the request for establishment of a panel and cannot refer to anything else. It therefore identifies the specific Act. The term "market loss assistance payments" does not appear.

7.127 In the Panel's view, this paragraph specifically identifies MLA payments in the marketing years 1999-2001 in accordance with Article 6.2 of the *DSU*. It specifically identifies the titles of the appropriating Acts and refers to the "subsidies" provided under them, one of which was in fact MLA payments. Brazil included the same paragraph (minus the 2003 Act) in its request for consultations and posed questions referring to "market loss assistance payments" by name during consultations<sup>179</sup> thereby confirming to the United States that the paragraph, when it was repeated in identical terms in all relevant respects in the request for establishment of a panel, referred to MLA payments, among other things. The United States has not alleged that the description in the request for establishment of a panel prejudiced the preparation of its defence.

7.128 Therefore, in light of our conclusion at paragraph 7.122, and the specific identification of MLA payments in the request for establishment of a panel, the Panel rules that PFC and MLA payments, as addressed in document WT/DS267/7, fall within its terms of reference.<sup>180</sup> This ruling is without prejudice to the relevance, if any, of PFC and MLA payments under the substantive provisions of Article 13(b) of the *Agreement on Agriculture*, Articles 5, 6 and 7 of the *SCM Agreement* and Article XVI of *GATT 1994*.

### 3. Payments with respect to non-upland cotton base acres<sup>181</sup>

7.129 The **United States** submits that payments made with respect to non-upland cotton "base acres" are not within the terms of reference of the Panel because neither the request for consultations nor the request for establishment of a panel referred to payments under programmes unrelated to upland cotton. It submits that Brazil has attempted to raise these payments at the very end of this proceeding which deprives the United States of fundamental rights of due process. The United States argues that the reference in Brazil's request for establishment of a panel to "payments ... providing direct or indirect support to the United States upland cotton industry" does not provide information that would allow identification of the specific measures at issue in accordance with Article 6.2 of the *DSU*. It argues that Brazil's own submissions to the Panel demonstrated that it did not consider payments with respect to non-upland cotton base acres within the terms of reference because it only referred to payments for upland cotton base acres or to measures with an upland cotton specific link in terms of historic, updated or present upland cotton acreage or present upland cotton production or prices.<sup>182</sup>

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<sup>178</sup> See section 201 of the ARP Act, the table of contents of which is reproduced in Exhibit BRA-137.

<sup>179</sup> See questions 11.1 to 11.3 in Exhibit BRA-101. The United States confirms that these questions were posed during consultations: see its response to Panel Question No. 8.

<sup>180</sup> The Panel communicated to the parties and third parties in a letter dated 25 July 2003 that it intended to make this ruling in this report, in order to assist them in deciding what argumentation and evidence to submit in their answers to questions and rebuttals.

<sup>181</sup> The term "base acres" is a feature of certain direct payments support programmes at issue, which is explained in the description of measures in Section VII:C below.

<sup>182</sup> See the United States' oral statement at the second substantive meeting, para. 31; its response to Panel Question No. 256; its 28 January 2004 comments on Brazil's response to Panel Question No. 204; its 11 February 2004 comments, paras. 48-50 and its 15 March 2004 comments, para. 4.

7.130 **Brazil** responds that the issue of the amount of these payments is part of the broader legal question of the amount of support to upland cotton under Article 13(b)(ii) of the *Agreement on Agriculture*. It also argues that its request for establishment of a panel fully complied with Article 6.2 of the *DSU* because it identified by name the specific laws providing the contract payments, the specific types of payments, the class of recipients and the specific time period when those payments were made. Brazil argues that there is no requirement to identify sub-categories of payments on non-upland cotton base acreage and on upland cotton base acreage. It submits that the United States' argument is untimely.<sup>183</sup>

7.131 The Panel notes that this issue relates to PFC, MLA, DP and CCP payments, which are described in Section VII:C of this report, and to the methodology for allocating those payments as support to specific commodities, which is discussed in Section VII:D of this report. The relevant paragraphs in Brazil's request for establishment of a panel read as follows:

"The measures that are the subject of this request are prohibited and actionable subsidies provided to US producers, users and/or exporters of upland cotton [original footnote omitted], as well as legislation, regulations and statutory instruments and amendments thereto providing such subsidies (including export credit guarantees), grants, and any other assistance to the US producers, users and exporters of upland cotton ("US upland cotton industry"). The measures include the following:

(...)

"Subsidies and domestic support provided under the Farm Security and Rural Investment Act of 2002 (FSRIA), including the regulations, administrative procedures and other measures implementing FSRIA related to marketing loans, loan deficiency payments (LDPs), commodity certificates, direct payments, counter-cyclical payments, conservation payments (to the extent they exceed the costs of complying with such programs), Step 2 certificate programme payments, export credit guarantees, crop insurance, and any other provisions of FSRIA that provide direct or indirect support to the US upland cotton industry;"

(...)

"Subsidies and domestic support provided under the Federal Agricultural Improvement and Reform Act (FAIR Act) of 1996, and programs under the FAIR Act or amendments thereto relating to marketing loans, loan deficiency payments, commodity certificates, production flexibility contract payments, conservation payments, Step 2 certificate programme payments, export credit guarantees, crop insurance, and any other FAIR Act provisions providing direct or indirect support to the US upland cotton industry;"

(..)

"Subsidies provided under the Agricultural Assistance Act of 2003; Subsidies provided under the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriation Act of 2002 (November 2001), the Crop Year 2001 Agricultural Economic Assistance Act (August 2001), the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2001 (October 2000), the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 2000 (October 1999),

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<sup>183</sup> Brazil's 28 January 2004 comments, paras. 18 and 19; 18 February 2004 comments, paras. 80-82.

and the Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act of 1999 (October 1998);"

7.132 These paragraphs contain no reference to payments on upland cotton base acres and there is nothing that would imply such a limitation. They specifically identify the four types of payments at issue, three of them by name.<sup>184</sup> The chapeau refers to "subsidies provided to US producers, users and/or exporters of upland cotton" and, together with the paragraphs quoted above, clearly covers payments under these programmes to recipients with current United States upland cotton production, whether or not they hold upland cotton base acreage. Therefore, the Panel rules that PFC, MLA, DP and CCP payments to upland cotton producers with respect to non-upland cotton base acres are within the terms of reference of the Panel.

7.133 The United States also refers to Brazil's submissions to the Panel. These do not alter the Panel's terms of reference and, in any event, the passages to which the United States refers do not support the inference which it asks the Panel to draw concerning Brazil's own understanding of the scope of the terms of reference. Brazil's first written submission referred to USDA data showing the amount of payments, which showed how Brazil calculated the *amount* of payments, not which payments it considered were within the Panel's terms of reference. In fact, at that stage, neither Brazil nor the Panel knew that the USDA data tabulated all payments with respect to upland cotton base acres. Brazil's response to Panel question No. 41 expressly indicated that the measures at issue could include those with a link to present upland cotton acreage or production, and not merely upland cotton base acreage. Brazil's response to Panel question No. 44 included payments with a link to one of those parameters: present upland cotton prices. Brazil's request for relief referred to sections of the FSRI Act of 2002 relating to DP and CCP payments "to the extent that they relate to upland cotton". Sections of that Act authorizing DP and CCP payments to recipients with present upland cotton acreage or production, and not merely upland cotton base acreage, relate to upland cotton and are therefore within the terms of Brazil's request for relief.

7.134 The United States submits that these payments were raised at the very end of this proceeding which deprives it of fundamental rights of due process.<sup>185</sup> However, the extent to which PFC, MLA, DP and CCP payments are relevant support to upland cotton has been a central issue in this dispute since the parties' first written submissions in June and July 2003. Brazil's first written submission expressly presented the following argument:

"Thus, the phrase "such measures ... grant support" requires identifying all such forms of support, and if need be, allocating the portion of support (by measures that are provided to more than one commodity) to the individual commodity under consideration."<sup>186</sup>

7.135 Brazil referred to the "portion of upland cotton (...) payments that actually benefits acres planted to upland cotton" on 11 August 2003 in its response to Panel question No. 67 after the first session of the first substantive meeting. The United States submitted that Brazil had failed to bring forward evidence that the recipients of these payments were upland cotton producers at the resumed session of the first substantive meeting on 7 October 2003. Both parties addressed payments on non-upland cotton base acreage in their responses to Panel question No. 125(8) on 27 October 2003. Brazil requested information on all programme crop base during the second substantive meeting on

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<sup>184</sup> The Panel considers that this paragraph identifies MLA payments for the reasons given in paras. 7.124-7.128 above.

<sup>185</sup> See the United States' oral statement at the second substantive meeting, para. 31; its response to Panel Question No. 256; its 28 January 2004 comments on Brazil's response to Panel Question No. 204 and its 11 February 2004 comments, paras. 48-50.

<sup>186</sup> Brazil's first written submission, para. 135.

2 December 2003.<sup>187</sup> Since that meeting, the United States has addressed the issue of allocation of these payments on four occasions in its response to Panel question No. 256 on 22 December 2003, its comment on Brazil's response to Panel question No. 204 on 28 January 2004, its comment on Brazil's comments on United States data on 11 February 2004 and its comment on Brazil's comments on United States data on 15 March 2004.

7.136 These facts show that this matter was not raised at the very end of the proceedings and that the United States has in fact responded to it. Therefore, the Panel considers that the United States' rights of due process have been respected.

#### 4. Cottonseed payments

##### (a) Public Laws 106-224 and 107-25

7.137 The **United States** submits that cottonseed payments for the 2000 crop of cottonseed are not within the Panel's terms of reference because they were not identified as measures at issue in the request for consultations or the request for establishment of a panel.<sup>188</sup>

7.138 **Brazil** argues that these measures were the subject of consultations and that they were identified in the request for establishment of a panel.<sup>189</sup>

7.139 The parties agree that cottonseed payments for the 2000 crop were made under Public Laws 106-224 and 107-25.<sup>190</sup> The Panel notes that Brazil's request for establishment defines "upland cotton" in the first footnote to include upland cotton cottonseed as follows:

"The term 'upland cotton' means raw upland cotton as well as the primary processed forms of such cotton including upland cotton lint and cottonseed."<sup>191</sup>

7.140 The short title as enacted of Public Law 106-224 is the Agricultural Risk Protection Act of 2000.<sup>192</sup> Both the request for consultations and the request for establishment of a panel refer to:

"Subsidies and domestic support provided under the Agricultural Risk Protection Act of 2000 and any other measures that provide subsidies relating to crop, disaster or other types of insurance to the US upland cotton industry;"

7.141 The short title as enacted of Public Law 107-25 is, according to the United States, the Emergency Agricultural Assistance Act, but the short title as introduced into the United States Congress was the Crop Year 2001 Agricultural Economic Assistance Act (August 2001).<sup>193</sup> Both the request for consultations and the request for establishment of a panel refer to:

"Subsidies provided under ... the Crop Year 2001 Agricultural Economic Assistance Act (August 2001) ...;"

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<sup>187</sup> See Exhibit BRA-369, dated 2 December 2003 and revised 3 December 2003, submitted with Brazil's oral statement at the second substantive meeting.

<sup>188</sup> United States' rebuttal submission, para. 108 and further written submission, para. 8.

<sup>189</sup> Brazil's oral statement at the resumed session of the first substantive meeting, para. 79.

<sup>190</sup> Brazil's response to Panel Question No. 17 and United States' rebuttal submission, para. 107.

<sup>191</sup> Upland cotton accounts for approximately 97 per cent of United States cotton production: see USDA Economic Research Service, Briefing Room – Cotton, and background paper dated July 2001 reproduced in Exhibits BRA-13 and BRA-46, respectively. It does not include extra long staple ("ELS") cotton.

<sup>192</sup> Public Law 106-224 is reproduced in Exhibit BRA-137. The short title as enacted appears on the cover page and in the first margin.

<sup>193</sup> Public Law 107-25 is reproduced in Exhibit BRA-138. No short title appears in it. The United States indicated the short title in its response to Panel Question No. 17.

7.142 The short title as introduced of Public Law 107-25 is listed on the United States Library of Congress legislative database as a title of that Act, whilst the title indicated by the United States to the Panel is not. In response to a question posed by the Panel, the United States at first agreed that Public Law 107-25 "arguably may be found in Brazil's consultation and panel requests" because it identified the Crop Year 2001 Agricultural Economic Assistance Act (August 2001) as a title of that Act.<sup>194</sup> That title cannot refer to any other Act. In these circumstances, the short title as introduced is sufficiently precise and has in fact identified the measure to the respondent for the purposes of both Articles 4.4 and 6.2 of the *DSU*.

7.143 Further, the cottonseed payments authorized by Public Law 107-25 were provided under the Agricultural Risk Protection Act of 2000, which is named in Brazil's request for establishment of a panel. Section 6 of Public Law 107-25 provided as follows:

"The Secretary shall use \$84,700,000 of funds of the Commodity Credit Corporation to provide supplemental assistance under section 204(e) of the Agricultural Risk Protection Act of 2000 (Public Law 106-224; 7 U.S.C. 1421 note) to producers and first-handlers of the 2000 crop of cottonseed that previously received assistance under such section."<sup>195</sup>

7.144 Therefore, the Panel rules that the cottonseed payments under both Public Law 106-224 and Public Law 107-25 are within its terms of reference.<sup>196</sup>

(b) Public Law 106-113

7.145 The **United States** submits that the cottonseed payments for the 1999 crop are not within the Panel's terms of reference because they were not identified as measure at issue in the request for consultations or the request for establishment of a panel. It is agreed that cottonseed payments for the 1999 crop were made under Public Law 106-113.<sup>197</sup> Brazil admits that it did not explicitly identify this law in its request for establishment of a panel.<sup>198</sup> There are dozens of short titles of this law, which was a consolidated appropriations Act. Neither the request for consultations nor the request for establishment of a panel refer to this Public Law by any of these titles or its number.

7.146 **Brazil** initially submitted in error that payments for the 1999 crop were made under Public Law 106-224.<sup>199</sup> Later, it left open the possibility that some payments for the 1999 crop were made under this law, in addition to those under Public Law 106-113.<sup>200</sup> However, section 204(e) of Public Law 106-224, which Brazil cites as the relevant provision, only referred to the 2000 crop.<sup>201</sup> The text of the implementing regulations which Brazil provided indicated that that law only applied to the

<sup>194</sup> United States' response to Panel Question No. 17.

<sup>195</sup> Public Law 107-25 is reproduced in Exhibit BRA-138.

<sup>196</sup> The Panel communicated to the parties in a letter dated 3 November 2003 that it intended to make this ruling in this report, in order to assist them in deciding what argumentation and evidence to submit in their further rebuttal submissions.

<sup>197</sup> Brazil's response to Panel Question No. 17 and United States' rebuttal submission, para. 107. Public Law 106-113 is reproduced in Exhibit BRA-136. Section 104 of Appendix E of that law granted the Secretary of Agriculture the discretion to make cottonseed payments for the 1999 crop from unused funds made available under section 802 of Title VIII of Public Law 106-78 (the short title of which was the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriations Act 2000) which is identified in both the request for consultations and the request for establishment of a panel, and section 1111 of Division A of Public Law 105-277, which was not identified in either. These two laws may have provided the source of funding but they did not provide the legal basis of the appropriation for the 1999 cottonseed payment program. They therefore did not identify the cottonseed payments for the 1999 crop as measures at issue.

<sup>198</sup> See Brazil's response to Panel Question No. 123.

<sup>199</sup> Brazil's first written submission, para. 106, footnote 274.

<sup>200</sup> See Brazil's response to Panel Question No. 123.

<sup>201</sup> Section 204 is reproduced in Exhibit BRA-137.

2000 crop.<sup>202</sup> There is no evidence before the Panel that any cottonseed payments for the 1999 crop were made under Public Law 106-224.

7.147 After the United States requested a preliminary ruling regarding Public Law 106-113, Brazil submitted that all forms of cottonseed payments from the marketing years 1999-2007 are covered by the following passages of its request for establishment of a panel.<sup>203</sup>

"Domestic support subsidies provided to the US upland cotton industry during marketing years 1999-2001;

Domestic support subsidies that are mandated to be provided to the US upland cotton industry during marketing years 2002-2007;

All subsidies or support measures benefiting upland cotton that have trade-distorting effects or effects on production by the US upland cotton industry,

Export subsidies, domestic support, and other subsidies provided under regulations, administrative procedures, administrative practices and any other present measures or future measures implementing or amending any of the measures listed above, that provide for or facilitate the payment of domestic support, export subsidies, and other subsidies for the production, use and/or export of US upland cotton and upland cotton products."

7.148 We recall that Article 6.2 of the *DSU* provides that a request for establishment of a panel:

"... shall indicate whether consultations were held, identify the specific measures at issue and provide a brief summary of the legal basis of the complaint sufficient to present the problem clearly. ..."

7.149 None of the passages cited by Brazil specifically mentions cottonseed payments or any instrument under which cottonseed payments were authorized or made. These descriptions of subsidies and measures are so vague that they do not give notice to the respondent that any specific cottonseed measures are at issue. The cottonseed payments that are within the Panel's terms of reference were made under legislation which Brazil chose to name in its request for establishment of a panel. That legislation does not include the legislation authorizing the payments for the 1999 crop.

7.150 The last passage cited refers to "future measures implementing or amending any of the measures listed above" which included the two Public Laws appropriating funds for cottonseed payments for the 2000 crop, discussed above. Public Law 106-113 does not fall within this description because it was prior legislation. Nor can payments under Public Law 106-113 be considered part of a single programme identified by the references to Public Laws 106-224 and 107-25, for the reasons given in paragraphs 7.163 to 7.167 below. Therefore, the quoted passages do not satisfy the requirements of Article 6.2 in relation to cottonseed payments.

7.151 In fact, Brazil posed questions to the United States during consultations concerning support for cottonseed production and exports, and specifically raised a "Cottonseed Payment Program", a "Recourse Seed Cotton Loan Program" and "any export enhancement programmes to encourage the export of cottonseed products".<sup>204</sup> Brazil indicated that the United States provided answers

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<sup>202</sup> The regulations are reproduced in Exhibit BRA-32

<sup>203</sup> Brazil's oral statement at the resumed session of the first substantive meeting, para. 79, quoting passages from its request for the establishment of a panel.

<sup>204</sup> See Exhibit BRA-101, questions 14.1-14.5. The United States confirmed that the document in which these questions were posed was sent to it during consultations – see its response to Panel Question No. 8.

concerning cottonseed payments in the marketing years 1999 and 2000.<sup>205</sup> The fact that Brazil then chose, in its request for establishment of a panel, only to name the Public Laws appropriating funds for cottonseed payments for the 2000 and 2002 crops, in the absence of a reference to "cottonseed payments", indicated, if anything, that it was *not* challenging the cottonseed payments for the 1999 crop.

7.152 For the above reasons, the Panel rules that the cottonseed payments under section 104 of Public Law 106-113 are not within its terms of reference.<sup>206</sup>

7.153 In the Panel's view, this is an issue which goes to its jurisdiction and which does not depend on whether a party requests a preliminary ruling in a timely manner. The Panel is not empowered to make a finding in relation to this measure. However, the Panel notes for the record that the United States respected the Panel's working procedures in raising its objection. These procedures provide relevantly as follows:

"12. A party shall submit any request for preliminary ruling not later than its first submission to the Panel. ... Exceptions to this procedure will be granted upon a showing of good cause."

7.154 The United States' request for this preliminary ruling was made later than its first submission to the Panel. Brazil mentioned cottonseed payments for the 1999 crop for the first time in these proceedings in its first written submission.<sup>207</sup> It mentioned Public Law 106-113 for the first time in its answers to the Panel's questions after the first session of the first substantive meeting, when it also provided a copy of the relevant section of the law.<sup>208</sup> The United States first raised this issue in its written answers to the Panel's questions at the same time, when it noted that the legislation authorizing cottonseed payments for the 1999 crop was not found in the request for consultations or the request for establishment of a panel.<sup>209</sup> The United States formally submitted that the payments did not form part of the Panel's terms of reference in its rebuttal submission. It explained that it became aware of this difficulty "in the course of preparing its answer to Question No. 17 from the Panel and reviewing Brazil's answers to Questions Nos. 17 and 19".<sup>210</sup> It reiterated its request in its further submission.<sup>211</sup> For these reasons, the Panel finds that the United States has shown good cause for not submitting its request for preliminary ruling earlier.

(c) Agricultural Assistance Act of 2003

7.155 The **United States** requests the Panel to rule that any measure under the Agricultural Assistance Act of 2003, including those portions of the Act that provide "a one-time cottonseed payment", is not within its terms of reference because the measure was not consulted upon and was not enacted until after Brazil presented its request for establishment of a panel.<sup>212</sup> The United States requested this preliminary ruling in its first written submission in accordance with paragraph 12 of the

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<sup>205</sup> See Brazil's first written submission, para. 106, footnote 272.

<sup>206</sup> The Panel communicated to the parties in a letter dated 3 November 2003 that it intended to make this ruling in this report, in order to assist them in deciding what argumentation and evidence to submit in their further rebuttal submissions. At that time, the Panel indicated that this was without prejudice to the relevance, if any, of the cottonseed payments for the 1999 crop to the conditions set out in Article 13(b) of the *Agreement on Agriculture*.

<sup>207</sup> Brazil's first written submission, para. 106. It had posed questions during consultations regarding cottonseed production and exports during the marketing years 1992-2002.

<sup>208</sup> See Brazil's response to Panel Question No. 17 and Exhibit BRA-136.

<sup>209</sup> See United States' response to Panel Question No. 17.

<sup>210</sup> See United States' rebuttal submission, para. 108.

<sup>211</sup> See United States' further written submission, para. 8.

<sup>212</sup> United States' first written submission, paras. 212-217, its rebuttal submission, para. 106 and its further written submission, para. 8.

Panel's working procedures. It did not address measures under this Act in terms of substance in its first written submission.

7.156 **Brazil** submits that the request should be rejected because the Agricultural Assistance Act of 2003 was enacted prior to the establishment of the Panel.<sup>213</sup>

7.157 The Panel notes that this piece of legislation has been raised in these proceedings only in relation to cottonseed payments of \$50 million to assist producers and first handlers for the 2002 crop. The Agricultural Assistance Act of 2003 is the short title as enacted of Title II of Public Law 108-7.<sup>214</sup> The parties agree that it was not enacted until 20 February 2003.<sup>215</sup> Brazil submitted its request for establishment of a panel (document WT/DS267/7) on 6 February 2003, which was considered by the DSB for the first time on 19 February 2003<sup>216</sup> and on the basis of which the DSB established the Panel on 18 March 2003. On the date of establishment, the DSB decided that the Panel's terms of reference were the following:

"To examine, in the light of the relevant provisions of the covered agreements cited by Brazil in document WT/DS267/7, the matter referred to the DSB by Brazil in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements".<sup>217</sup>

7.158 The "matter" referred to the DSB by Brazil in document WT/DS267/7 consisted of the measures and claims set out in that document<sup>218</sup> which was dated 6 February 2003. On that date, the Agricultural Assistance Act of 2003 did not exist, had never existed and might not subsequently have ever come into existence. Brazil anticipated adoption of that Act in its panel request and its claim in respect of that Act was entirely speculative. Therefore, Brazil could not refer it to the DSB at that time and it does not form part of the Panel's terms of reference.<sup>219</sup>

7.159 We believe that this is consistent with the principle set out in Article 3.3 of the *DSU* which provides that:

"The prompt settlement of situations in which a Member considers that any benefits accruing to it directly or indirectly under the covered agreements are being impaired by measures taken by another Member is essential to the effective functioning of the WTO and the maintenance of a proper balance between the rights and obligations of Members."

7.160 In this case, the Agricultural Assistance Act of 2003 could not possibly have been impairing any benefits at the date of Brazil's referral of its complaint to the DSB because it did not yet exist.<sup>220</sup>

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<sup>213</sup> Brazil's oral statement at the first session of the first substantive meeting, para. 145.

<sup>214</sup> The Act is reproduced in Exhibit BRA-135.

<sup>215</sup> United States' first written submission, para. 212; Brazil's oral statement at the first session of the first substantive meeting, para. 148.

<sup>216</sup> See the minutes of the DSB meeting in document WT/DSB/M/143, paras. 22-25.

<sup>217</sup> Document WT/DS267/15; See the minutes of the DSB meeting in document WT/DSB/M/145, para. 22.

<sup>218</sup> See Appellate Body Report, *Guatemala – Cement I*, para. 72, and the Panel Report, *Australia – Automotive Leather II (Article 21.5 – US)*, para. 6.4.

<sup>219</sup> In our communication dated 25 July 2003, the Panel asked the parties not to exclude consideration of the Agricultural Assistance Act of 2003 in responding to the Panel's written questions and in rebuttal submissions.

<sup>220</sup> We note that the Panel in *Australia – Automotive Leather II (Article 21.5 – US)*, at paras. 6.4-6.5, declined to conclude that a measure specifically identified in the request for establishment was not within its

7.161 Brazil argues that the Agricultural Assistance Act of 2003 essentially continues a supposed "Cottonseed Payment Program that existed since at least MY 1999" by authorizing funding of \$50 million for the 2002 crop. It argues that all aspects of the existing programme remained intact and that there was an "existing unfunded" programme at the time the Agricultural Assistance Act of 2003 was enacted.<sup>221</sup>

7.162 The Panel notes that the cottonseed payments for each year were *ad hoc* appropriations, each with a separate legal basis, which did not follow a single model.<sup>222</sup> The scope of each appropriation was distinct and limited to a single year's crop of cottonseed. The frequency of the appropriations was irregular, with one for each of the 1999 and 2002 crops, two for the 2000 crop and none for the 2001 crop. The value of the funds available to each programme varied widely: \$79 million for the 1999 crop,<sup>223</sup> \$100 million for the 2000 crop, a further \$84.7 million for the 2000 crop and \$50 million for the 2002 crop.

7.163 The Panel's terms of reference include Public Laws 106-224 and 107-25, which each appropriated a specific amount of money for the 2000 crop of cottonseed only. Under the regulation implementing the cottonseed payments appropriated by both those laws, payments were available to first handlers of cottonseed who had applied to participate in the "Cottonseed Payment Program" in accordance with section 204(e) of Public Law 106-224. Payments were made in accordance with regulations dated 2 November 2000. The payment rate (dollars per ton) was calculated by dividing the total available funds by the total payment quantity of 2000 crop cottonseed.<sup>224</sup> No cottonseed payments were made for the 2001 crop.

7.164 The Agricultural Assistance Act of 2003 contains a single provision regarding cottonseed, which reads, in its entirety, as follows:

"Sec. 206. COTTONSEED

The Secretary shall use \$50,000,000 of funds of the Commodity Credit Corporation to provide assistance to producers and first-handlers of the 2002 crop of cottonseed."

7.165 Section 206 did not amend or modify any existing or previous programme. Unlike Public Law 107-25, it did not provide for assistance under an earlier law, it did not define the recipients as those who had previously received assistance and it was not implemented by an existing regulation.<sup>225</sup>

7.166 Section 206 was implemented by means of new regulations dated 25 April 2003,<sup>226</sup> the text of which was modelled on the regulations for the 1999 and 2000 crops.<sup>227</sup> Each set of regulations required the submission of fresh applications by first handlers, so that eligibility in one year did not

terms of reference "in the absence of any compelling reason". We believe that the speculative inclusion of a something which had not yet been adopted is such a compelling reason.

<sup>221</sup> Brazil's oral statement at the first session of the first substantive meeting, paras. 146 and 148 and its response to Panel Question No. 17.

<sup>222</sup> The Agricultural Assistance Act of 2003 was a title within Public Law 108-7 which made consolidated appropriations for fiscal year 2002, most of them unrelated to agriculture. Cottonseed payments for the 2000 crop were made under Public Laws devoted solely to agriculture and the cottonseed payments for the 1999 crop were made under a consolidated appropriations Act, discussed above.

<sup>223</sup> United States' and Brazil's respective responses to Panel Question No. 17.

<sup>224</sup> See 7 CFR 1427.1100(a) and 1427.1109, reproduced in Exhibit BRA-32.

<sup>225</sup> See section 6 of Public Law 107-25, reproduced in Exhibit BRA-138.

<sup>226</sup> See the 2002 regulation from 68 FR 20331 *et seq.*, reproduced in Exhibits BRA-139 and US-14.

<sup>227</sup> See the 2000 regulation from 65 FR 65722 *et seq.*, reproduced in Exhibits BRA-32 and US-15. See the 1999 regulation from 65 FR 36563 *et seq.*, reproduced in Exhibit US-16. The background notes in the supplementary information published with the 2002 regulation expressly state that "This rule follows the model set by those preceding programs", i.e. for the 1999 and 2000 crops of cottonseed.

carry over to the next. The formula for calculating the payment rate was basically the same in each regulation, being the quotient of the funds available (which varied in each year) divided by the eligible quantity of cottonseed (which varied in each year). The administration had a discretion to adjust the payment rate in 1999 and 2002, but not in 2000. In contrast, Public Law 107-25, which appropriated a second payment for the 2000 crop, was expressed as supplemental assistance under Public Law 106-224.

7.167 This evidence discloses the existence of separate and legally distinct cottonseed payment programmes for crops in different years rather than a single cottonseed payment programme. There was not in fact any programme in effect at the time of Brazil's request for establishment of a panel. At that time, for the 2002 crop of cottonseed, there was no applicable statute, no applicable regulation, no eligible quantity of cottonseed nor any available funds. As a result, the payments under section 206 of the Agricultural Assistance Act of 2003 were entirely separate measures which Brazil could not refer to the DSB on 6 February 2003, a date prior to its adoption.

7.168 The Panel also notes that the Agricultural Assistance Act of 2003 was not specifically the subject of consultations, nor could it have been, since it did not yet exist at the time consultations were held. It was not named in Brazil's request for consultations. Brazil argues<sup>228</sup> that the authorization of funds for the "Cottonseed Payment Program", including under the Agricultural Assistance Act of 2003, was covered in its request for consultations by the following paragraph:

"Export subsidies, domestic support, and other subsidies provided under regulations, administrative procedures, administrative practices and any other present measures, amendments thereto, or future measures implementing any of the measures listed above, that provide for or facilitate the payment of domestic support, export subsidies, and other subsidies for the production, use and/or export of US upland cotton and upland cotton products."

7.169 It highlights the following words in that paragraph:

"... other subsidies provided under regulations ... amendments thereto, of future measures implementing any of the measures listed above ..."

7.170 However, for the reasons already given, the Panel does not consider that the Agricultural Assistance Act of 2003 is an amendment, or a measure implementing any of the measures within the Panel's terms of reference. It appropriated funds to a separate programme - "the 2002-Crop Cottonseed Payment Program"<sup>229</sup> - in respect of which the complainant did not request consultations and with regard to which the parties did not actually consult.

7.171 Therefore, for all of the above reasons, the Panel rules that the cottonseed payments under the Agricultural Assistance Act of 2003 are not within its terms of reference.<sup>230</sup> No ruling is required in relation to other provisions of that Act since none have been raised in the parties' substantive submissions to the Panel.

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<sup>228</sup> Brazil's oral statement at the first session of the first substantive meeting, para. 146.

<sup>229</sup> See title of Subpart F of 7 CFR 1427 published at 68 FR 20331 *et seq.* (25 April 2003), reproduced in Exhibit BRA-139.

<sup>230</sup> The Panel communicated to the parties in a letter dated 8 December 2003 that it intended to make this ruling in this report, in order to assist them in deciding what argumentation and evidence to submit in their answers to questions. At that time, the Panel indicated that this was without prejudice to the relevance, if any, of the cottonseed payments for the 2002 crop to the conditions set out in Article 13(b) of the *Agreement on Agriculture*.

## 5. Storage payments and interest subsidies

7.172 The United States, in response to a question posed by the Panel at the first session of the first substantive meeting, prepared AMS calculations which included a line that read "Other payments", followed by a number and the source "USDA estimate of storage payments and interest subsidy".<sup>231</sup> Brazil then referred to these other payments in its comments on the United States' responses<sup>232</sup> and included them in its further submission.<sup>233</sup>

7.173 The **United States** requests the Panel to rule that "other payments", as referred to in Brazil's further submission, are not within its terms of reference because they did not appear in the request for consultations or the request for establishment of a panel.<sup>234</sup> The United States submits that these other payments are storage payments and interest subsidies estimated by the United States Department of Agriculture.

7.174 **Brazil** submits that these other payments are covered by the same passages of its request for establishment of a panel quoted in full at paragraph 7.147 of this report. Brazil submits that they encompass, but apparently are not limited to, storage payments and interest subsidies.<sup>235</sup>

7.175 The Panel notes that none of the passages in the request for establishment of a panel cited by Brazil specifically mention storage payments or interest subsidies or any measures under which such payments and subsidies were authorized or made. These descriptions of subsidies and measures are so vague that they do not give notice to the respondent that any specific storage payments or interest subsidies are at issue. They therefore do not satisfy the requirements of Article 6.2 of the *DSU*.

7.176 Brazil submits that these payments were covered by the reference in the questions posed during consultations to "any other support to or government funding for the US upland cotton industry."

7.177 The Panel notes that, even if this were correct, this would not bring them within the Panel's terms of reference if they were not covered by the request for establishment of a panel.

7.178 Brazil also submits that these other payments are part of the operation of the marketing loan programme.<sup>236</sup> The United States agrees that interest subsidies and storage payments are support provided in connection with the marketing loan programme.<sup>237</sup>

7.179 The Panel notes that the United States government's Commodity Credit Corporation pays storage charges and waives interest upon forfeit of warehouse-stored upland cotton under loan. It also waives storage and interest charges on redemption of upland cotton under loan where the repayment amount is low enough in order to implement its obligation to permit producers to repay a marketing loan at the repayment rate.<sup>238</sup> Were these charges not borne by the United States government, they could reduce the guaranteed revenue to the producer below the loan rate.<sup>239</sup> The waiver of storage and

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<sup>231</sup> United States' response to Panel Question No. 67, para. 129.

<sup>232</sup> Brazil's 22 August comments on United States' responses to Panel Questions Nos. 54, 57 and 60.

<sup>233</sup> Brazil's further written submission, para. 7.

<sup>234</sup> United States' further written submission, para. 7.

<sup>235</sup> Brazil's oral statement at the resumed session of the first substantive meeting, paras. 80-81.

<sup>236</sup> Brazil's oral statement at the resumed session of the first substantive meeting, para. 80.

<sup>237</sup> United States' 27 August 2003 comments, para. 13, and its response to Panel Question No. 192.

<sup>238</sup> FAIR Act of 1996, section 134(b) and FSRI Act of 2002, section 1204(b), reproduced in Exhibits BRA-28 and BRA-29, respectively.

<sup>239</sup> See United States' 27 August 2003 comments, para. 13; United States' response to Panel Question No. 192(b); USDA Fact Sheet: Upland Cotton, January 2003, page 2; and USDA Farm Services Agency "Background Information: Non-Recourse Marketing Assistance Loans and Loan Deficiency Payments", March 1998, reproduced in Exhibits BRA-4 and BRA-50, respectively.

interest charges is provided for in the marketing loan programme regulations.<sup>240</sup> Therefore, the waiver of these storage and interest charges formed part of the conditions of the marketing loan programme.

7.180 The request for establishment of a panel refers to:

"Subsidies and domestic support provided under the Federal Agricultural Improvement and Reform Act (FAIR Act) of 1996, and programs under the FAIR Act or amendments thereto relating to marketing loans ..." and

"Subsidies and domestic support provided under the Farm Security and Rural Investment Act of 2002 (FSRIA), including the regulations, administrative procedures and other measures implementing FSRIA related to marketing loans ...".

7.181 The storage payments and interest subsidies fall squarely within the descriptions set out in these paragraphs of the request for establishment of the Panel. The reference to the specific name of the programme and the name of the statutes under which it existed and exists at all relevant times, provide the level of specificity that was required to notify the United States that Brazil put these payments in issue. The reference to the implementing regulations and administrative procedures under the FSRI Act of 2002 confirmed this. The request therefore satisfied the requirements of Article 6.2 of the *DSU* in relation to these storage payments and interest subsidies and the Panel rules that storage and interest payments that implement the marketing loan programme are within its terms of reference.<sup>241</sup>

## 6. Payments made after the establishment of the Panel

7.182 The **United States** submits that measures taken after the Panel was established cannot be within the Panel's terms of reference and, to the extent that Brazil challenges payments, as opposed to legal instruments "as such", those made after the date of establishment of the Panel are outside the Panel's terms of reference.<sup>242</sup> The United States raised this issue in passing in its response to a question from the Panel concerning the calculation of AMS, and later explained its views in response to questioning by the Panel.<sup>243</sup>

7.183 **Brazil** submits that these payments are identified in its request for establishment of a panel and are within the Panel's terms of reference.<sup>244</sup> It recalls that the panel in *Indonesia – Autos* did not find that only non-expired subsidies paid up until the date of establishment of the panel should be considered for the purposes of assessing serious prejudice. It notes that the statutes and regulations set out in the terms of reference have not changed and mandated payments both before and after the date of establishment of the Panel.<sup>245</sup>

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<sup>240</sup> 7 CFR 1427.13 and 1427.19, (1 January 2000 edition), first published at 61 FR 37601 on 18 July 1996, and (1 January 2003 edition), first published at 67 FR 64459 on 18 October 2002, reproduced in Exhibits US-117 and US-118, respectively.

<sup>241</sup> In our communications dated 3 November and 8 December 2003, the Panel asked the parties not to exclude consideration of these other payments in their further rebuttal submissions, to respond to its written questions relevant to these payments and not to exclude consideration of these payments in their answers to other questions.

<sup>242</sup> United States' responses to Panel Questions No. 67, paras. 129, and 194.

<sup>243</sup> United States' response to Panel Question No. 194.

<sup>244</sup> Brazil's response to Panel Question No. 194. Brazil has also argued that the cottonseed payments made in June 2003 is "before the Panel" because an objective assessment of support to upland cotton in the marketing year 2002 requires the tabulation of all support to upland cotton. See Brazil's oral statement at the first session of the first substantive meeting, para. 151 and its response to Panel Question No. 17.

<sup>245</sup> Brazil's 28 January 2004 comments on the United States' response to Panel Question No. 194.

7.184 The Panel was established on 18 March 2003, a date during the term of the FSRI Act of 2002, which provides authority for the marketing loan, user marketing (step 2), counter-cyclical payments and direct payments programmes during the 2002 through 2007 crop years.<sup>246</sup> Payments were authorized and continued to be authorized under these programmes, as well as the crop insurance and export credit guarantee programmes at issue, before and after the date of establishment of the Panel.

7.185 The date on which the Panel was established fell during the 2002 marketing year for upland cotton in the United States, which began on 1 August 2002 and ended on 31 July 2003.<sup>247</sup> Therefore, payments made during the complete 2002 marketing year include those made during the period of 4½ months immediately following the date of establishment of the Panel.<sup>248</sup>

7.186 Brazil's request for establishment of a panel specifically identifies these current domestic support and export credit guarantees in the following paragraphs:

"Subsidies and domestic support provided under the Farm Security and Rural Investment Act of 2002 (FSRIA), including the regulations, administrative procedures and other measures implementing FSRIA related to marketing loans, loan deficiency payments (LDPs), commodity certificates, direct payments, counter-cyclical payments, conservation payments (to the extent they exceed the costs of complying with such programs), Step 2 certificate programme payments, export credit guarantees, crop insurance, and any other provisions of FSRIA that provide direct or indirect support to the US upland cotton industry;

Subsidies and domestic support provided under the Agricultural Risk Protection Act of 2000 and any other measures that provide subsidies relating to crop, disaster or other types of insurance to the US upland cotton industry;

Export subsidies, exporter assistance, export credit guarantees, export and market access enhancement to facilitate the export of US upland cotton, and other eligible agricultural commodities as addressed herein, provided under the Agricultural Trade Act of 1978, as amended, and other measures such as the GSM-102, GSM-103, and SCGP programs, and the Step 1 and Step 2 certificate programs, among others;"

7.187 The programmes and legislation identified in these paragraphs include payments made before the date of establishment of the Panel, and those made subsequently. All such payments were and are made under the same legislative and regulatory provisions which entered into effect prior to the consultations and have remained in place throughout this Panel proceeding. Therefore, the Panel rules that payments under programmes and legislation within the Panel's terms of reference, made after the date on which the Panel was established, as addressed in document WT/DS267/7, are within its terms of reference.

7.188 Certain other considerations support this finding. Brazil's request for establishment of a panel specifically identifies the fact that some of the measures at issue were provided in the past, some in the current marketing year, and others will be provided in the future, in the paragraphs which immediately preceded those quoted above, as follows:

"Domestic support subsidies provided to the US upland cotton industry during marketing years 1999-2001 [original footnote omitted];

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<sup>246</sup> Sections 1108, 1201(a)(1) and 1207(a)(1) of the FSRI Act of 2002, reproduced in Exhibit BRA-29. The crop year is the same as the marketing year.

<sup>247</sup> See the definition in 7 CFR 1412.103 (1 January 2003 edition), reproduced in Exhibit BRA-35.

<sup>248</sup> This does not include the cottonseed payments for the 2002 crop, which were not made until 5 June 2003: see Exhibit BRA-129, cited in the United States' rebuttal submission, para. 106, footnote 132. The Panel has ruled that these payments are not within its terms of reference in paragraph 7.171.

Domestic support subsidies that are mandated to be provided to the US upland cotton industry during marketing years 2002-2007;

Export subsidies provided to the US upland cotton industry during marketing years 1999-2001;

Export subsidies that are mandated to be provided to the US upland cotton industry during marketing years 2002-2007;

Subsidies provided contingent upon the use of US over imported upland cotton in marketing years 1999-2001 and that are mandated to be provided to the US upland cotton industry during marketing years 2002-2007;"

7.189 The second, fourth and fifth of these paragraphs expressly put the respondent on notice that Brazil put subsequent payments in issue. Although these paragraphs are not sufficiently specific to identify subsequent payments under any programme or provision of legislation not itself specifically identified in accordance with Article 6.2 of the *DSU*, neither party has put any such payments in issue.

7.190 In each of the same paragraphs Brazil asserts that the alleged subsidies at issue provided during marketing years 2002-2007 were mandated to be provided as at the date of establishment of the Panel. Therefore, on its face, the request does not assert speculative claims.<sup>249</sup> The question whether the subsidies are indeed mandated to be provided is one of substance which the Panel will consider together with the claims.<sup>250</sup>

7.191 Furthermore, the claims in the present dispute raise the issue of serious prejudice to the interests of another Member, which includes a threat of serious prejudice.<sup>251</sup> Part III of the *SCM Agreement* and Article XVI of *GATT 1994* expressly provides Members with a right to take action against serious prejudice which may not yet have occurred. There is nothing in the text which indicates that this right is limited to a window of subsidies provided in the past but which cause serious prejudice in the future. The object and purpose of Part III of the *SCM Agreement*, which can be summed up in the basic obligation that "no Member should cause, through the use of any subsidy ... adverse effects to the interests of other Members",<sup>252</sup> confirm this view. If a Member were unable to bring an action against subsidies until they were actually paid, this would undermine the object of preventing adverse effects to its interests. This approach is consistent with the approach of certain previous WTO and GATT panels.<sup>253</sup>

7.192 The evidence properly before the Panel is a separate issue from the measures within its terms of reference. It is agreed that the Panel may look at evidence subsequent to the date of its establishment.<sup>254</sup> Payments made after that date under legislative instruments that are within the Panel's terms of reference form an essential part of the facts of this case for two reasons.

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<sup>249</sup> The United States argues that payments after the date of establishment of the panel under the marketing loan, user marketing (step 2), counter-cyclical and direct payments programmes are not mandatory at least in the sense that recipients must comply with programme conditions and payment is subject to the availability of funds. The Secretary of Agriculture also has authority to adjust payments to comply with AMS commitments. See United States' responses to Panel Questions Nos. 253 and 254.

<sup>250</sup> The issue is discussed in later Sections of this report. This view is consistent with the view of the Appellate Body expressed in a different context, in Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review*, para. 89.

<sup>251</sup> Article 5(c), footnote 13 of the *SCM Agreement* and the request for establishment of a panel, page 4.

<sup>252</sup> Article 5 of the *SCM Agreement*.

<sup>253</sup> See the following Panel Reports: *Indonesia – Autos*, para. 14.206, *Australia – Automotive Leather II*, paras. 9.37-9.42 and *US – Superfund*, paras. 5.2.1.-5.2.2.

<sup>254</sup> See United States' response to Panel Question No. 247.

7.193 First, the 2002 marketing year is the only complete marketing year that has elapsed to date in which counter-cyclical payments and direct payments have been authorized, and the only complete marketing year that has elapsed to date in which the marketing loan and user marketing (Step 2) programmes "as such" have been authorized under the FSRI Act of 2002. Evidence of payments throughout the 2002 marketing year is therefore essential to assess those programmes under Article 13(b)(ii) of the *Agreement on Agriculture*, which the parties agree calls for a marketing year-on-marketing year comparison with support decided during the 1992 marketing year. Second, Brazil makes claims under Article 5 of the *SCM Agreement* and Article XVI of the *GATT 1994* regarding subsidies which *threaten* serious prejudice, which necessarily involves a projection regarding events that lay in the future at the time of establishment of the Panel. Data relating to the most recent past is usually the best gauge of future events<sup>255</sup>, and events which took place after the establishment of the Panel provide a more solid basis for projections about the future. Our duty to make an objective assessment of the matter before us under Article 11 of the *DSU* actually *requires* us to examine recent data, including that which relates to the period after the date of establishment of the Panel.<sup>256</sup>

## 7. Summary of preliminary rulings

7.194 The Panel rules that the following measures, as addressed in document WT/DS267/7, are within its terms of reference:

- (i) export credit guarantees to facilitate the export of United States upland cotton, and other eligible agricultural commodities;
- (ii) production flexibility contract payments and market loss assistance payments;
- (iii) production flexibility contract payments, market loss assistance payments, direct payments and counter-cyclical payments to upland cotton producers with respect to non-upland cotton base acres;
- (iv) cottonseed payments under both Public Law 106-224 and Public Law 107-25 (for the 2000 crop);
- (v) storage payments and interest subsidies that implement the marketing loan programme; and
- (vi) payments under programmes and provisions within the Panel's terms of reference made after the date on which the Panel was established.

7.195 The Panel rules that the following measures, as addressed in document WT/DS267/7, are *not* within its terms of reference:

- (i) cottonseed payments under Public Law 106-113 (for the 1999 crop); and
- (ii) cottonseed payments under the Agricultural Assistance Act of 2003 and implementing regulations (for the 2002 crop).

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<sup>255</sup> See, for example, Appellate Body Report, *US – Lamb*, para. 137, in relation to a threat of serious injury analysis under the *Agreement on Safeguards*.

<sup>256</sup> We note that Brazil has argued that payments made under the Agricultural Assistance Act of 2003 are "before the Panel" because an objective assessment of support to upland cotton in marketing year 2002 requires the tabulation of all support to upland cotton. See Brazil's oral statement at the first session of the first substantive meeting, para. 151 and its response to Panel Question No. 17.

7.196 The Panel also rules that, in its request for consultations in document WT/DS267/1, Brazil provided a statement of available evidence with respect to export credit guarantees under the GSM 102, GSM 103 and SCGP programmes relating to upland cotton and eligible agricultural commodities other than upland cotton, as required by Article 4.2 of the *SCM Agreement*.

## C. PRELIMINARY ISSUES

### 1. Products at issue

7.197 This dispute principally concerns alleged United States subsidies in respect of "upland cotton"<sup>257</sup> (*Gossypium hirsutum*). This is defined in relevant United States legislation as:

"Planted and stub cotton that is produced from other than pure strain varieties of the Barbados species, any hybrid thereof, or any other variety of cotton in which one or more of these varieties predominate."<sup>258</sup>

7.198 In relation to Brazil's claims that United States export credit guarantee measures constitute export subsidies under the *Agreement on Agriculture* and the *SCM Agreement*, the dispute concerns upland cotton and other eligible agricultural products as well.<sup>259</sup>

7.199 Upland cotton, and the other agricultural products eligible under the export credit guarantee programmes at issue, are products covered by the *Agreement on Agriculture*.<sup>260</sup>

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<sup>257</sup> Brazil's request for the establishment of a panel (document WT/DS267/7) and the parties respective responses to Panel Question No. 1.

<sup>258</sup> Definition for marketing loan programme in 7 CFR 1427.3 (1 January 2003 edition), reproduced in Exhibit BRA-36 and also in 7 CFR 1413.3 (1 January 1993 edition), reproduced in Exhibit US-3. Upland cotton harvested from a field has cotton lint and cottonseed. Ginning involves separating cotton lint from cottonseed. See, for example, Exhibit BRA-12, USDA, ERS, "Cotton: Background for 1995 Farm Legislation", p. 1; and Exhibit BRA-32, 7 CFR 1427.1102 (1 January 2002 edition), pertaining to the cottonseed payment programme, discussed *infra*, paras. 7.233 *ff.* Certain of the United States measures at issue expressly require, as a condition of eligibility, that upland cotton be "baled" and/or "ginned" (see e.g. Exhibit BRA-36, 7 CFR 1427.5(b)(11) in respect of marketing loan programme and loan deficiency payments; and Exhibit BRA-37, 7 CFR 1427.103(b) in respect of user marketing (Step 2) payments, referring to "baled" upland cotton "lint"; "loose"; semi-processed and reginned (processed) motes). The definition of upland cotton for the PFC programme also included brown lint cotton in 7 CFR 1412.103 (1 January 2002 edition), reproduced in Exhibit BRA-31. Unless otherwise indicated, references in this report to "upland cotton" ordinarily refer to upland cotton lint.

Upland cotton accounts for approximately 97 per cent of United States cotton production: see USDA Economic Research Service, Briefing Room – Cotton, and background paper dated July 2001, reproduced in Exhibits BRA-13 and BRA-46, respectively. It does not include extra long staple ("ELS") cotton. The parties confirmed in response to Panel Question No. 1 that the information submitted -- at least up to that point -- related to upland cotton.

<sup>259</sup> See the preliminary rulings in Section VII:B *supra*. The three export subsidy programmes at issue are briefly described in this Section, *infra*, paras. 7.236 *ff.* Our export subsidy findings are contained *infra* in Section VII:E. In response to Panel Question No. 1, the United States indicated that the CCC does not maintain data to distinguish transactions involving different types of cotton, but indicated that "[...] the United States has no reason to believe that types of cotton other than upland cotton constitute a material percentage of such transactions".

<sup>260</sup> Article 2 and Annex 1 of the *Agreement on Agriculture*. In particular, the Panel notes that the Agreement covers products under Harmonized System Headings 52.01 to 52.03 (raw cotton, waste and cotton carded and combed). The other agricultural commodities eligible under the export credit guarantee programmes are considered in Section VII:E of this report.

## 2. Measures at issue

### (a) General overview

7.200 The *Agricultural Act of 1949*<sup>261</sup> and the *Agricultural Adjustment Act of 1938*<sup>262</sup> make up the major part of what is known as the "permanent law" that provides for United States commodity price and farm income support. The United States Congress regularly enacts omnibus farm bills that expire after four, five or six years which amend and suspend many provisions of the *Agricultural Act of 1949* in order to effect temporary changes in the levels and design of commodity programmes. If temporary legislation were to expire before new legislation was enacted, the law would revert back to the provisions of the permanent law.<sup>263</sup>

7.201 The last three farms bills have been the Food, Agriculture, Conservation and Trade Act of 1990 (the "FACT Act of 1990"), the Federal Agricultural Improvement and Reform Act of 1996 (the "FAIR Act of 1996") and the Farm Security and Rural Investment Act of 2002 (the "FSRI Act of 2002").<sup>264</sup> The FAIR Act of 1996 repealed some provisions of the *Agricultural Act of 1949*, suspended the application of other provisions through 2002 and authorized payments under programmes for the 1996 through 2002 crops of specified agricultural commodities, including upland cotton. The FSRI Act of 2002, which entered into law on 13 May 2002, suspends the vast majority of the provisions of the permanent law and authorizes payments under programmes for the 2002 through 2007 crop years for specified agricultural commodities, including upland cotton. Additionally, Congress provides ad hoc emergency and supplementary assistance under separate legislation.<sup>265</sup>

7.202 The United States federal commodity programmes are administered by the Secretary of the United States Department of Agriculture (referred to in this report as the "Secretary" or the "USDA"). The *Commodity Credit Corporation Charter Act of 1948*, which also forms part of the permanent law, provides the Secretary with broad authority to implement commodity programmes to support prices through loans, purchases, payments and other operations.<sup>266</sup> The Commodity Credit Corporation ("CCC"), which has no staff, is essentially a financing institution for USDA's farm price and income support commodity programmes and support to agricultural exports.<sup>267</sup> It is authorized to buy, sell, lend, make payments and engage in other activities for the purpose of increasing production, stabilizing prices, assuring adequate supplies, and facilitating the efficient marketing of agricultural commodities. The majority of the programmes funded through CCC are administered by employees of the Farm Service Agency ("FSA").<sup>268</sup>

7.203 The *Federal Crop Insurance Act* is Title V of the *Agricultural Adjustment Act of 1938* which grants the Secretary authority to provide crop insurance and reinsurance.<sup>269</sup> Congress amends this title

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<sup>261</sup> Public Law 81-439.

<sup>262</sup> Public Law 75-430.

<sup>263</sup> See USDA: "Provisions of the Agricultural Improvement and Reform Act of 1996, Appendix III: Major Agricultural and Trade Legislation 1933-1996" and Congressional Research Service: "Farm Commodity Programs: A Short Primer", reproduced in Exhibits BRA-24 and BRA-255, respectively.

<sup>264</sup> Public Laws 101-624, 104-127 and 107-171, respectively.

<sup>265</sup> See Congressional Research Service: "Farm Commodity Programs: A Short Primer", reproduced in Exhibit BRA-255.

<sup>266</sup> See Congressional Research Service: "Farm Commodity Programs: A Short Primer", reproduced in Exhibit BRA-255.

<sup>267</sup> See Congressional Research Service report for Congress "What is a Farm Bill?" dated 5 May 2001, an extract of which is reproduced in Exhibit BRA-416. The CCC is the entity responsible for providing the three types of export credit guarantee programmes at issue in this dispute – see 7 USC 5622, reproduced in Exhibit BRA-141.

<sup>268</sup> See Congressional Research Service: "Farm Commodity Programs: A Short Primer", reproduced in Exhibit BRA-255.

<sup>269</sup> See USDA: "Provisions of the Agricultural Improvement and Reform Act of 1996, Appendix III: Major Agricultural and Trade Legislation 1933-1996", reproduced in Exhibit BRA-24.

from time to time. Two major amendments have been the *Federal Crop Insurance Reform Act of 1994* and the *Agricultural Risk Protection Act of 2000* (the "ARP Act of 2000").<sup>270</sup> Federal crop insurance is administered by the Federal Crop Insurance Corporation ("FCIC"), which is an agency within the USDA, supervised by the Risk Management Agency, which is an independent office within the USDA.

(b) Marketing loan programme payments

7.204 Marketing loan programme payments for upland cotton began in 1986 and have continued under successive legislation, including the FAIR Act of 1996<sup>271</sup> and the FSRI Act of 2002.<sup>272</sup> The marketing loan programme is intended to minimize potential loan forfeitures by providing interim financing to eligible producers on their eligible production and facilitate the orderly distribution of eligible commodities throughout the year.<sup>273</sup> Accordingly, rather than selling the crop at harvest when prices tend to be at their lowest, the proceeds of the interim loan enable producers to pay off their expenses when they become due, while storing their pledged harvested crop as collateral and repaying the loan when market conditions are potentially more favourable.

7.205 Under the FAIR Act of 1996, marketing assistance loans for upland cotton were provided to producers for upland cotton harvested on a farm containing eligible cropland covered by a production flexibility contract (see below). The loans for upland cotton were made on conditions prescribed by the Secretary for a term of ten months. The legislation provided that the loan rate for upland cotton was determined by the Secretary for each year's crop at a rate that was no less than the smaller of 85 per cent of the five year Olympic average<sup>274</sup> of county spot market prices<sup>275</sup>, or 90 per cent of the Northern Europe-based average price but which should be not less than 50 cents per pound and not more than 51.92 cents per pound.<sup>276</sup> The loan rates for the 1999, 2000, 2001 and 2002 crops of upland cotton were each determined at 51.92 cents per pound.<sup>277</sup> The loans were non-recourse, so a producer had the option to deliver to the CCC the quantity of a commodity pledged as collateral for the loan as payment in full when the loan was due to be repaid.

7.206 Under the FSRI Act of 2002, marketing assistance loans continue to be provided, but certain features of the programme have been changed. In particular, loans are provided to producers for any upland cotton produced on a farm, the term of a marketing assistance loan for upland cotton is now nine months and the loan rate for upland cotton is fixed by the Act itself at 52 cents per pound for the 2002 through 2007 crop years.

7.207 The repayment rate for marketing loans is the lower of the adjusted world market price<sup>278</sup> and the loan rate plus interest. When the adjusted world market price is lower than the loan rate, the producer repays at less than the loan rate and the difference is referred to as a "marketing loan gain".

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<sup>270</sup> Public Law 103-354, Title I, and Public Law 106-224, respectively.

<sup>271</sup> FAIR Act of 1996, Title I, Subtitle C (sections 131-135), reproduced in Exhibits BRA-28 and US-22.

<sup>272</sup> FSRI Act of 2002, Title I, Subtitle B (sections 1201-1205), reproduced in Exhibits BRA-29 and US-1, implemented under 7 CFR 1427, Subpart A, reproduced in Exhibit BRA-36.

<sup>273</sup> USDA Fact Sheet, June 2003, "Nonrecourse marketing assistance loan and loan deficiency payment program".

<sup>274</sup> An "Olympic average" is a 5-year average excluding the highest and lowest values. See USDA Economic Research Service side-by-side comparison of 1996 and 2002 farm bills' commodity programs, reproduced in Exhibit BRA -27.

<sup>275</sup> The price at which a physical commodity (e.g., upland cotton) for immediate delivery is selling at a given time and county.

<sup>276</sup> FAIR Act of 1996, section 132(c), reproduced in Exhibit BRA-28.

<sup>277</sup> Table 19 in *Agricultural Outlook*, published by USDA, May 2002, p. 50, (May 2002) reproduced in Exhibit BRA-142 and (November 2003), reproduced in Exhibit BRA-394.

<sup>278</sup> That is, adjusted to United States quality and location as determined by the Secretary.

Alternatively, a producer may forego a marketing loan and receive a "loan deficiency payment" in the amount of the difference between the lower adjusted world market price and the loan rate.<sup>279</sup> Additionally, in October 1999, the FAIR Act of 1996 was amended to include provisions for the issuance of "commodity certificates", available to producers, including upland cotton producers, to use in acquiring 1998 through 2002 crop collateral pledged to CCC for a commodity loan.<sup>280</sup> Marketing loan gains, loan deficiency payments and commodity certificate exchange gains are collectively referred to below as "marketing loan programme payments".

7.208 When loans are repaid, the CCC charges interest at a rate 1 per cent higher than the rate it pays the Treasury. The CCC forgives interest and pays storage charges for the loan period when upland cotton under loan is forfeited, and also on redemption of upland cotton under loan where the repayment amount is too low to satisfy the loan amount and those charges.<sup>281</sup>

(c) User marketing (Step 2) payments

7.209 The upland cotton user marketing certificate or "Step 2" programme is a special marketing loan provision for upland cotton. The programme has been authorized since 1990 under successive legislation, including the FAIR Act of 1996<sup>282</sup> and the FSRI Act of 2002.<sup>283</sup> It provides for the issuance of marketing certificates or cash payments (collectively referred to below as "user marketing (Step 2) payments")<sup>284</sup> to eligible domestic users and exporters of eligible upland cotton<sup>285</sup> when certain market conditions exist such that United States cotton pricing benchmarks are exceeded.

7.210 Under the FAIR Act of 1996, the Secretary issued user marketing (Step 2) payments to domestic users and exporters of upland cotton for documented purchases by domestic users and sales for export by exporters made in a week following a consecutive four-week period when the lowest price quotation for United States cotton delivered to Northern Europe exceeded the Northern Europe price quotation by more than 1.25 cents per pound, and the adjusted world price did not exceed 130 per cent of the marketing loan rate for upland cotton. Payments were made in certificates or cash to domestic users or exporters at a rate per pound equal to the difference between the two price quotations during the fourth week of the period, minus the 1.25 cents per pound threshold.<sup>286</sup>

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<sup>279</sup> All the eligibility requirements for Market Assistance loans for upland cotton apply to LDPs, except the cotton does not have to be ginned or stored in a warehouse and LDPs are paid after the cotton is ginned.

<sup>280</sup> See USDA Fact Sheet "Commodity Certificates" July 2000; and regulations at 7 CFR 1401 and 1427.22 (1 January 2003 edition), reproduced in Exhibits BRA-52, BRA-34 and BRA-36, respectively. Payment limitations under the marketing loan payment programme are explained in the Report of the Commission on the Application of Payment Limitations for Agriculture, August 2003, reproduced in Exhibit BRA-276.

<sup>281</sup> See 7 CFR 1427.13 and 7 CFR 1427.19(e), reproduced in Exhibit BRA-36. See also 7 CFR 1405, cited in the United States' response to Panel Question No. 192(b); and see USDA fact sheet: Upland Cotton (1 January 2003 edition), page 2, reproduced in Exhibit BRA-4.

<sup>282</sup> Section 136 of the FAIR Act of 1996, reproduced in Exhibits BRA-28 and US-22.

<sup>283</sup> Section 1207 of the FSRI Act of 2002, reproduced in Exhibits BRA-29 and US-1, implemented under 7 CFR 1427, Subpart C, reproduced in Exhibit BRA-37.

<sup>284</sup> For the purposes of this dispute, on the basis of the views of the parties, we make no distinction between user marketing (Step 2) cash payments and marketing certificates. See Brazil's and the United States' respective responses to Panel Question No. 110 (a).

<sup>285</sup> "Eligible upland cotton" is defined as: "domestically produced baled upland cotton which bale is opened by an eligible domestic user ... or exported by an eligible exporter" during a certain period. It can be "baled lint", loose, certain semi-processed motes and re-ginned (processed) motes. It cannot be cotton for which a user marketing (Step 2) payment has been made available; imported cotton; raw (unprocessed) motes or textile mill wastes. See 7 CFR 1427.103(a),(b) and (c), reproduced in Exhibit BRA-37.

<sup>286</sup> Section 136(a) of the FAIR Act of 1996 reproduced in Exhibits BRA-28 and US-22. Section 136(a)(5) limited total expenditures under this programme to \$701 million, but was later repealed.

7.211 Under the FSRI Act of 2002, Step 2 payments continue to be paid, but certain features of the programme have been changed. In particular, application of the 1.25 cents per pound threshold has been delayed until 1 August 2006 (i.e. for the 2002 through 2005 marketing years). Consequently, Step 2 payments are issued following a consecutive four-week period when the lowest price quotation for United States cotton delivered to Northern Europe exceeded the Northern Europe price quotation by any amount and the adjusted world price did not exceed 134 per cent (not 130 per cent, as under the FAIR Act of 1996) of the marketing loan rate. Payments are made at a rate per pound equal to the difference between the two price quotations during the fourth week of the period, with no reduction for the threshold.<sup>287</sup>

(d) Production flexibility contract payments

7.212 Production flexibility contract ("PFC") payments were only made under the FAIR Act of 1996.<sup>288</sup> The last payment was made not later than 30 September 2002.<sup>289</sup> The programme provided support to producers (as defined)<sup>290</sup> based on historical acreage and yields for seven commodities, including upland cotton (referred to in this report as "covered commodities"<sup>291</sup>). Its stated purpose was to support farming certainty and flexibility while ensuring continued compliance with farm conservation and wetland protection requirements.<sup>292</sup>

7.213 An eligible producer could enter into a PFC for the 1996 through 2002 crops during a one-time enrolment period that ended on 1 August 1996.<sup>293</sup> Cropland was eligible for coverage under a PFC if at least a portion of it had been enrolled in the deficiency payments programme under the previous farm bill for at least one of the 1991 through 1995 crops.<sup>294</sup>

7.214 PFC payments did not depend on then-current prices of commodities. The FAIR Act of 1996 appropriated a budgetary amount to the programme for each fiscal year from 1996 through 2002 and allocated a certain percentage of that amount to each of the seven commodities.<sup>295</sup> The allocation for a commodity was distributed among the PFC contracts according to the acreage and yield for the particular commodity which each PFC contract covered. That acreage was not the amount of acres currently planted to that commodity (referred to in this report as "planted acres"). Rather, it was the average of the plantings of each commodity in the 1993 through 1995 marketing years according to

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<sup>287</sup> Section 1207(a) of the FSRI Act of 2002, reproduced in Exhibits BRA-29 and US-1, and 7 CFR 1427.107 (1 January 2003 edition), reproduced in Exhibit BRA-37.

<sup>288</sup> FAIR Act of 1996, Title I, Subtitle B (sections 111-118), reproduced in Exhibits BRA-28 and US-22, and 7 CFR 1412.101-1412.501 (1 January 2002 edition), reproduced in Exhibit BRA-31.

<sup>289</sup> Section 112(d)(1) of the FAIR Act of 1996, reproduced in Exhibit BRA-28.

<sup>290</sup> "Producer" was defined as "an owner, operator, landlord, tenant, or sharecropper that shares in the risk of producing a crop and is entitled to share in the crop available for marketing from the farm, or would have shared had the crop been produced." See section 102(12) of the FAIR Act of 1996 and 7 CFR 1412.202 (1 January 2002 edition), reproduced in Exhibits BRA-28 and US-22, and BRA-31, respectively.

<sup>291</sup> The FAIR Act of 1996 used the term "contract commodity".

<sup>292</sup> Section 101(b)(1) of the FAIR Act of 1996, reproduced in Exhibit BRA-28.

<sup>293</sup> Acreage returning from conservation reserve was allowed to enrol subsequently.

<sup>294</sup> Under the FACT Act of 1990, "deficiency payments" were direct payments made to producers who participated in an annual programme for certain commodities, including upland cotton. The crop-specific payment rate for a particular crop year was based on the difference between an established target price and the higher of the loan rate for that commodity or the national average market price for the commodity during a specified time period. During the marketing years 1990 to 1996, the target price for upland cotton was 72.9 cents per pound. Payment was conditional upon planting upland cotton for harvest – see the United States' rebuttal submission, para. 112, and USDA Economic Research Service: *Agricultural Outlook Supplement*, April 1996, "Glossary of Agriculture Policy Terms" at p. 5, reproduced in Exhibit BRA-25.

<sup>295</sup> The amount appropriated for each fiscal year ranged between \$5.8 billion to \$4.008 billion. The amount of this allocated to upland cotton in each fiscal year was 11.63 per cent; see section 113(a) and (b) of the FAIR Act of 1996, reproduced in Exhibit BRA-31.

the method of calculation that would have applied to the 1996 crop under the previous farm bill<sup>296</sup> (referred to in this report as "base acres"<sup>297</sup>). The payment rate for the 1999, 2000 and 2001 crops were set for each of the seven covered commodities. The payment rates for upland cotton were 7.88 cents, 7.33 cents and 5.99 cents, per pound, respectively.<sup>298</sup> PFC payments were made on 85 per cent of the base acreage for each commodity multiplied by the corresponding payment rate multiplied by the applicable payment yield, which was the yield established for the 1995 crop.<sup>299</sup>

7.215 Producers were permitted to plant any commodity or crop on base acres, subject to certain limitations and exceptions concerning the planting of fruits and vegetables.<sup>300</sup> PFC payments were either eliminated or reduced if producers planted fruits and vegetables on base acres, unless they satisfied a special eligibility criterion. Additionally, producers had to use the land for an agricultural or related activity and not for a non-agricultural commercial or industrial use and comply with certain conservation requirements.<sup>301</sup> Otherwise, PFC payments were not affected by what was planted on base acreage nor by whether anything was produced on it at all.<sup>302</sup>

(e) Market loss assistance payments

7.216 Market loss assistance ("MLA") payments were made under four separate pieces of legislation, one each for the years 1998 through 2001.<sup>303</sup> They were *ad hoc* emergency and supplementary assistance provided to producers in order to make up for losses sustained as a result of recent low commodity prices.<sup>304</sup>

7.217 The 1998 MLA payments were intended essentially as a 50 per cent additional PFC payment.<sup>305</sup> The 1998, 1999 and 2001 Acts each appropriated a dollar amount to assistance which was divided among PFC payment recipients proportionately to their respective previous PFC payment.<sup>306</sup> The 2000 Act provided for payments at the same contract payment rates as the 1999 Act.<sup>307</sup> MLA payments were only made to recipients enrolled in the PFC programmes.

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<sup>296</sup> Under the FACT Act of 1990, base acres were calculated according to a rolling average of the previous three crop years for upland cotton. See the United States' corrected response to Panel Question No. 216 in its 28 January 2004 comments on Brazil's responses.

<sup>297</sup> The FAIR Act of 1996 used the term "contract acreage".

<sup>298</sup> See USDA Economic Research Service *Agricultural Outlook* (online data as of November 2003) reproduced in Exhibit BRA-394, also May 2002 edition, p. 50, reproduced in Exhibit BRA-142, and USDA Farm Service Agency Fact Sheet *Upland Cotton – Summary of 2000 Commodity Loan and Payment Program* June 2001 edition, p.1, reproduced in Exhibit BRA-45.

<sup>299</sup> Section 114(d) of the FAIR Act of 1996, reproduced in Exhibit BRA-28.

<sup>300</sup> The limitations and exceptions are set out in detail in Section VII:D of this report.

<sup>301</sup> Section 111(a) of the FAIR Act of 1996. An agricultural use refers to cropland planted to a crop, used for haying or grazing, idled for weather-related reasons or natural disasters, or diverted from crop production to an approved cultural practice that prevents erosion or other degradation.

<sup>302</sup> The Panel makes certain factual findings on the relationship between farms with upland cotton base acres and upland cotton planted acres in the 1999 through 2002 marketing years in the Attachment to Section VII:D of this report.

<sup>303</sup> Market loss assistance payments were provided pursuant to the following Acts: the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriation Act of 1999 for the 1998 crop; the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriation Act of 2000 for the 1999 crop; the Agriculture Risk Protection Act of 2000 for the 2000 crop; and the Crop Year 2001 Agriculture Economic Assistance Act for the 2001 crop, reproduced in Exhibit BRA-138, as discussed in Section VII:B of this report.

<sup>304</sup> See United States' rebuttal submission, para. 100 and USDA Economic Research Service: "Cotton: Background and Issues for Farm Legislation", July 2001 at page 9, reproduced in Exhibit BRA-46.

<sup>305</sup> See United States' rebuttal submission, para. 99.

<sup>306</sup> The budgetary outlays for MLA payments (in respect of wheat, feed grains, rice and upland cotton base acres) in 1998, 1999 and 2001 were \$2.857 billion, \$5.544 billion and \$4.622 billion, respectively. See

## (f) Direct payments

7.218 The direct payments ("DP") programme was established under the FSRI Act of 2002.<sup>308</sup> It provides support to producers (as defined)<sup>309</sup> based on historical acreage and yields for nine commodities, which are those that were covered by the PFC programme, including upland cotton, plus soybeans and other oilseeds (referred to in the legislation and this report as "covered commodities").<sup>310</sup> There are special provisions for peanuts (also referred to in this report as a "covered commodity").<sup>311</sup>

7.219 An eligible producer must enter into an annual agreement in order to receive payments for a crop year. DP payments are made to producers on farms for which payment yields and base acres are established for each of the 2002 through 2007 crop years of each covered commodity.

7.220 DP payments do not depend on current prices of commodities. The FSRI Act of 2002 sets fixed payment rates on a per unit basis for the 2002 through 2007 crop years. The payment rate for upland cotton is 6.67 cents per pound. Payments are not made in respect of planted acres. DP payments are made on 85 per cent of the base acreage for each commodity multiplied by the applicable payment yield, which was the yield established for the 1995 crop (if there was one). Under the implementing regulations, the amount of a PFC payment received for the 2002 crop was deducted from the DP payment made in the 2002 crop year.<sup>312</sup>

7.221 Owners had a one-time opportunity to elect the method for calculation of their base acreage. An owner could elect to have base acreage for all covered commodities calculated on the basis of the four-year average of planted acreage during the 1998 through 2001 crop years plus acreage the producers were prevented from planting by natural disasters during the same period. Failing such an election, an owner's base acreage in the DP programme is the same as under the PFC programme for the 2002 payment (i.e. the three year average of the 1993 through 1995 marketing years for upland cotton and rice), plus the four-year average of planted acreage for eligible oilseeds during the 1998 through 2001 crop years.<sup>313</sup>

7.222 Producers are permitted to plant any commodity or crop on base acres, subject to certain limitations concerning the planting of fruits and vegetables.<sup>314</sup> DP payments are either eliminated or reduced if producers plant these crops on base acres, unless they are destroyed before harvest, subject to certain exceptions. Additionally, producers must use the land for an agricultural or conserving use and not for a non-agricultural commercial or industrial use and abide by conservation compliance

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USDA Economic Research Service Features: *"The 2002 Farm Bill: Title I – Commodity Programs"*, printed 16 September 2002, page 2, reproduced in Exhibit BRA-27.

<sup>307</sup> The resulting budgetary outlay in 2000 was \$5.465 billion.

<sup>308</sup> FSRI Act of 2002, Title I, Subtitle A, reproduced in Exhibits BRA-29 and US-1, implemented by 7 CFR 1412, reproduced in Exhibit BRA-35.

<sup>309</sup> "Producer" is defined as "an owner, operator, landlord, tenant, or sharecropper that shares in the risk of producing a crop and is entitled to share in the crop available for marketing from the farm, or would have shared had the crop been produced." See section 1001(12) of the FSRI Act of 2002 and 7 CFR 1412.402 (1 January 2003 edition), reproduced in Exhibits BRA-29 and US-1, and BRA-35, respectively.

<sup>310</sup> The term "other oilseed" includes sunflower seed, rapeseed, canola, safflower, flaxseed, mustard seed, and any other oilseed designated by the United States Secretary of Agriculture. A direct payment of \$36 per ton is available to peanut producers on eligible base period (1998-2001) peanut production: see section 1301 of the FSRI Act of 2002. The parties agree that the direct payments programme covers peanuts: see Brazil's first written submission, para. 49, footnote 110 and the United States' rebuttal submission, para. 57, footnote 46.

<sup>311</sup> FSRI Act of 2002, Title I, Subtitle C, reproduced in Exhibit US-1.

<sup>312</sup> See 7 CFR Chapter. XIV (1 January 2003 edition) 1412.502(f), reproduced in Exhibit BRA-35.

<sup>313</sup> Generally, oilseed base acres can not exceed the difference between total acreage for covered crops for the crop year and the sum of base acreage under the PFC programme for the 2002 payment.

<sup>314</sup> The limitations are set out in detail in Section VII:D of this report.

requirements.<sup>315</sup> Otherwise, DP payments are not affected by what is produced on base acreage nor by whether anything is produced on it at all.<sup>316</sup>

(g) Counter-cyclical payments

7.223 The counter-cyclical payments ("CCP") programme was also established by the FSRI Act of 2002.<sup>317</sup> It provides support to producers (as defined)<sup>318</sup> based on historical acreage and yields for the same commodities as DP payments, including upland cotton.

7.224 An eligible producer must enter into an annual agreement in order to receive payments for a crop year. The eligibility requirements and planting flexibility requirements are the same as for the DP programme. CCP payments, like DP payments, are made to producers on farms for which payment yields and base acres are established for each of the 2002 through 2007 crop years of each covered commodity.

7.225 CCP payments depend on the current prices of commodities. They are provided to producers with base acres and yields for a covered commodity for each of the 2002 through 2007 crop years whenever the effective price falls below the target price, which is fixed by the Act at 72.4 cents per pound for upland cotton.<sup>319</sup> The effective price for a commodity is the sum of the DP payment rate (see above), plus the higher of the national average farm price for the marketing year or the loan rate (see above). The difference between the effective price and the target price is the CCP payment rate. Consequently, the CCP payment rate, DP payment rate and, where applicable, the loan rate, are equal to the difference between the market price and 72.4 cents per pound.

7.226 CCP payments are made on 85 per cent of the base acreage for each commodity multiplied by the corresponding payment rate multiplied by the applicable payment yield.<sup>320</sup> An owner who elected to have his or her base acreage calculated on the basis of the four-year average of planted acreage during the 1998 through 2001 crops, had a one-time opportunity partially to "update" CCP payment yields for CCP payments for all covered commodities, using one of two methods which both included the farm's average yields for the 1998 through 2001 crop years.<sup>321</sup>

(h) Crop insurance payments

7.227 The United States government offers annual crop yield or revenue insurance coverage to producers of upland cotton and other crops for losses due to natural disasters and market fluctuations and offers reinsurance to providers of such insurance under the *Federal Crop Insurance Act*<sup>322</sup>, as amended by other legislation, including the ARP Act of 2000. A stated objective of this legislation is

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<sup>315</sup> Section 1105(a)(1) of the FSRI Act of 2002.

<sup>316</sup> The Panel makes certain factual findings on the relationship between farms with upland cotton base acres and upland cotton planted acres in the 1999 through 2002 marketing years in the Attachment to Section VII:D of this report.

<sup>317</sup> FSRI Act of 2002, Title I, Subtitle A, reproduced in Exhibits BRA-29 and US-1, implemented by 7 CFR 1412, reproduced in Exhibit BRA-35.

<sup>318</sup> See *supra*, footnote 309.

<sup>319</sup> Target prices are fixed for MY 2002-03 and then raised to fixed levels for MY 2004-07 except for soybeans, rice, upland cotton and peanuts, which remain at the MY 2002-03 levels throughout the term of the FSRI Act of 2002.

<sup>320</sup> Section 1104(e) of the FSRI Act of 2002.

<sup>321</sup> Section 1102(e) of the FSRI Act of 2002.

<sup>322</sup> Sections 501 through 522, and Section 523, of the *Federal Crop Insurance Act*, as amended, in 7 USC 1501 *et seq.*, are reproduced in Exhibits BRA-30 and BRA-336, respectively.

to promote the national welfare by improving the economic stability of agriculture through a sound system of crop insurance.<sup>323</sup>

7.228 In general, the Federal Crop Insurance Corporation ("FCIC") may insure, or provide reinsurance for insurers of, producers of agricultural commodities grown in the United States under one or more plans of insurance determined to be adapted to the agricultural commodity concerned. To qualify for coverage under a plan of insurance, the losses of the insured commodity must be due to drought, flood, or other natural disaster as determined by the Secretary.<sup>324</sup> There are also "special provisions for cotton and rice" whereby, beginning with the 2001 crop, the FCIC "shall offer plans of insurance, including prevented planting coverage and replanting coverage, ... that cover losses of upland cotton ...resulting from failure of irrigation water supplies due to drought and saltwater intrusion".<sup>325</sup>

7.229 There are also specific provisions on catastrophic risk protection and additional coverage. In particular, FCIC crop insurance plans include both protection against losses resulting from low crop *yields* and protection against low *revenue*, whether it results from low yields or low crop prices. Coverage levels range from catastrophic risk coverage (50 per cent of yield, indemnified at 55 per cent of expected price for the 1999 and subsequent crop years) for which the producer pays none of the premium,<sup>326</sup> to additional or "buy-up" coverage, which provides a higher level of coverage (up to 75, or in some cases 85 per cent of expected yield or revenue) for which the producer pays a portion of the premium. The FCIC pays the balance of the premium.<sup>327</sup> It also reinsures the insurance provider, thereby covering underwriting costs, and defrays some of its administrative costs.

7.230 The *Federal Crop Insurance Act* defines the "agricultural commodities" to which it applies.<sup>328</sup> These are predominantly crops (as opposed to livestock). The legislation also provides for "livestock pilot programmes".<sup>329</sup> These pilot programmes, such as the Adjusted Gross Revenue programme<sup>330</sup> and the "AGR-Lite" programme<sup>331</sup> provide for payment by the FCIC of a percentage of premium and

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<sup>323</sup> Section 502 of the *Federal Crop Insurance Act*, as amended, in 7 USC 1501 *et seq.*, reproduced in Exhibits BRA-30. Federal crop insurance is explained in USDA: "U.S. Crop Insurance: Premiums, Subsidies and Participation" in *Agricultural Outlook*, December 2001, and USDA: "Briefing Room: Farm and Commodity Policy: Crop Yield and Revenue Insurance", reproduced in Exhibits BRA-58 and BRA-59, respectively.

<sup>324</sup> Section 508(a)(1) of the *Federal Crop Insurance Act*, as amended, in 7 USC 1501 *et seq.*, reproduced in Exhibit BRA-30.

<sup>325</sup> Section 508(a)(8) of the *Federal Crop Insurance Act*, as amended, in 7 USC 1501 *et seq.*, reproduced Exhibit BRA-30.

<sup>326</sup> Section 508(e)(2)(A) of the *Federal Crop Insurance Act*, as amended, in 7 USC 1501 *et seq.*, reproduced Exhibit BRA-30. An administrative fee, up to a maximum of \$100, is payable per crop per county, which can be waived for limited-resource farmers: see section 508(b)(5)A and E.

<sup>327</sup> The formula for the amount of such premium paid by the FCIC is set out in section 508(e)(2)(B)-(G) of the *Federal Crop Insurance Act*, as amended, in 7 USC 1501 *et seq.*, reproduced Exhibit BRA-30.

<sup>328</sup> Section 518 of the *Federal Crop Insurance Act*, as amended, in 7 USC 1501 *et seq.*, reproduced in Exhibit BRA-30.

<sup>329</sup> Exhibit BRA-336 contains section 523 of the *Federal Crop Insurance Act*. Entitled "Pilot Programs", this section envisages that pilot programs may provide insurance protection against losses involving, *inter alia*, livestock poisoning and disease. The livestock eligible for livestock pilot programmes are defined as including, but not being limited to, cattle, sheep, swine, goats and poultry (Section 523(b)).

<sup>330</sup> Exhibit BRA-272 contains a USDA fact sheet description of the AGR pilot programme for MY 2003. It indicates that AGR "complements other Federal crop insurance plans". When a producer purchases both AGR and other crop insurance plans, the AGR premium will be reduced. A producer must "earn no more than 35 per cent of expected allowable income from animals and animal products".

<sup>331</sup> This programme is described as "a streamlined whole-farm revenue protection package that can be used as a stand-alone coverage or in addition to other individual crop insurance policies (except A.G.R.)". Initially available in Pennsylvania, AGR-Lite has been expanded to 11 northeastern states: see USDA RMA fact sheets, Adjusted Gross Revenue – Lite (AGR-Lite), February 2003, reproduced in Exhibit BRA-338 and

administrative fee<sup>332</sup> in respect of certain policies for some types of livestock production in certain limited areas of the United States.

7.231 Producers generally apply for FCIC crop insurance policies prior to planting but usually pay their share of the premiums after harvest.<sup>333</sup> The policies are sold through government-approved private insurance providers.<sup>334</sup> The price paid by the producer is the total premium minus the amount paid by the FCIC. The portion of the premium paid by the FCIC depends on the level of coverage and the features of the relevant plan but is the same for all crops covered by a particular plan.<sup>335</sup> Emergency premium discounts additionally reduced producer costs of buy-up coverage, at rates of 30 per cent and 25 per cent in 1999 and 2000, respectively.<sup>336</sup> The ARP Act of 2000 increased the portion of the premium<sup>337</sup> paid by the FCIC commencing in the 2001 crop year.

7.232 Over 90 per cent of cotton area covered by federal crop insurance in the 2002 crop year is insured at coverage levels of 70 per cent or less of expected yield or revenue for which the FCIC pays a portion of the premium.<sup>338</sup>

(i) Cottonseed payments

7.233 Cottonseed payments are *ad hoc* emergency and supplementary assistance provided to first handlers<sup>339</sup> and producers of cottonseed.<sup>340</sup> The payments within the Panel's terms of reference were made under the ARP Act of 2000 in order to offset low commodity prices. Payments were available only for cottonseed produced and ginned in the United States.<sup>341</sup>

7.234 The ARP Act of 2000 and a later Act<sup>342</sup> each appropriated a specific amount of money for the 2000 crop of cottonseed.<sup>343</sup> The payment rate (dollars per ton) was calculated by dividing the total available funds by the total payment quantity of 2000 crop cottonseed of first handlers who applied to participate.<sup>344</sup>

November 2003 available on the USDA Risk Management website: see also United States' response to Panel Question No. 133.

<sup>332</sup> These are to be determined by the amount of funds made available and the number of participants.

<sup>333</sup> USDA Economic Research Service: Briefing Room, farm and commodity policy – crop yield and revenue insurance, reproduced in Exhibit BRA-59.

<sup>334</sup> USDA Economic Research Service: Briefing Room, farm and commodity policy – crop yield and revenue insurance, reproduced in Exhibit BRA-59.

<sup>335</sup> USDA Economic Research Service: Briefing Room, farm and commodity policy – crop yield and revenue insurance, reproduced in Exhibit BRA-59.

<sup>336</sup> See Exhibit BRA-61.

<sup>337</sup> See Exhibits BRA-59 and BRA-61.

<sup>338</sup> See United States' oral statement at the resumed session of the first substantive meeting, para. 46, United States' response to Panel Question No. 136, and Exhibit BRA-61.

<sup>339</sup> A first-time handler of cottonseed is a gin, which means a person that removes cotton seed from cotton lint. See 7 CFR 1427.1102 (1 January 2002 edition), reproduced in Exhibit BRA-32.

<sup>340</sup> The implementing regulations of cottonseed payments define cottonseed as, "the seed from any variety of upland cotton and extra long staple cotton (ELS) produced in the United States." Approximately 97 per cent of the annual United States cotton crop is from upland cotton: see USDA Economic Research Service Briefing Room Cotton document, reproduced in Exhibit BRA-13.

<sup>341</sup> 7 CFR 1427.1100 (b) (1 January 2002 edition), reproduced in Exhibit BRA-32.

<sup>342</sup> The *Agricultural Risk Protection Act of 2000*, Public Law 106-224, section 204(e), reproduced in Exhibit BRA-137, and the *Crop Year 2001 Agricultural Economic Assistance Act*, Public Law 107-25, reproduced in Exhibit BRA-138.

<sup>343</sup> \$100 million and \$84.7 million, respectively.

<sup>344</sup> See 7 CFR 1427.1100(a) and 1427.1109, reproduced in Exhibit BRA-32.

7.235 Payments were made to first-time handlers because they usually retained proceeds from the sale of cottonseed. However, it was a condition that they shared any payment received with producers to the extent that the revenue from the sale of the cottonseed was shared with the producer.

(j) Export credit guarantee measures

(i) *Overview*

7.236 The USDA administers export credit guarantee programmes for commercial financing of United States agricultural commodities<sup>345</sup> through the CCC.<sup>346</sup> The CCC operates three export credit guarantee programmes: General Sales Manager 102 ("GSM 102"), General Sales Manager 103 ("GSM 103") and the Supplier Credit Guarantee Programme ("SCGP").<sup>347</sup>

7.237 According to the stated "purpose of the program", the CCC may use export credit guarantees authorized under the statute to "increase exports of agricultural commodities"; "to compete against foreign agricultural exports"; "to assist countries in meeting their food and fiber needs..."; and "for such other purposes as the Secretary determines appropriate ...".<sup>348</sup>

7.238 Pursuant to the statute, the CCC may: guarantee the repayment of credit made available to finance commercial export sales of agricultural commodities on credit terms that do not exceed three years (under the GSM 102 programme); issue guarantees for the repayment of credit made available for a period of not more than 180 days by a United States exporter to a buyer in another country (under the SCGP programme); and guarantee the repayment of credit made available by financial institutions in the United States to finance commercial export sales of agricultural commodities on credit terms of between 3 and 10 years (under the GSM 103 programme) "in a manner that will directly benefit United States agricultural producers." We examine additional details of each of the three programmes below.

7.239 The CCC "shall make available" for each relevant fiscal year "not less than \$5,500,000,000 in credit guarantees" under the three export credit guarantee programmes.<sup>349</sup>

7.240 Export credit guarantees "shall contain such terms and conditions as the [CCC] determines to be necessary."<sup>350</sup>

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<sup>345</sup> We recall that our terms of reference include upland cotton and other eligible agricultural products under the three challenged export credit guarantee programmes. See *supra*, Section VII:B. According to Exhibits BRA-141, -366, 7 USC 5622(h), the CCC "shall finance or guarantee under this section only United States agricultural commodities". 7 USC 5622(k) sets out percentages of the total amount of export credit guarantees issued for certain fiscal years that promote the export of processed or high-value agricultural products, with the balance issued to promote the export of bulk or raw agricultural commodities. This percentage requirement applies to the extent that a reduction in the total amount of guarantees issued is not required to meet it.

Exhibit BRA-73 contains an excerpt from the USDA website ([www.fas.usda.gov/excredits/...](http://www.fas.usda.gov/excredits/)) which offers a summary of activity under the challenged export credit guarantee programmes, indicating the allocations and applications received by country and commodity, MY 1999-MY 2003.

<sup>346</sup> The CCC is a wholly owned government corporation within the USDA. The CCC has no employees and carries out the majority of its programmes through the personnel and facilities of the Farm Service Agency. See, for example, *Commodity Credit Corporation's Financial Statements for Fiscal Year 2002* (Exhibit BRA-158). Brazil's does not challenge the CCC Facility Guarantee programme in this dispute – see Brazil's 11 August responses to the questions posed by the Panel, footnote 206.

<sup>347</sup> These programmes were established by 7 USC 5622. Exhibits BRA-141 and BRA-366.

<sup>348</sup> 7 USC 5622(d), reproduced in Exhibits BRA-141, BRA-366.

<sup>349</sup> 7 USC 5641(b)(1), reproduced in Exhibit BRA-297. The CCC retains discretion as to allocation between short and intermediate terms.

<sup>350</sup> 7 USC 5622(g), reproduced in Exhibits BRA-141, BRA-366.

7.241 The statute also sets out certain restrictions on the use of credit guarantees. In general, "the CCC shall not make credit guarantees available in connection with sales of agricultural commodities to any country that the Secretary determines cannot adequately service the debt associated with such sale."<sup>351</sup> All countries eligible for any of the CCC export credit guarantee programmes are categorized according to risk. A country's risk premium has no impact on the premiums payable under the programmes.<sup>352</sup>

(ii) *General Sales Manager 102 ("GSM 102")*

7.242 Under the GSM 102 export credit guarantee programme, the CCC is authorized to guarantee the repayment of credit made available to finance commercial export sales of agricultural commodities from privately owned stocks on credit terms between 90 days and three years. The CCC generally covers 98 per cent of the principal and a portion of the interest. The CCC selects agricultural commodities and products according to market potential. The CCC does not provide financing, but rather guarantees payments due from foreign banks. To secure such a payment guarantee, once a firm export sale exists, the United States exporter must apply prior to the date of exportation. The exporter pays a fee calculated on the dollar amount guaranteed, based on a schedule of rates applicable to different credit periods. There is a statutory cap on the fee charged of 1 per cent of the guaranteed dollar value of the transaction.<sup>353</sup> In terms of financing, the CCC-approved foreign bank issues an irrevocable letter of credit in favour of the United States exporter, ordinarily advised or confirmed by the financial institution in the United States which agrees to extend credit to the foreign bank. If the foreign bank fails to make any payment as agreed, the exporter is required to submit a notice of default to the CCC. The CCC pays a valid claim for loss.<sup>354</sup>

(iii) *General Sales Manager 103 ("GSM 103")*

7.243 The GSM 103 programme operates in a similar fashion to GSM 102. The main differences between the two programmes include: export credit guarantees under GSM 103 are "intermediate term credit guarantees" issued for terms from three to 10 years<sup>355</sup>; there are additional statutory required determinations to be made when the CCC issues guarantees<sup>356</sup>; and there is no statutory cap on the origination fees that may be charged by the CCC in connection with an export credit guarantee transaction.

(iv) *Supplier Credit Guarantee Programme ("SCGP")*

7.244 Under the SCGP, the CCC is authorized to issue guarantees for the repayment of credit made available for a period not exceeding 180 days by a United States exporter to a purchaser of United States agricultural commodities in a foreign country. These direct credits must be secured by

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<sup>351</sup> 7 USC 5622(f), reproduced in Exhibits BRA-141, BRA-366.

<sup>352</sup> See United States' response to Panel Question No. 86.

<sup>353</sup> See United States' response to Panel Question No. 84, where the United States indicates that section 211(b)(2) of the Agricultural Trade Act of 1978, 7 USC 5641(b)(2) limits the fee of transactions under the GSM 102 programme, except for those transactions under the CCC Facility Guarantee programme.

<sup>354</sup> FAS Online Fact Sheet: CCC Export Credit Guarantee Programmes, reproduced in Exhibit BRA-71.

<sup>355</sup> 7 USC 5641(b), reproduced in Exhibit BRA-141.

<sup>356</sup> 7 USC 5622(c), reproduced in Exhibits BRA-141, BRA-366, provides as follows: "The [CCC] shall not guarantee [...] the repayment of credit made available to finance an export sale unless the Secretary determines such sale will: (1) develop, expand or maintain the importing country as a foreign market, on a long-term basis, for the commercial sale and export of United States agricultural commodities, without displacing normal commercial sales; (2) improve the capability of the importing country to purchase and use, on a long-term basis, United States agricultural commodities; or (3) otherwise promote the export of United States agricultural commodities." ("The reference to ...'on a long-term basis' shall not apply in the case of determinations with respect to sales to the independent states of the former Soviet Union.") 7 USC 5622(f)(2) sets out additional criteria for determinations to be made relating to GSM 103.

promissory notes signed by the importers. The CCC does not provide financing, but rather guarantees payment due from the importer. Typically, the CCC guarantees a portion (65 per cent) of the value of the exports (principal only; the guarantee does not cover interest). The exporter negotiates terms of export credit sales with the importer. Once a firm export sale exists, the United States exporter must apply for a payment guarantee prior to the date of exportation. The exporter pays a fee for the guarantee calculated on the guaranteed portion of the value of the export sales. There is a statutory cap on the fee charged of 1 per cent of the guaranteed dollar value of the transaction.<sup>357</sup> The importer must issue a dollar-denominated promissory note in favour of the United States exporter in the form specified in the applicable country or regional programme announcement. The United States exporter may negotiate an arrangement to be paid, in full or in part, by assigning the right to proceeds that may become payable under the CCC's guarantee to a United States financial institution. If the foreign bank fails to make any payment, the exporter or assignee is required to submit a notice of default to the CCC. The CCC pays a valid claim for loss.

(k) Export subsidies under the ETI Act of 2000

7.245 The request for establishment of the Panel includes export subsidies provided to exporters of United States upland cotton under the "*FSC Repeal and Extraterritorial Income Exclusion Act of 2000*" (referred to in this report as the "ETI Act of 2000").<sup>358</sup>

7.246 Brazil refers the Panel to the findings in the panel and Appellate Body reports in an earlier dispute<sup>359</sup> and to a page on the website of the European Commission.<sup>360</sup> Brazil asserts that the ETI Act of 2000 sets out conditions for the non-taxation of a portion of extraterritorial income that would otherwise be taxed. It outlines the reasoning of the panel and Appellate Body in that earlier dispute and recalls that the Appellate Body noted that in order to obtain a subsidy under the ETI Act of 2000, property produced in the United States must be sold, leased or rented for direct use, consumption or disposition "outside the United States".<sup>361</sup> Brazil also refers us to the panel's finding in that earlier dispute that the ETI Act of 2000 created a legal entitlement for recipients to receive export subsidies with respect to both scheduled and unscheduled agricultural products, as the United States must provide the tax exclusion upon fulfilment by the taxpayer of the conditions stipulated in the ETI Act of 2000.<sup>362</sup>

7.247 Brazil asserts that exporters in the United States exported United States upland cotton benefiting from the ETI tax breaks, but it is not in a position to quantify the amount of the subsidy provided to upland cotton, although it posed this question to the United States during consultations.<sup>363</sup>

7.248 Brazil requests this Panel to make factual findings regarding the ETI Act of 2000 based on this evidence.<sup>364</sup> It does not submit a copy of the ETI Act of 2000, or the relevant sections of it.

7.249 The panel report in that dispute, which established the facts in that dispute, cites the short title set out in our terms of reference<sup>365</sup> but the Appellate Body report sets out a short title that we cannot

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<sup>357</sup> See United States' response to Panel Question No. 85, where the United States indicates that section 211(b)(2) of the Agricultural Trade Act of 1978, 7 USC 5641(b)(2) limits the fee of transactions to this level.

<sup>358</sup> Brazil's first written submission, para. 315, refers to the "*FSC Repeal and Extraterritorial Income Act of 2000* (the 'ETI Act')" and its response to Panel Question No. 19 refers to the "*FSC Repeal and Extraterritorial Exclusion Act of 2000* (Public Law 106-519)".

<sup>359</sup> Panel Report, *US – FSC (Article 21.5 – EC)*, WT/DS108/RW, as modified by the Appellate Body Report in *US – FSC (Article 21.5 – EC)*, WT/DS108/AB/RW.

<sup>360</sup> See Brazil's oral statement at the first session of the first substantive meeting, para. 137.

<sup>361</sup> Brazil's first written submission, para. 322.

<sup>362</sup> Brazil's first written submission, para. 325.

<sup>363</sup> Brazil's first written submission, para. 330.

<sup>364</sup> See Brazil's oral statement at the first session of the first substantive meeting, para. 139.

<sup>365</sup> Panel Report, *US – FSC (Article 21.5 – EC)*, para. 2.1, footnote 14.

identify.<sup>366</sup> However, the Public Law number in the second footnote of the Appellate Body report matches the one given to this Panel by Brazil.<sup>367</sup> Therefore, we are satisfied that the earlier dispute in fact concerned the same law at issue in the present dispute.

(l) Legislative and regulatory provisions

7.250 Brazil challenges certain legislation and regulations under which the above subsidies are currently provided. This challenge relates to this legislation and these regulations "as such". Specifically, the measures are:

(i) *Marketing loan/Loan deficiency provisions*

- Sections 1201(a)-(b), 1202(a)(6), 1202(b)(6), 1204(b), 1205(a)(1), 1205(b), 1205(c)(1), 1608 of the FSRI Act of 2002<sup>368</sup> and 7 USC 7286 (Section 166 of the FAIR Act of 1996 as amended) and 7 CFR 1427.22<sup>369</sup> to the extent that these provisions relate to upland cotton.

(ii) *User marketing (Step 2) provisions*

- Section 1207(a) of the FSRI Act of 2002<sup>370</sup> and 7 CFR 1427.103, 7 CFR 1427.104(a)(1) and (2), 7 CFR 1427.105(a) and 7 CFR 1427.108(d).<sup>371</sup>

(iii) *Direct payments provisions*

- Section 1103(a)-(d)(1) of the FSRI Act of 2002<sup>372</sup> and 7 CFR 1412.502.<sup>373</sup>

(iv) *Counter-cyclical payments provisions*

- Section 1104(a)-(f)(1) of the FSRI Act of 2002<sup>374</sup> and 7 CFR 1412.503.<sup>375</sup>

(v) *Crop insurance provisions*

- Sections 508(a)(8), 508(b)(1), 508(b)(2)(A)(ii), 508(b)(3), 508(e) and 508(k) and 516 of "the ARP Act of 2000".<sup>376</sup>

(vi) *Export credit guarantee provisions*

- 7 USC 5622,<sup>377</sup> in particular, 7 USC 5622(a)(1) and (b), and 7 CFR 1493<sup>378</sup> which established and maintain the GSM 102, GSM 103 and SCGP programmes.

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<sup>366</sup> Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 1.

<sup>367</sup> See Brazil's response to Panel Question No. 19.

<sup>368</sup> The provisions of the FSRI Act of 2002 are reproduced in Exhibits BRA-29 and US-1.

<sup>369</sup> 7 CFR 1427.1-1427.25 (1 January 2003 edition) are reproduced in Exhibit BRA-36.

<sup>370</sup> Section 1207(a) of the FSRI Act of 2002 is reproduced in Exhibits BRA-29 and US-1.

<sup>371</sup> 7 CFR 1427.100-1427.108 (1 January 2003 edition) are reproduced in Exhibit BRA-37.

<sup>372</sup> Section 1103 of the FSRI Act of 2002 is reproduced in Exhibits BRA-29 and US-1.

<sup>373</sup> 7 CFR 1412 is reproduced in Exhibit BRA-35.

<sup>374</sup> Section 1103 of the FSRI Act of 2002 is reproduced in Exhibits BRA-29 and US-1.

<sup>375</sup> 7 CFR 1412 is reproduced in Exhibit BRA-35.

<sup>376</sup> The ARP Act of 2000 amended the *Federal Crop Insurance Act* which is reproduced in Exhibit BRA-30 as amended through Public Law 107-136, 24 January 2002. See Brazil's first written submission, footnotes 178 and 184.

<sup>377</sup> 7 USC 5622 is reproduced in Exhibit BRA-141.

<sup>378</sup> 7 CFR 1493 is reproduced in Exhibit BRA-38.

(vii) *ETI Act of 2000*

- ETI Act of 2000, in particular, Section 3, which Brazil asserts inserted new Sections 114, 941, 942 and 943 in the United States Internal Revenue Code.

### 3. Claims

7.251 **Brazil** claims that the measures at issue are inconsistent with the obligations of the United States under the following provisions:

- the export subsidy provisions of Articles 3.3, 8, 9.1 and 10.1 of the *Agreement on Agriculture*;
- the prohibited subsidies provisions of Articles 3.1(a) and (b) and 3.2 of the *SCM Agreement*;
- the actionable subsidies provisions of Articles 5(c) and 6.3(c) and (d) of the *SCM Agreement*;
- the subsidies provisions of paragraphs 1 and 3 of Article XVI of the *GATT 1994*; and
- the national treatment provision of Article III:4 of the *GATT 1994*.

7.252 Brazil submits that the domestic support measures and alleged export subsidies at issue are not exempt from actions based on Article 13(b)(ii) and 13(c)(ii), respectively, of the *Agreement on Agriculture*.

7.253 Brazil also claimed in its request for establishment of a panel that the measures were inconsistent with the obligations of the United States under the domestic support provisions of Article 7.1 of the *Agreement on Agriculture*; and with the obligations of the United States under the actionable subsidies provisions of Articles 5(a) and 6.3(b) of the *SCM Agreement*. Brazil did not pursue these claims in its submissions and the United States did not respond to them. The Panel considers these claims abandoned and makes no other findings in relation to them.

### 4. Order of analysis

7.254 The claims in this dispute are made under the *SCM Agreement*, the *Agreement on Agriculture* and the *GATT 1994*. The *SCM Agreement* prohibits certain subsidies and creates obligations with respect to so-called "actionable subsidies".<sup>379</sup> The *Agreement on Agriculture* contains domestic support and export subsidy disciplines for certain products at issue in this dispute. Article XVI of the *GATT 1994* also contains obligations with respect to subsidies, and Article III:4 of the *GATT 1994* contains obligations with respect to laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution and use of imported products.

7.255 An appropriate order of analysis of the claims requires careful consideration due to the interlocking nature of the *SCM Agreement* and the *Agreement on Agriculture*, the relationship between the *SCM Agreement* and Article XVI of the *GATT 1994*, and the relationship between the *SCM Agreement* and the *Agreement on Agriculture*, and Article III:4 of the *GATT 1994*. The respective texts of the covered agreements expressly provide for a general order of precedence among them. The general interpretative note to Annex 1A of the *WTO Agreement* provides that:

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<sup>379</sup> Article 1.2 of the *SCM Agreement*.

"In the event of conflict between a provision of the General Agreement on Tariffs and Trade 1994 and a provision of another agreement in Annex 1A to the Agreement Establishing the World Trade Organization (referred to in the agreements in Annex 1A as the "WTO Agreement"), the provision of the other agreement shall prevail to the extent of the conflict."

7.256 This note only applies "[i]n the event of conflict". It does not exclude the *GATT 1994* from the scope of application of the agreements set out in Annex 1A, including the *SCM Agreement* and the *Agreement on Agriculture*, in any other circumstances. Similarly, Article 21.1 of the *Agreement on Agriculture* provides that:

"1. The provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement."

7.257 This paragraph expressly provides for the application of the *GATT 1994* and the *SCM Agreement*. It does not exclude their application, although it indicates that the *Agreement on Agriculture* takes precedence.

7.258 The specific provisions of the covered agreements raised in the claims contain consistent references to each other. With respect to prohibited subsidies, Article 3 of the *SCM Agreement* provides that certain subsidies are prohibited "[e]xcept as provided in the Agreement on Agriculture".

7.259 With respect to actionable subsidies, Articles 5 and 6.9 of the *SCM Agreement* both provide as follows:

"This Article does not apply to subsidies maintained on agricultural products as provided in Article 13 of the Agreement on Agriculture."

Article 7.1 of the *SCM Agreement* also begins with the phrase "[e]xcept as provided in Article 13 of the Agreement on Agriculture".

7.260 Article 13 of the *Agreement on Agriculture* applies, during the implementation period, "notwithstanding the provisions of GATT 1994 and the Agreement on Subsidies and Countervailing Measures". In the Panel's view, this refers to the provisions of Articles II and XVI of the *GATT 1994* and Parts II, III and V of the *SCM Agreement* that are specifically listed in the subparagraphs of Article 13.<sup>380</sup> It provides, *inter alia*, that domestic support measures and export subsidies for agricultural products that fulfil certain conditions shall be "exempt from actions" based on various provisions of Article XVI of the *GATT 1994* and the *SCM Agreement*<sup>381</sup>, and based on non-violation nullification or impairment of the benefits accruing from tariff concessions, and it also limits their exposure to countervailing duties.<sup>382</sup> Most of the conditions are set out in the three paragraph chapeaux of Article 13 and cross-reference compliance with particular substantive provisions of the *Agreement on Agriculture* and commitments in Part IV of each Member's Schedule, although there is an additional condition in subparagraphs (b)(ii) and (b)(iii) that is not an obligation.

7.261 This web of cross-references discloses a scheme according to which an analysis of the same measures under the *Agreement on Agriculture*, the *SCM Agreement* and Article XVI of the *GATT 1994* concerning export subsidies for agricultural products and, at least during the implementation

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<sup>380</sup> For the reasons given in paragraphs 7.315 to 7.319, the Panel does not consider that it also refers to Articles XXII and XXIII of the *GATT 1994*, as elaborated and applied by the DSU.

<sup>381</sup> Subparagraphs (a)(ii), (a)(iii), (b)(i), (b)(ii), (b)(iii) and (c)(ii) of Article 13.

<sup>382</sup> An additional cross-reference is found in Article 10 of the *SCM Agreement* which subjects countervailing duties investigations to the provisions of both the *SCM Agreement* and the *Agreement on Agriculture*.

period for the purposes of Article 13, allegedly actionable subsidies for agricultural products, should be examined first under the *Agreement on Agriculture*. The implementation period for the purposes of Article 13 had not yet expired on the date of establishment of the Panel.<sup>383</sup> Therefore, the Panel will follow this order of analysis with respect to the alleged export subsidies and actionable subsidies in issue.<sup>384</sup>

7.262 The Panel's approach is consistent with the following statement of the Appellate Body in *Canada – Dairy (Article 21.5 – New Zealand and US)*, which specifically addressed the order of analysis of the WTO-consistency of an export subsidy for agricultural products:

"The relationship between the *Agreement on Agriculture* and the *SCM Agreement* is defined, in part, by Article 3.1 of the *SCM Agreement*, which states that certain subsidies are "prohibited" "[e]xcept as provided in the *Agreement on Agriculture*". This clause, therefore, indicates that the WTO-consistency of an export subsidy for agricultural products has to be examined, in the first place, under the *Agreement on Agriculture*."<sup>385</sup>

7.263 The Panel takes note that a previous panel and the Appellate Body did not follow this order of analysis in *US – FSC*, a dispute which did not primarily concern agricultural products.<sup>386</sup> Instead, that panel and the Appellate Body first examined the consistency of export subsidies with Article 3.1(a) of the *SCM Agreement*, and then proceeded to examine the consistency of subsidies under the same provisions for agricultural products with Article 3.3 and Part V of the *Agreement on Agriculture*. Nevertheless, for the reasons given above, the Panel chooses to follow the order of analysis explained in *Canada – Dairy (Article 21.5 – New Zealand and US)*.

7.264 The Panel's order of analysis does not preclude it from looking to the *SCM Agreement* for contextual guidance in its interpretation of the *Agreement on Agriculture*, for example, with respect to the meaning of the terms "subsidy" and "export subsidies".

## 5. Burden of proof

### (a) Main arguments of the parties

7.265 **Brazil** requests that the Panel make a finding that Article 13 of the *Agreement on Agriculture* is in the nature of an affirmative defence. It submits that in light of the relevant WTO jurisprudence on the burden of proof, Article 13 of the *Agreement on Agriculture* is in the nature of an affirmative defence and, as such, the United States bears the burden of proving that its measures are in conformity with Article 13 for the following reasons: (1) Article 13 does not alter the scope of other provisions providing positive obligations for Members; (2) Article 13 provides no positive obligations in itself; and (3) Article 13 does not alter the legal nature of Members' measures, but simply allows Members to maintain those measures exempt from actions if they comply with the conditions that it sets out.<sup>387</sup>

7.266 The **United States** argues that Article 13 forms part of the balance of rights and obligations of Members and is not an affirmative defence but a threshold procedural hurdle that Brazil must overcome. The United States claims that the use of the word "notwithstanding" in the introductory paragraph of Article 13 means that conforming measures are exempt from action "in spite of and without regard to or prevention by" the obligations contained in the *GATT 1994* or the *SCM*

<sup>383</sup> For the reasons given in paragraphs 7.340 to 7.345.

<sup>384</sup> It does not affect the Panel's examination of measures under Article 3.1(b) of the *SCM Agreement*, for the reasons given in Section VII:F of this report.

<sup>385</sup> Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 123.

<sup>386</sup> Appellate Body Report, *US – FSC*, sections V, VI and IX, applied in its Report in *US – FSC (Article 21.5 – EC)*, paras. 187-196.

<sup>387</sup> Brazil's first written submission, para. 117.

*Agreement*. The United States argues that Article 21.1 of the *Agreement on Agriculture* further clarifies that the obligations under the *SCM Agreement* and the *GATT 1994* only apply "subject to" the provisions of the *Agreement on Agriculture*, including Article 13.<sup>388</sup> The United States submits that the burden is on Brazil to show that the conditions exist that would allow it to bring its action, that is, that the United States measures do not conform to Article 13.<sup>389</sup> It also asserts that Brazil's approach would produce bizarre results.<sup>390</sup>

(b) Main arguments of the third parties

7.267 **Argentina**<sup>391</sup>, **Australia**<sup>392</sup>, **Benin**<sup>393</sup>, **China**<sup>394</sup> and **India**<sup>395</sup> agree with Brazil that Article 13 is in the nature of an affirmative defence and that the United States bears the burden of proving that the measures at issue fully conform with the applicable conditions of Article 13 of the *Agreement on Agriculture*.

7.268 The **European Communities** agrees with the United States that Article 13 is not an affirmative defence and that Brazil bears the burden of proving that the measures at issue are not in conformity with the conditions set out in Article 13.<sup>396</sup>

7.269 **Chinese Taipei** submits that it is inappropriate to label Article 13 as an "affirmative defence" or "exception" purely in order to determine which of the two parties bears the burden of proof. Article 13 contains a right to exemption from actions conditional upon conformity with a positive obligation of full conformity with the *Agreement on Agriculture*. It is for Brazil to prove a breach of this positive obligation by demonstrating non-conformity.<sup>397</sup>

(c) Evaluation by the Panel

7.270 The Panel will apply the usual rule regarding the burden of proof in WTO proceedings, unless the text of the covered agreements indicates otherwise. Accordingly, the initial burden of proof rests upon the party, whether complaining or defending, who asserts the affirmative of a particular claim or defence. If that party adduces evidence sufficient to raise a presumption that what it asserts is correct, the burden then shifts to the other party, who will fail unless it adduces sufficient evidence to rebut that presumption.<sup>398</sup> In the Panel's view, asserting the affirmative of a claim requires the complainant first to show that a measure falls within the *scope* of a positive obligation, that is, that the obligation is applicable to the measure, and then to show that the measure is inconsistent with that obligation.<sup>399</sup>

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<sup>388</sup> United States' first written submission, paras. 38-39.

<sup>389</sup> United States' first written submission, para. 41.

<sup>390</sup> The United States provides an example of this with respect to Article 6 of the *Agreement on Agriculture*. According to the United States, Brazil would bear the burden of proof if it only claimed a violation under Article 6, which it emphasizes is also a requirement found in Article 13. Consequently, the United States submits that there is no basis for concluding that the burden of proving a violation of Article 6 would be reversed merely because a Member were to claim a violation of one of the provision of the *SCM Agreement* found in Article 13 in addition to Article 6. See the United States first written submission, para. 44.

<sup>391</sup> Argentina's written submission to the first session of the first substantive meeting, paras. 43-46.

<sup>392</sup> Australia's written submission to the first session of the first substantive meeting, paras. 5-15.

<sup>393</sup> Benin's written submission to the first session of the first substantive meeting, paras. 21-36.

<sup>394</sup> China's written submission to the first session of the first substantive meeting, paras. 3-9.

<sup>395</sup> India's oral statement at the first session of the first substantive meeting, para. 8.

<sup>396</sup> European Communities' written submission to the first session of the first substantive meeting, paras. 8-14.

<sup>397</sup> Chinese Taipei's written submission to the first session of the first substantive meeting, para. 8.

<sup>398</sup> See Appellate Body Report, *US – Wool Shirts and Blouses*, p. 14, quoted in Brazil's first written submission at para. 111.

<sup>399</sup> This was the approach of the Appellate Body in *Brazil – Aircraft*, paras. 139-141 and *US – FSC (Article 21.5 – EC)*, para. 128, and recalled in *EC – Tariff Preferences*, para. 88.

7.271 This situation is to be contrasted with at least one other example. As regards agricultural export subsidies, the text of Article 10.3 of the *Agreement on Agriculture* articulates a special rule that alters the usual rule on burden of proof in certain disputes under Articles 3, 8, 9, and 10 of the *Agreement on Agriculture*.<sup>400</sup>

7.272 We recall that, pursuant to Article 3 of the *Agreement on Agriculture*, a Member is entitled to grant export subsidies within the limits of the reduction commitment specified in its Schedule. Where a Member claims that another Member has acted inconsistently with Article 3.3 of the *Agreement on Agriculture* by granting export subsidies in excess of a quantity commitment level, there are two separate parts to the claim. First, the responding Member must have exported an agricultural product in quantities exceeding its quantity commitment level. If the quantities exported do not reach the quantity commitment level, there can be no violation of that commitment, under Article 3.3. However, merely exporting a product in quantities that exceed the quantity commitment level is not inconsistent with the commitment. The commitment is an undertaking to limit the quantity of exports that may be *subsidized* and not a commitment to restrict the volume or quantity of exports *as such*. The second part of the claim is, therefore, that the responding Member must have granted export subsidies with respect to quantities exceeding the quantity commitment level. There is, in other words, a *quantitative* aspect and an *export subsidization* aspect to the claim.

7.273 Article 10.3 of the *Agreement on Agriculture* allocates to different parties the burden of proof with respect to the two parts of such a claim. Where a Member exports an agricultural product in quantities that exceed its quantity commitment level, that Member will be treated as if it has granted WTO-inconsistent export subsidies, for the excess quantities, unless the Member presents adequate evidence to "establish" the contrary. This reversal of the usual rule obliges the responding Member to bear the consequences of any doubts concerning the evidence of export subsidization. With respect to the export subsidization part of the claim, the complaining Member, therefore, is relieved of its burden, under the usual rule, to establish a prima facie case of export subsidization of the excess quantity, provided that this Member has established the quantitative part of the claim.<sup>401</sup>

7.274 Turning to Article 13 of the *Agreement on Agriculture*, we note that its text does not contain any special rule on the burden of proof. Therefore, the usual rule applies. Article 13 contains positive obligations only to show due restraint in initiating countervailing duties investigations; these are not relevant in this dispute.<sup>402</sup> Otherwise, it sets out conditions according to which certain domestic support measures and export subsidies for agricultural products benefit from certain protection, including in relation to Article XVI of the *GATT 1994* and the *SCM Agreement*. Measures that do not satisfy those conditions are not necessarily inconsistent with Article XVI of the *GATT 1994* or the *SCM Agreement*. Members have a choice throughout the implementation period whether or not to satisfy the additional condition set forth in Article 13(b)(ii) and (iii) and benefit from the protection that it provides, or whether to comply with the obligations in Article XVI of the *GATT 1994* and the *SCM Agreement*, or both. The additional condition is not an obligation. Although the other

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<sup>400</sup> Article 10.3 provides:

"Any Member which claims that any quantity exported in excess of a reduction commitment level is not subsidized must establish that no export subsidy, whether listed in Article 9 or not, has been granted in respect of the quantity of exports in question."

We find support for our approach in the Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, paras. 69-71, 73-75. Contrary to the United States' assertion, in its further rebuttal submission at para. 191, we do not believe that our observation (in our 20 June 2003 communication, set out in Annex L) that no provisions of the *Agreement on Agriculture* are identified as special or additional rules and procedures in Appendix 2 to the *DSU*, is at variance with our articulation and application of this burden of proof, which flows from the text of Article 10.3 itself and related provisions.

<sup>401</sup> See Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, paras. 70-75.

<sup>402</sup> Subparagraphs (b)(i) and (c)(i) of Article 13.

conditions in Article 13 of the *Agreement on Agriculture* stipulate compliance with other provisions of that agreement, many of which set out positive obligations, they are only obligations for the purposes of claims under those other provisions of the *Agreement on Agriculture*. They do not arise as positive obligations under Article 13.

7.275 The obligation with respect to actionable subsidies is found in Articles 5 and 6 of the *SCM Agreement*, both of which provide, in identical terms, that:

"This Article does not apply to subsidies maintained on agricultural products as provided in Article 13 of the *Agreement on Agriculture*."<sup>403</sup>

7.276 This language shows that, during the implementation period for the purposes of Article 13, the obligation regarding actionable subsidies simply does not apply to subsidies for agricultural products that satisfy the conditions set forth in Article 13 of the *Agreement on Agriculture*. The obligation is not applicable and, hence, such subsidies are not actionable subsidies. Satisfaction of the conditions in Article 13 is therefore a question of the scope of the obligation and the initial burden is on the complainant to adduce evidence sufficient to raise a presumption that domestic support measures do not satisfy those conditions.

7.277 The obligations with respect to prohibited subsidies are found in Part II of the *SCM Agreement*. Article 3.1 provides that certain subsidies are prohibited "[e]xcept as provided in the *Agreement on Agriculture*". In the Panel's view, the mere use of the word "except" does not indicate that subsidies covered by this introductory phrase (i.e. export subsidies provided for in the *Agreement on Agriculture*) necessarily fall within the scope of the basic obligation in Article 3.1 of the *SCM Agreement* because, read in context, the introductory phrase of Article 3.1 forms part of the scheme referred to above in paragraph 7.261. The introductory phrase refers to the *Agreement on Agriculture* as a whole which includes Article 13(c). The parallel structure of paragraphs (b) and (c) of Article 13 indicates that the drafters intended them to operate in the same way. Accordingly, given that the conditions in Article 13(b) clearly affect the scope of obligations in Part III (Articles 5 and 6) of the *SCM Agreement*, it appears to us that those in Article 13(c) are also intended to affect the scope of relevant obligations in Article 3.1 of the *SCM Agreement*.

7.278 The Panel notes that the wording of the reference to the *Agreement on Agriculture* found in Article 3.1 of the *SCM Agreement* differs from those found in Articles 5 and 6.9. However, this difference appears to be due to the fact that both agreements contain export subsidy disciplines, but only the *SCM Agreement* contains actionable subsidies obligations.

7.279 The Panel also notes that Article 13 uses the words "notwithstanding" and "exempt". The ordinary meaning of "notwithstanding" is "in spite of, without regard to or prevention by".<sup>404</sup> The ordinary meaning of exempt is "[n]ot exposed or subject to something unpleasant or inconvenient; not liable to a charge, tax, etc. (Foll. by *from*)"<sup>405</sup> The mere use of these words does not indicate whether the measures provided for in that article fall within or without the scope of the relevant obligations in the listed provisions, any more than merely characterizing a provision as an exception.<sup>406</sup> Read in context, these words do not indicate that domestic support measures provided for in paragraph (b) fall within the scope of the obligations in Articles 5 and 6 of the *SCM Agreement* in light of the clear wording of the last sentence of Article 5 and Article 6.9. Therefore, there is no basis to conclude that

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<sup>403</sup> Article 5, last sentence, and Article 6.9 of the *SCM Agreement*.

<sup>404</sup> *The New Shorter Oxford English Dictionary*, (1993). This definition was also quoted by the Appellate Body in *EC – Tariff Preferences* at para. 90, in its interpretation of the Enabling Clause.

<sup>405</sup> *The New Shorter Oxford English Dictionary*, (1993). The meaning of "exempt" in the phrase "exempt from actions" is discussed in greater detail below.

<sup>406</sup> See the Appellate Body Reports in *EC – Hormones*, para. 104, and *EC – Sardines*, para. 275, which commented on this issue.

the use of those words indicates that export subsidies provided for in paragraph (c) fall within the scope of the obligations in Article 3.1 of the *SCM Agreement* either.

7.280 The position under Article XVI of the *GATT 1994* is no different. If the obligations found in Article XVI dealing with "Subsidies in General" (Part A - Article XVI:1) and "Export Subsidies" (Part B - Articles XVI:2-5) are now subsumed within, or elaborated and applied by, the *SCM Agreement* and the *Agreement on Agriculture*, and no longer have independent application, the limitation on the scope of the prohibited and actionable subsidies obligations in the *SCM Agreement* applies to the interpretation of Article XVI as well. Alternatively, if Article XVI continues to have independent application, the scope of such application during the implementation period is defined by the texts of Article XVI itself, the *SCM Agreement*, and the *Agriculture Agreement*, including the terms of Article 13 of the *Agreement on Agriculture*.<sup>407</sup>

7.281 This interpretation is supported by the content of Article 13 of the *Agreement on Agriculture*. The principal conditions that it sets forth are simply conformity with Article 6 and Part V of that same agreement. There is no dispute that a complainant bears the burden of proving claims of violation of domestic support commitments under Article 6 or violation or circumvention of export competition commitments under Part V (subject to the special provision in Article 10.3) irrespective of the Panel's order of analysis. In the Panel's view, the insertion of Article 13 was not intended to require a panel confronted with claims of serious prejudice as well as violations of the *Agreement on Agriculture* to assess twice the conformity of measures with Article 6 and Part V, allocating the burden of proof once to the complainant and once to the respondent according to whether it was assessing conformity for the purposes of the *Agreement on Agriculture* or the *SCM Agreement* and Article XVI of the *GATT 1994*. Rather, as part of a scheme, it was intended to ensure that if a complaint was ever filed during the implementation period, the Panel would first analyse the measures under the *Agreement on Agriculture*. If the measures satisfied the conditions set forth in Article 13, the Panel would not proceed to find any inconsistency with the *SCM Agreement* or Article XVI of the *GATT 1994*, as referred to in Article 13 of the *Agreement on Agriculture*.

7.282 The Panel notes that Brazil cites the Appellate Body report in *US – FSC (Article 21.5 - EC)*. In that case, the Appellate Body interpreted the fifth sentence of footnote 59 of the *SCM Agreement* as an affirmative defence because it did not alter the scope of an obligation and was therefore an exception.<sup>408</sup> This is precisely the approach that the Panel has adopted in its interpretation of Article 13 of the *Agreement on Agriculture*. Articles 3.1, 5 and 6.9 of the *SCM Agreement* do alter the scope of the prohibited and actionable subsidies obligations by reference to the conditions in Article 13. Consequently, neither those conditions nor Article 13 are an affirmative defence.

7.283 Similarly, Brazil cites the Appellate Body report in *Brazil – Aircraft*. In that case, the Appellate Body considered the provisions of Articles 3.1(a), 27.2(b) and 27.4 of the *SCM Agreement*. It upheld the Panel's finding that certain provisions in Article 27.4 were "positive obligations" and not an affirmative defence, because if a developing country Member complied with them during a transitional period, the export subsidy prohibition in Article 3.1(a) simply did not apply.<sup>409</sup> Whilst we do not consider that the conditions in Article 13 of the *Agreement on Agriculture* are positive obligations as such for the purposes of the claims pursued in this dispute, they do partly define the scope of positive obligations. If domestic support measures and export subsidies comply with these conditions during the implementation period, the obligations in Articles 3.1(a), 5 and 6 of the *SCM Agreement* simply do not apply. Therefore, in the Panel's view, those conditions as referred to in Article 13 are not an affirmative defence.

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<sup>407</sup> We refer to our findings on Article XVI:3 of the *GATT 1994* in Section VII:E and on Article XVI:1 of the *GATT 1994* in Section VII:G of this report.

<sup>408</sup> See the Appellate Body Report, *US – FSC (Article 21.5 – EC)*, paras. 131 and 132.

<sup>409</sup> See the Appellate Body Report, *Brazil – Aircraft*, paras. 134 – 141.

7.284 Article 13 of the *Agreement on Agriculture* was drafted later than the basic obligations in Parts II and III of the *SCM Agreement*, which may contribute to a perception that it should also be analysed later and is somehow an affirmative defence. However, this is a matter of drafting chronology. The results of the Uruguay Round are a single undertaking simultaneously agreed in the Final Act, and the order in which a Panel should analyse them and allocate the burden of proof is dictated by a proper interpretation of the texts of the covered agreements and not by the order in which they were negotiated.

7.285 For these reasons, the Panel declines to make a finding that Article 13 is in the nature of an affirmative defence. Rather, the Panel finds that the conditions in Article 13, for a limited time, partly define the scope of the obligations in Article XVI of the *GATT 1994* and Articles 3, 5 and 6 of the *SCM Agreement*, among other things. According to the usual rule regarding the burden of proof, the complainant, Brazil, bears the initial burden to show that the measures at issue fall within the scope of the obligations with which it alleges that the measures are inconsistent. That includes the burden to show that they do not satisfy the conditions in Article 13 of the *Agreement on Agriculture*.

7.286 In the present dispute, the Panel is of the view that Brazil has succeeded in discharging the burden to show that certain measures at issue do not satisfy the conditions in Article 13<sup>410</sup>, for the reasons given in Sections VII:D and E of this report.

## 6. "Exempt from actions"

### (a) Main arguments of the parties

7.287 Immediately following the composition of the Panel, the United States submitted a letter dated 21 May 2003 in which it asserted that Brazil may not maintain its action based on its claims of adverse effects and serious prejudice under the *SCM Agreement* and Article XVI of the *GATT 1994* unless the Panel had found that United States support measures for upland cotton do not conform to Article 13 of the *Agreement on Agriculture*. Brazil replied in a letter dated 23 May 2003 in which it disagreed.<sup>411</sup>

7.288 The **United States** requested the Panel to organize its procedures to determine first whether Brazil was permitted to maintain any actions based on the provisions exempted by Article 13 of the *Agreement on Agriculture*. If the Panel allowed Brazil to proceed with its substantive claims under the *SCM Agreement* and the *GATT 1994*, and only concluded later that the measures at issue conformed to Article 13 of the *Agreement on Agriculture*, the measures at issue would already have been subject to actions based on those claims, which would contradict the ordinary meaning of "exempt from actions". It asserted that the normal rules of the *DSU* allow the Panel to first determine the conformity of United States measures with Article 13.<sup>412</sup>

7.289 **Brazil** asserted that the phrase "exempt from actions" means that a complainant cannot receive authorization from the DSB to obtain a remedy against another Member's measures that would otherwise be subject to the disciplines of certain provisions of the *SCM Agreement* and the *GATT 1994* if the measures comply with Article 13 of the *Agreement on Agriculture*. According to Brazil, a WTO panel is not a "court" where lawsuits are initiated by filing the appropriate papers. Rather, the word "action" means joint action by WTO Members. *DSU* panel proceedings only begin when Members take collective actions to establish a panel. Brazil argued that providing special proceedings

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<sup>410</sup> With the exception of the ETI Act of 2000 and export subsidies granted under it, for the reasons given in Section VII:E of this report.

<sup>411</sup> These letters are contained in Annex K to this report.

<sup>412</sup> See United States' initial brief, para. 3, and its comments on initial briefs, para. 5.

for determining compliance with Article 13 would effectively add Article 13 to the closed list of special and additional rules and procedures in Appendix 2 to the *DSU*.<sup>413</sup>

(b) Main arguments of the third parties

7.290 **Argentina**<sup>414</sup>, **Australia**<sup>415</sup>, **India**<sup>416</sup>, **New Zealand**<sup>417</sup> and **Paraguay**<sup>418</sup> generally agreed with Brazil that the Panel was not precluded from considering claims under the *SCM Agreement* and Article XVI of the *GATT 1994* until it first determined whether United States measures conformed with Article 13 of the *Agreement on Agriculture*.

7.291 The **European Communities** was of the view that the issue of whether a measure falls within Article 13 is a question which a panel must decide before it determines whether the measure potentially violates provisions of the *SCM Agreement* and the *GATT 1994*, but this does not imply that a panel is precluded from hearing evidence and arguments relating to provisions of the *SCM Agreement* and the *GATT 1994* until after it has decided on the applicability of Article 13 of the *Agreement on Agriculture*.<sup>419</sup>

(c) Evaluation by the Panel

7.292 The Panel is satisfied that it had authority to deal with the claims raised under the *SCM Agreement* and Article XVI of the *GATT 1994*.<sup>420</sup> It communicated to the parties on 20 June 2003 its views that it was not required to defer any examination of certain of Brazil's claims based on Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* until after making a ruling or expressing views on the issue of fulfilment of the conditions in Article 13 of the *Agreement on Agriculture*.<sup>421</sup> The Panel concluded at that time that there is no special dispute settlement requirement foreseen in the covered agreements in respect of a panel's consideration of the fulfilment of Article 13 conditions. The issue of fulfilment of the conditions of Article 13 of the *Agreement on Agriculture* is to be resolved using generally applicable *DSU* rules and procedures. It was not necessary for the Panel to look for any further interpretive guidance on this issue.

7.293 Further, in accordance with the Panel's ordering of its procedures, after the parties and third parties presented evidence and submissions focused on the conditions in Article 13 of the *Agreement on Agriculture*, but before they presented evidence and submissions focused on the claims under the *SCM Agreement* and Article XVI of the *GATT 1994*, the Panel issued a communication to the parties and third parties which stated, *inter alia*, as follows:

"4. The Panel takes note of the correspondence from the parties dated 27, 28 and 29 August 2003 and declines to make findings at this stage as to whether measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*, for the reasons given in its communication dated 20 June 2003. The Panel's findings on that issue will be included in its interim report, on which the parties will have the right to comment in accordance with Article 15.2 of the *DSU*.

<sup>413</sup> See Brazil's initial brief, para. 9, and its comments on initial briefs, paras. 2-4 and 18-19.

<sup>414</sup> See Argentina's initial brief, para. 16.

<sup>415</sup> See Australia's initial brief, para. 8.

<sup>416</sup> See India's initial brief, para. 8.

<sup>417</sup> See New Zealand's initial brief, p. 2.

<sup>418</sup> See Paraguay's initial brief, p. 1.

<sup>419</sup> See the European Communities' initial brief, para. 7.

<sup>420</sup> A panel's duty to deal with such issues in order to satisfy itself that it has authority to proceed was discussed by the Appellate Body in *Mexico – Corn Syrup (21.5 – US)*, para. 36, *US – 1916 Act*, para. 54 and *US – Carbon Steel*, para. 123.

<sup>421</sup> The Panel's communication dated 20 June 2003 is set out in full in Section VII:A of this report.

5. The Panel has now had the opportunity to consider the parties' and third parties' evidence and arguments to date. At this stage, the Panel cannot conclude its assessment of the matter before it on the basis that the measures raised in this dispute satisfy the conditions in Article 13 of the *Agreement on Agriculture*. The expression by the Panel of this view is without prejudice to the Panel's eventual findings, and is subject to paragraph 6 below. In this context, the Panel is of the view that consideration, as appropriate, of Brazil's claims under Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994*, as those provisions are referred to in Article 13 of the *Agreement on Agriculture*, is warranted in order for the Panel properly to discharge its responsibilities under the *DSU* and the relevant covered agreements. Therefore, the Panel will consider those claims at a second session of the first substantive meeting."

7.294 The United States submits that:

"As a responding party cannot prevent panel establishment from occurring, it will inevitably be forced to argue to a panel that the panel's procedures should be structured so that the party's challenged measures are not subject, from that point on, to actions based on provisions specified in the Peace Clause. Thus, given the automaticity in *DSU* rules relating to consultations and panel establishment, the Panel's organization of its procedures provides the first opportunity to arrest Brazil's taking of 'legal steps to establish a claim' ..."<sup>422</sup>

7.295 In the Panel's view, this argument implies that there was an oversight in the *DSU* rules and procedures, as a result of which a panel must organize its procedures to enforce the conditions in Article 13 as a second-best option. However, the absence of any reference to any applicable special dispute settlement rule in Appendix 2 to the *DSU* indicates that a panel is under no obligation to organize its procedures in this way, but is only prevented from making a finding that measures that comply with the conditions set out in Article 13 of the *Agreement on Agriculture* are inconsistent with the relevant provisions that it lists.

7.296 The United States' argument would also seemingly require a Panel to make a definitive finding on Article 13 before it could go on. This could mean that a separate panel on Article 13 would be necessary every time, before a Member could bring any action based on the listed provisions of the *SCM Agreement*, or at least require a panel to conduct basically two consecutive panel proceedings from first submissions to interim or even final report, where measures did not satisfy the conditions set out in Article 13. Nowhere is such a procedure required in the *DSU* or the relevant special rules and procedures. Rather, Article 12.1 and 12.2 provide that:

1. Panels shall follow the Working Procedures in Appendix 3 unless the panel decides otherwise after consulting the parties to the dispute.

2. Panel procedures should provide sufficient flexibility so as to ensure high-quality panel reports, while not unduly delaying the panel process."

7.297 The United States requested a separate interim report devoted to Article 13 of the *Agreement on Agriculture*:

"In this dispute, the Panel's findings on the Peace Clause are presumably intended to be dispositive of substantive claims and arguments of the parties for the remainder of the panel proceedings. Because of the substantive nature of those findings, the Panel's findings on September 5 will need to provide the factual basis and basic

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<sup>422</sup> United States' comments on parties' initial briefs, para. 37.

rationale underlying the findings. Both parties have a significant interest in those findings, in terms not just of the ultimate conclusion reached, but also in terms of the factual findings, rationale underlying those findings, and an understanding of the scope of those findings. Accordingly, in keeping with Article 15.2 of the DSU, and in order to be fair to both parties, the United States respectfully requests that the Panel provide Brazil and the United States with the Panel's September 5 Peace Clause findings in an interim form and provide the parties an opportunity to comment on the Panel's findings. The United States suggests that, in keeping with the practice in other panel proceedings and this Panel's timetable for the interim review in this dispute, two weeks should be sufficient time to comment."<sup>423</sup>

7.298 The Panel's expression of views on 5 September 2004 was not "dispositive of substantive claims and arguments", on which the United States' request was premised. In any event, Article 15.2 of the *DSU* only envisages one interim report in respect of the entire matter before a panel. It appears to us that this is because multiple interim report procedures would unduly delay the panel process without benefiting the quality of the final panel report. We therefore rejected this suggestion.

7.299 The Panel also notes for the record that the United States submitted detailed argument on interpretation and fulfilment of the conditions in Article 13 of the *Agreement on Agriculture* after the Panel's communication to the parties of 5 September 2003.<sup>424</sup>

7.300 In the present case, the Panel has, in fact, organized its proceedings to phase examination of different issues. This was due to the potential complexity of the claims, the conditional nature of certain of these claims and the volume of evidence which we expected would be introduced by the parties in support of their claims and arguments, and in order to organize our proceedings in an orderly, effective and efficient manner. This served to facilitate an objective assessment of the matter before us, and optimized use of our resources. The order of our procedures was not due to lack of jurisdiction or authority to hear all claims at once.

7.301 The conditionality of Article 13 was therefore one of the Panel's prime considerations. In that context, we now set out our views on the meaning and implications of the phrase "exempt from actions" as it is used in Article 13.

7.302 **Brazil** submits that the word "actions" refers to "multilateral actions taken collectively by Members" and that therefore:

"The phrase 'exempt from actions' in Article 13 means that if all the conditions of Article 13(b)(ii) and 13(c)(ii) are fulfilled ... a complaining Member cannot receive authorization from the DSB to obtain a remedy against another Member's domestic and export support measures that otherwise would be subject to the disciplines of certain provisions of the *SCM Agreement* or Article XVI of GATT 1994."<sup>425</sup>

7.303 The **United States** argues that the phrase "exempt from actions" means "not exposed or subject to" a "legal process or suit" or the "taking of the legal steps to establish a claim" such as a formal complaint or any formal proceedings, including an adjudication of the claim. It requests that the Panel find that measures that conform to Article 13 are exempt from any action, including

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<sup>423</sup> Letter from the United States to the Panel dated 27 August 2003.

<sup>424</sup> See United States' 28 January 2004 comments on Brazil's response to Panel Question No. 258, its 11 February 2004 comments, its 3 March 2004 comments and its 15 March 2004 comments, concerning the interpretation of Article 13(b)(ii). The Panel takes note that para. 1 of the 3 March 2004 comments stated that it was odd to "advance new arguments concerning the applicability of the peace clause at this late stage in the proceedings, long after the time when the peace clause portion of the dispute was supposed to have been concluded."

<sup>425</sup> Brazil's initial brief, para. 2.

consultations and panel proceedings, based on the listed provisions of the *SCM Agreement* and Article XVI of the *GATT 1994*.<sup>426</sup>

7.304 The Panel disagrees with Brazil's interpretation of the word "actions" because it does not take account of the fact that individual Members can take certain actions based on the relevant provisions of Article XVI of the *GATT 1994* and the *SCM Agreement*, including requests for consultations and establishment of a panel, prior to a multilateral finding that the conditions of Article 13 are fulfilled. It is based on specific uses of the word "action" in the English and French versions of the *DSU*, without taking account of other uses of that word in those versions of the *DSU* which refer to an action by an individual Member.<sup>427</sup>

7.305 Further, "multilateral actions taken collectively by Members" include decisions by the DSB to establish panels, which are taken prior to any Panel assessment as to whether the conditions in Article 13 are fulfilled, and from which certain disputes could only be exempted with the consent of all Members in the DSB, including the complainant party. They also include decisions by the DSB to adopt reports in which panels conclude that certain measures are *not* inconsistent with the conditions in Article 13 of the *Agreement on Agriculture*, from which there is no exemption.

7.306 The Panel agrees with the United States' definition of the words "exempt from actions" but not with the conclusions that the United States requested the Panel to arrive at as a result of that definition. The Panel does not consider that the *possibility* earlier in the dispute that the measures at issue were "exempt from actions" by virtue of Article 13 of the *Agreement on Agriculture* has affected its authority to examine the claims raised under the *SCM Agreement* and Article XVI of the *GATT 1994* in these proceedings in accordance with its discretion to organize its own procedures.

7.307 Turning to the meaning of the phrase "exempt from actions", the adjective "exempt" can be defined as follows:

"Not exposed or subject to something unpleasant or inconvenient; not liable to a charge, tax, etc. (Foll. by *from*)"<sup>428</sup>

7.308 The English and French versions of the text of Article 13(b)(ii) and (iii) use the word "actions". There are various definitions of the word "action", including the generic senses of:

"The process or condition of acting or doing; the exertion of energy or influence; working, agency, operation; ... A thing done, a deed, an act";

and the more specific judicial senses of:

"1. The taking of legal steps to establish a claim or obtain remedy; the right to institute a legal process. b A legal process or suit".<sup>429</sup>

7.309 Article 13 uses the word in a judicial sense, because it qualifies the "actions" as those based on listed treaty provisions<sup>430</sup> and non-violation nullification or impairment of the benefits of tariff

<sup>426</sup> See United States' initial brief, paras. 2 and 12, and its comments on initial briefs, para. 5.

<sup>427</sup> See Brazil's comments on initial briefs, para. 15. See Articles 3.7, 3.8 and 4.5 of the *DSU*.

<sup>428</sup> *The New Shorter Oxford English Dictionary*, (1993).

<sup>429</sup> *The New Shorter Oxford English Dictionary*, (1993). See also the definition of "proceeding" in Article 17.10 of the *DSU* discussed by the Appellate Body in *Brazil – Aircraft*: "In a general sense, the form and manner of conducting juridical business before a court or judicial officer. Regular and orderly progress in form of law, including all possible steps in an action from its commencement to the execution of judgment." See Appellate Body Report, *Brazil – Aircraft*, para. 121.

<sup>430</sup> Various Article XVI of *GATT 1994*, paragraph 1 of Article XVI of *GATT 1994*, Part III of the *SCM Agreement*, Articles 5 and 6 of the *SCM Agreement* and Articles 3, 5 and 6 of the *SCM Agreement*.

concessions accruing to another Member under Article II of the *GATT 1994*, in the sense of paragraph 1(b) of Article XXIII of the *GATT 1994*, which is itself a "right to institute a legal process" (collectively referred to below as the "listed provisions"). The only difference between the two possible judicial senses is that the sum of the "legal steps" to establish a particular claim or obtain a particular remedy in a given case is "a legal process or suit", and both can be called an "action" in English or French.

7.310 The Spanish version of the text uses the word "*medidas*". This word is used in many places in the covered agreements where the English version uses the word "measures" and the French version uses the word "*mesures*". It refers to dispositions taken by a Member which, in the context of Article 13(b)(ii), are the legal steps to establish a particular claim or obtain a particular remedy. There seems to be no practical difference in this sense between the legal steps to establish a particular claim or obtain a particular remedy, in the plural, and a lawsuit.<sup>431</sup>

7.311 Accordingly, the ordinary meaning of the phrase "exempt from actions" is "not exposed or subject to the taking of steps to establish claims or obtain remedies" based on the listed provisions. However, the ordinary meaning of the terms used in the text must be read in context and in the light of the agreement's object and purpose.<sup>432</sup>

7.312 The context within Article 13 itself shows that the drafters did not use the term "exempt from actions" in every subparagraph of Article 13, notably, in subparagraph (a)(i), which uses the term "non-actionable subsidies". Yet all subparagraphs of Article 13 share the same purpose of setting out protection for certain agricultural measures from particular consequences outside the *Agreement on Agriculture*, which are generally actions of various kinds. The range of actions differs in each subparagraph of Article 13. The actions to which the term "non-actionable subsidies" normally applied were limited to those based on Parts III and V of the *SCM Agreement*<sup>433</sup>, and subparagraph (a)(i) limits their scope even further to countervailing duties (i.e. Part V of the *SCM Agreement*). In contrast, the phrase "exempt from actions" itself is not limited to any particular actions. Subparagraphs (a)(ii), (a)(iii), (b)(ii), (b)(iii) and (c)(ii) apply it to provisions beyond those based on Parts III and V of the *SCM Agreement* to which the term "non-actionable subsidies" cannot apply. In these subparagraphs, the relevant actions include those based on provisions in Part III of the *SCM Agreement*, but also variously non-violation nullification or impairment of the benefits of tariff concessions, actions based on paragraphs of Article XVI of the *GATT 1994* and actions based on Article 3 of the *SCM Agreement* as well. This may explain why the different terms "non-actionable subsidies" and "exempt from actions" are used.

7.313 The class of "non-actionable subsidies", which were not exposed to certain types of actions, was governed by Part IV of the *SCM Agreement*, comprising Articles 8 and 9 of the *SCM Agreement*. These have now lapsed.<sup>434</sup> Part IV did not exclude any measures from multilateral evaluation but in fact provided a multilateral procedure to evaluate the consistency of a programme with the conditions and criteria to be considered non-actionable.<sup>435</sup> Failing a notification under that procedure, it was

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<sup>431</sup> The Spanish version of Article 25.11 of the *SCM Agreement* also uses "*medidas*" where the English version uses "actions" and the French version uses "*decisions*" with respect to countervailing duties. The Spanish version of Article 4.5 of the DSU uses the word "*medidas*" where the English and French versions use "action" in the sense of legal steps, or a lawsuit, taken by a Member to establish a claim or obtain a remedy under the WTO dispute settlement procedures.

<sup>432</sup> In accordance with the general rule of interpretation in Article 31(1) of the Vienna Convention on the Law of Treaties.

<sup>433</sup> Footnote 35 to the *SCM Agreement*.

<sup>434</sup> By virtue of the operation of Article 31 of the *SCM Agreement*.

<sup>435</sup> Article 8.1 of the Agreement identified certain subsidies that "shall be considered non-actionable". Article 8.2 set out conditions and criteria identifying subsidies that "shall be non-actionable". Article 8.3 provided that a subsidy for which the provisions of paragraph 8.2 were invoked "shall be notified in advance" to the SCM Committee. Any such notification "shall be sufficiently precise to enable other Members to evaluate

expressly provided that Parts III or V of the *SCM Agreement* "may be invoked".<sup>436</sup> If Parts III or V were invoked, there was no requirement to reach preliminary findings on whether a measure satisfied the conditions and criteria to be considered non-actionable first, although that would naturally have been a question to be addressed by a panel or a Member's authorities in the course of their examination or investigation.

7.314 Measures that are "exempt from actions" by virtue of Article 13 are not exposed to certain types of actions based on particular provisions. However, unlike Part IV of the *SCM Agreement*, none of those provisions creates a special multilateral procedure for evaluation of whether the measures satisfy the conditions set out in Article 13. Rather, all of them are subject to the rules and procedures of the *DSU*, although some<sup>437</sup> are also subject to certain special and additional rules and procedures in Appendix 2 to the *DSU*. If any of these provisions are invoked, there is no requirement to reach preliminary findings on whether a measure satisfies the conditions set out in Article 13 first, although that is a question to be addressed by a panel in accordance with a proper order of analysis and in accordance with the organization of its own procedures.

7.315 Further relevant context is found in the procedures that apply to disputes arising under the *Agreement on Agriculture*. Article 19 provides that the applicable procedures are those set out in the *DSU*:

"The provisions of Articles XXII and XXIII of GATT 1994, as elaborated and applied by the Dispute Settlement Understanding, shall apply to consultations and the settlement of disputes under this Agreement."

7.316 Neither this article, nor the *DSU*, contain any exception for consultations and disputes arising in relation to Article 13. The list of special and additional rules or procedures in Appendix 2 to the *DSU* does not include Article 13 or any other provision of the *Agreement on Agriculture*.

7.317 The first step in bringing an action under the *DSU* rules and procedures is a request for consultations, which is a unilateral step taken by an individual Member, as is a request for establishment of a panel. There is no multilateral mechanism to prevent a Member making these requests on the basis that the measures at issue do, in fact, satisfy the conditions in Article 13 of the *Agreement on Agriculture*. Once a request is received, the *DSU* rules and procedures apply. Nothing in the *DSU* or the relevant special and additional rules and procedures prevents a dispute proceeding in the usual way where a Member alleges non-compliance with the conditions in Article 13 of the *Agreement on Agriculture*. In fact, the only way to obtain a multilateral finding that measures do or do not satisfy the conditions in Article 13 and therefore are or are not exempt from actions is for the complainant to take further legal steps in an attempt to establish its claims and the right to relief. A panel can only make findings as to whether measures are consistent with the listed provisions of the

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the consistency of the programme with the conditions and criteria" in Article 8.2. Under Article 8.4, upon request of a Member, the Secretariat was to review the notification and could request additional information. It was to report its findings to the SCM Committee, and the Committee was to review such findings (or, absent a request for such findings, the notification itself) with a view to determining whether the conditions and criteria for "non-actionability" in Article 8.2 were met. Pursuant to Article 8.5, identified in Appendix 2 of the *DSU* as a special or additional rule or procedure, upon request of a Member, the determination by the Committee, or failure by the Committee to make a determination, as well as the violation of the conditions set out in a notified programme, "shall be submitted to binding arbitration." The SCM Committee adopted a format for notifications under Article 8.3 on 22 February 1995 (documents PC/IPL/11; G/SCM/14), and adopted a format for updates of Article 8.3 notifications on 23 October 1997 (document G/SCM/13). The SCM Committee also adopted procedures for arbitration under Article 8.5 on 2 June 1998 (document G/SCM/19). No Member availed itself of these notifications or procedures.

<sup>436</sup> Footnote 35 to the *SCM Agreement*.

<sup>437</sup> Those based on Articles 3, 5 and 6 or "Part III" of the *SCM Agreement*.

*SCM Agreement* and Article XVI of the *GATT 1994* where a complainant has taken certain actions based on those provisions.

7.318 The object and purpose of WTO dispute settlement procedures are to provide security and predictability to the multilateral trading system.<sup>438</sup> A cornerstone of the *DSU* is the prompt settlement of situations in which a Member considers that its benefits under the covered agreements are being impaired,<sup>439</sup> which is given effect *inter alia* through a Member's comprehensive right to bring dispute settlement actions.<sup>440</sup> This is not conditional upon whether the complaining Member is correct in its views. Therefore, the Panel would need a clear injunction in the treaty text to depart from the objective of prompt settlement by deferring jurisdiction to examine any claims pending a final conclusion on Article 13 and we see none.<sup>441</sup>

7.319 Further, the conditions in Article 13 help define the scope of substantive obligations and rights to relief, and most of the conditions themselves refer to compliance with substantive obligations under the *Agreement on Agriculture*. The *DSU* provides a multilateral procedure to settle disputes arising under the covered agreements and it is most unlikely that the negotiators intended to provide only for unilateral determinations by Members as to whether their own measures satisfy conditions such as those set forth in Article 13.

7.320 Accordingly, the Panel considers that the ordinary meaning of the terms read in their context and in light of the object and purpose of the treaty, indicates that "exempt from actions" means that dispute settlement actions based on the listed provisions shall not be invoked with respect to measures that satisfy the conditions in Article 13. However, that does not preclude multilateral dispute settlement based on the listed provisions where a Member considers that benefits accruing under covered agreements are being impaired by a measure taken by another Member that does *not* satisfy the relevant conditions set forth in Article 13. The issue of whether a measure satisfies the relevant conditions is an issue of substance in a dispute.

7.321 The meaning of the phrase "exempt from actions" as used in Article 13 is confirmed by the drafting history of the *Agreement on Agriculture*.<sup>442</sup> The basic form of what is now Article 13 emerged from the first US/EC Blair House Agreement of November 1992<sup>443</sup>, which was inserted in

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<sup>438</sup> Article 3.2 of the *DSU*.

<sup>439</sup> Article 3.3 of the *DSU*.

<sup>440</sup> Articles 4.2 and 6.1 of the *DSU*. However, that right is subject to Articles 3.7, 3.10 and 24.1 of the *DSU*.

<sup>441</sup> This is consistent with the views of the Appellate Body in *US – Corrosion-Resistant Steel Sunset Review*, regarding allegedly mandatory measures, that:

"[...] As long as a Member respects the principles set forth in Articles 3.7 and 3.10 of the *DSU*, namely, to exercise their 'judgement as to whether action under these procedures would be fruitful' and to engage in dispute settlement in good faith, then that Member is entitled to request a panel to examine measures that the Member considers nullify or impair its benefits. We do not think that panels are obliged, as a preliminary jurisdictional matter, to examine whether the challenged measure is mandatory. This issue is relevant, if at all, only as part of the panel's assessment of whether the measure is, as such, inconsistent with particular obligations. [...]" (para. 89)

Similarly, the Panel considers that it is not obliged, as a preliminary jurisdictional matter, to examine whether challenged measures satisfy the conditions set out in Article 13 of the *Agreement on Agriculture*. This issue is relevant as part of the Panel's assessment of whether those measures are inconsistent with the obligations in Articles 3, 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994*.

<sup>442</sup> The Panel has recourse to supplementary means of interpretation in accordance with Article 32 of the Vienna Convention on the Law of Treaties in order to confirm the meaning resulting from the application of the general rule of treaty interpretation in Article 31 of that convention.

<sup>443</sup> See the draft article which formed part of the first US/EC Blair House agreement, dated 20 November 1992, reproduced in Exhibit EC-1.

the agriculture text of the draft Final Act of December 1991. It included the exemptions from actions, more or less in their current form. There is no explanation outside the text itself as to why those two Members' negotiators chose this form of words. The first footnote of the draft article, which became Article 13, provided that:

"The provisions of this Article replace those in Article 7:3, Article 12 and Article 18:2 of the Text on Agriculture of this Draft Final Act."

7.322 Articles 7:3, 12 and 18:2 of the agriculture text of the draft Final Act<sup>444</sup> read as follows:

"Article 7 – General Disciplines on Domestic Support

3. The domestic subsidies listed in Annex 2 to this Agreement shall be considered as non-actionable for the purposes of countervailing measures, but not otherwise, provided that such subsidies are in conformity with the general and specific criteria relating thereto as prescribed in that Annex."

"Article 12 – Serious Prejudice

Where reduction commitments on domestic support and export subsidies are being applied in conformity with the terms of this Agreement, the presumption will be that they do not cause serious prejudice in the sense of Article XVI:1 of the General Agreement."

"Article 18 – Consultation and Conciliation

2. On the basis of the commitments undertaken in the framework of this Agreement, Members will exercise due restraint in the application of their rights under the General Agreement in relation to products included in the reform programme."

7.323 Draft Article 18:2 had been included in the list of special or additional rules and procedures in the draft DSU text, which became Appendix 2 to the *DSU*.<sup>445</sup> This reference was then placed in square brackets<sup>446</sup> and the final version of Appendix 2 of the *DSU* contains no reference to any provision of the *Agreement on Agriculture*. Given that draft Article 18:2 was the predecessor of parts of the final Article 13, this is an indication that the omission of Article 13 from the final list of special or additional rules or procedures was deliberate and that the negotiators did not intend it to operate as a special dispute settlement procedure.<sup>447</sup>

7.324 Draft Article 7:3 provided for an exclusion from certain types of actions, without using the phrase "exempt from actions". It provided that green box measures should be "non-actionable" for the purposes of countervailing measures, which was retained in paragraph (a)(i) of the final Article 13. At the same time as the drafters modified the content of draft Article 7:3, they replaced draft Article 12 with a raft of provisions, choosing the phrase "exempt from actions" in five of them. These were the predecessors of subparagraphs (a)(ii), (a)(iii), (b)(ii), (b)(iii) and (c)(ii) in the final Article 13. Whilst three of these provisions referred to provisions in Part III of the *SCM Agreement*, all five extended beyond these to actions based on other types of complaints and provisions as well, in particular, non-violation nullification or impairment of the benefits of tariff concessions, Article XVI

<sup>444</sup> Extracted from document MTN.TNC/W/FA, dated 20 December 1991, reproduced in Exhibits US-29 and EC-2.

<sup>445</sup> See the extract of the draft text of the DSU, dated 15 June 1992, reproduced in Exhibit BRA-1.

<sup>446</sup> See the extract of the draft text of the DSU, dated 15 November 1993, reproduced in Exhibit BRA-2.

<sup>447</sup> Draft Article 18:1 was later revised to become the final Article 19 in the *Agreement on Agriculture*.

of the *GATT 1994* or its paragraph 1, and Article 3 of the *SCM Agreement*. In these circumstances, the record discloses that the drafters chose a phrase with a meaning similar to "non-actionable" but which was not limited in its application to Part III or V of the *SCM Agreement*.<sup>448</sup>

7.325 Accordingly, the Panel considers that the drafting history confirms the ordinary meaning of the terms read in their context and in light of their object and purpose, as set out in paragraph 7.320 above.

7.326 The Panel has a mandate to examine the matter referred to the DSB by the complainant. The Panel has a duty under Article 11 of the *DSU* to make an objective assessment of the facts of the case and the applicability of and conformity of the measures at issue with the relevant covered agreements. The Panel makes that assessment in accordance with the dispute settlement rules and procedures of the *DSU*, subject to the applicable special or additional rules and procedures in the covered agreements listed in Appendix 2 to the *DSU*. In conducting its examination of the applicability of, and conformity with the provisions of Articles 3, 5 and 6 of the *SCM Agreement* and paragraphs 1 and 3 of Article XVI of the *GATT 1994*, the Panel's order of analysis is indicated by the relevant covered agreements, as discussed above. If the Panel were to conclude that measures did satisfy the conditions in Article 13, it could not find that they were inconsistent with the obligations set out in the listed provisions and need not continue its examination in order to provide a solution to the dispute.

7.327 This interpretation is confirmed in respect of actionable subsidies by the last sentence of Article 5 and Article 6.9 of the *SCM Agreement* which clarify that each of those articles "does not apply" to subsidies maintained on agricultural products as provided in Article 13. This clarifies that the conditions in Article 13 partially define the scope of those substantive obligations. Emphasis of that point may have been considered important due to the unusual nature of the exemption from actions in Article 13 and its key role in the successful conclusion of the Uruguay Round.<sup>449</sup>

7.328 Article 7.1 of the *SCM Agreement*, which is the first provision in the article on remedies for actionable subsidies, applies "[e]xcept as provided in Article 13 of the Agreement on Agriculture". In the Panel's view, this indicates that the remedies for actionable subsidies are not available for domestic support measures that conform to the conditions in paragraphs (a) and (b) of Article 13. Although that phrase is located in Article 7.1, which refers to requests for consultations only, it cannot refer only to that merely procedural step, for the above reasons. This is confirmed by the fact that Article 7.1 is singled out as the only part of that article not listed as a special and additional rule and procedure in Appendix 2 of the *DSU*, which indicates that the normal dispute settlement rules are intended to apply.

7.329 The Panel also notes that the Appellate Body paraphrased the English version of Article 13 in *EC – Bananas III* in terms of bringing (and preventing) dispute settlement actions.<sup>450</sup> However, in

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<sup>448</sup> The drafters chose to use the phrase "exempt from the imposition of countervailing duties" in paragraph (b)(i) in a context in which neither the term "non-actionable" nor "exempt from actions" was appropriate. The obligation to show due restraint in initiating any countervailing duty investigations found in the final Article 13(b)(i) and (c)(i), and the title of the article, can be traced to draft Article 18:2. The final Article 13(b)(ii) and (c)(ii), as well as the last sentence of Article 5, and Article 6.9 of the *SCM Agreement*, can be contrasted with the "presumption" in draft Article 12.

<sup>449</sup> Note that the draft texts of Article 6 of the *SCM Agreement* did not include any reference to the predecessors of Article 13 of the Agreement on Agriculture: see draft texts reproduced in Exhibit BRA-372.

<sup>450</sup> The relevant passage in that report reads as follows:

"[...] In addition, Article 13 of the *Agreement on Agriculture* provides that, during the implementation period for that agreement, Members may not bring dispute settlement actions under either Article XVI of the *GATT 1994* or Part III of the *Agreement on Subsidies and Countervailing Measures* for domestic support measures or export subsidy measures that conform fully with the provisions of the *Agreement on Agriculture*. With these examples in mind, we believe it is significant that Article 13 of

doing so, the Appellate Body was not commenting on the manner in which a panel must go about deciding whether an action was prevented, and the fact that a panel can only decide whether measures satisfy the conditions in Article 13 after a proceeding has been brought.

## 7. Mandatory or discretionary distinction

7.330 A number of Brazil's claims relating to export subsidies under the *Agreement on Agriculture*, as well as the prohibited and actionable subsidy provisions of the *SCM Agreement* and Article XVI of the *GATT 1994*, rely on the allegedly "mandatory" nature of certain of the United States measures in dispute.<sup>451</sup>

7.331 In addition, the FSRI Act of 2002 contains a so-called "circuit-breaker" provision, in section 1601(e) which, the United States submits, could result in certain payments not being made.<sup>452</sup> That section provides that if:

"the Secretary determines that expenditures under [subtitles A through E<sup>453</sup> of the FSRI Act of 2002] that are subject to the total allowable domestic support levels under the Uruguay Round Agreements ... will exceed such allowable levels for any applicable reporting period, the Secretary shall, to the maximum extent practicable, make adjustments in the amount of such expenditures during that period to ensure that such expenditures do not exceed such allowable levels."

7.332 Brazil's allegations of the mandatory nature of certain measures, as well as the United States' rebuttal of such allegations in respect of certain measures, are therefore relevant to our examination of numerous claims.

7.333 WTO panels have developed a relatively consistent approach to the so-called "mandatory/discretionary distinction" whereby a WTO Member's law *as such* can be challenged before a WTO panel if the law mandates WTO-inconsistent behaviour. WTO panels have generally found that a law is WTO-inconsistent if they find that it *mandates* WTO-inconsistent behaviour.<sup>454</sup> If, on the other hand, the law provides the executive branch of a Member's government with discretionary authority to act in a WTO-consistent manner, then WTO panels have generally found that the law is not WTO-inconsistent.<sup>455</sup>

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the *Agreement on Agriculture* does not, by its terms, prevent dispute settlement actions relating to the consistency of market access concessions for agricultural products with Article XIII of the GATT 1994." (Appellate Body Report, *EC – Bananas III*, para. 157).

<sup>451</sup> We recall Brazil's claims as set out in its Panel request reproduced in Annex N of this report, our preliminary ruling concerning payments made after the date of establishment of the Panel in Section VII:B, our description of the measures at issue in Section VII:C, and Brazil's clarifications in its submissions described in subsequent Sections of this report. We have summarized these above in the descriptive part of this report.

<sup>452</sup> United States' oral statement at the second substantive meeting, para. 82.

<sup>453</sup> Under Title I of the FSRI Act of 2002, entitled "Commodity Programs", Subtitles A through E deal with direct and counter-cyclical payments for covered commodities, marketing assistance loans and loan deficiency payments for loan commodities and specific programme payments for peanuts, sugar and dairy.

<sup>454</sup> For example, the panel in *US – Section 301 Trade Act*, recognized the "classical test in the pre-existing jurisprudence that only legislation mandating a WTO inconsistency or precluding WTO consistency, could, as such, violate WTO provisions" (at para. 7.54 of that Panel Report). See also Panel Report, *US – Steel Plate*, para. 7.88.

<sup>455</sup> See, for example, Panel Report, *US – Export Restraints*, para. 8.131.

7.334 This test has been generally applied by GATT/WTO panels<sup>456</sup>, although the Appellate Body has never pronounced generally upon the continuing relevance or significance of the mandatory/discretionary distinction nor specifically ruled that it was determinative in consideration of whether a legal instrument was inconsistent with relevant WTO obligations.<sup>457</sup> The Appellate Body has not, however, precluded the possibility that a Member could violate its WTO obligations by enacting legislation granting discretion to its authorities to act in violation of its WTO obligation<sup>458</sup>, and sees no reason for concluding that, in principle, non-mandatory measures cannot be challenged "as such" in WTO dispute settlement.<sup>459</sup> Furthermore, panels are not obliged, as a preliminary jurisdictional matter, to examine whether a challenged measure is mandatory. This issue is relevant, if at all, only as part of the panel's assessment of whether the measure is, as such, inconsistent with particular obligations.<sup>460</sup>

7.335 Recalling that the import of the "mandatory/discretionary distinction" will vary from case to case, as well as from measure to measure, in our examination of the matter before us, we do not apply this analytical tool mechanistically.<sup>461</sup> It is our duty properly to characterize each of the measures challenged in these proceedings, as appropriate.<sup>462</sup>

7.336 In the course of our examination of each of the claims and measures concerned, we therefore make an objective assessment of the particular United States legal and regulatory provisions forming the basis of Brazil's claims, in the first instance, on the basis of the text of those provisions and, as appropriate, determine the extent to which they are of binding normative nature and operation. In this respect, we recall the reproach of the Appellate Body in *US – Corrosion-Resistant Steel Sunset Review* that the panel in that case "... did not consider the extent to which the specific provisions of the Sunset Policy Bulletin are normative in nature, nor the extent to which the USDOC itself treats these provisions as binding."<sup>463</sup>

#### D. DOMESTIC SUPPORT MEASURES AND ARTICLE 13 OF THE *AGREEMENT ON AGRICULTURE*

##### 1. Measures at issue

7.337 This section of our report deals with domestic support measures. These are the following measures, as described in Section VII:C of this report:

- (i) marketing loan programme payments;

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<sup>456</sup> In application of this distinction, there were generally two issues to be considered in a case where a WTO Member's law was being challenged before a panel: first, whether the Member's law mandates a certain course of action; and second, whether that course of action is inconsistent with the WTO provision cited by the complainant. Previous WTO panels followed different sequences in approaching these two issues. However, the sequence in which these two issues are considered will not change the ultimate conclusion of the panel. (See, e.g. Panel Report, *US – Corrosion-Resistant Steel Sunset Review*) That is because whatever sequence a panel follows, in order to conclude that certain aspects of a WTO Member's law are inconsistent with the WTO provisions, the panel had to conclude that both elements were present.

<sup>457</sup> In *US – Corrosion-Resistant Steel Sunset Review*, the Appellate Body addresses the distinction, but also indicates its view that the Appellate Body had not, as yet, been required to pronounce generally upon the continuing relevance or significance of the mandatory/discretionary distinction. The Appellate Body then stated: "Nor do we consider that this appeal calls for us to undertake a comprehensive examination of this distinction." See Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review*, para. 93.

<sup>458</sup> See Appellate Body Report, *US – Countervailing Measures on Certain EC Products*, para. 159 and note 334.

<sup>459</sup> Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review*, para. 88.

<sup>460</sup> Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review*, para. 89.

<sup>461</sup> Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review*, para. 93.

<sup>462</sup> We note that the United States has not contested, before us, that the relevant measures are measures.

<sup>463</sup> Appellate Body Report, *US – Corrosion-Resistant Steel Sunset Review*, para. 99.

- (ii) user marketing (Step 2) payments paid to domestic users<sup>464</sup>;
- (iii) production flexibility contract payments;
- (iv) market loss assistance payments;
- (v) direct payments;
- (vi) counter-cyclical payments;
- (vii) crop insurance payments;
- (viii) cottonseed payments<sup>465</sup>; and
- (ix) current legislative and regulatory provisions providing for the payment of measures (i), (ii), (v), (vi) and (vii), above.<sup>466</sup>

## 2. Applicability of Article 13 of the *Agreement on Agriculture*

7.338 **Brazil** requests a finding that Article 13(b)(ii) of the *Agreement on Agriculture* does not exempt these United States domestic support measures made in marketing years 1999-2002 to upland cotton from actions based on Articles 5 and 6 of the *SCM Agreement* and Article XVI:1 of the *GATT 1994*.<sup>467</sup>

7.339 The **United States** requests a finding that, pursuant to Article 13(b)(ii) of the *Agreement on Agriculture*, its domestic support measures are "exempt from actions based on paragraph 1 of Article XVI of the *GATT 1994* and Articles 5 and 6 of the Subsidies Agreement" and that Brazil may not bring or maintain any action against such measures "based on" those provisions.

7.340 The Panel will first consider whether Article 13 is applicable in this dispute.

7.341 Domestic support measures on agricultural products are the subject of paragraphs (a) and (b) of Article 13 and are considered here in Section VII:D of this report. Paragraph (c) of Article 13 only deals with export subsidies, which we will consider in Section VII:E.

7.342 Article 13 is a temporary provision applying only "[d]uring the implementation period". The implementation period is defined in Article 1(f) as follows:

"(f) 'implementation period' means the six-year period commencing in the year 1995, except that, for the purposes of Article 13, it means the nine-year period commencing in 1995;"

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<sup>464</sup> In Section VII:E of this report, user marketing (Step 2) payments *to exporters* are found to be export subsidies. That being the case, the United States accepts that they no longer constitute domestic support and do not form part of an analysis under Article 13(b). See the United States' response to Panel Question No. 45.

<sup>465</sup> In Section VII:B of this report, cottonseed payments for the 2000 crop only were ruled within the Panel's terms of reference, and they therefore are the only cottonseed payments described in Section VII:C of this report. Nevertheless, cottonseed payments for the 1999 and 2002 crops are relevant to the assessment of whether domestic support measures satisfy the conditions in Article 13(b), for the reasons given in paragraphs 7.533 and following, and are considered in this Section VII:D as well.

<sup>466</sup> In 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.

<sup>467</sup> Brazil does not pursue a claim that domestic support measures are inconsistent with the obligations of the United States under the *Agreement on Agriculture*.

7.343 Brazil requested consultations regarding this matter on 27 September 2002 and the Panel was established on 18 March 2003, which were clearly dates during the implementation period for the purposes of Article 13. The Panel's terms of reference are as follows:

"To examine, in the light of the relevant provisions of the covered agreements cited by Brazil in document WT/DS267/7, the matter referred to the DSB by Brazil in that document and to make such findings as will assist the DSB in making the recommendations or in giving the rulings provided for in those agreements."<sup>468</sup>

7.344 The Panel's function is explained in Article 11 of the *DSU*, which provides, relevantly, as follows:

"The function of panels is to assist the DSB in discharging its responsibilities under this Understanding and the covered agreements. Accordingly, a panel should make an objective assessment of the matter before it, including an objective assessment of the facts of the case and *the applicability of and conformity with the relevant covered agreements*, and make such other findings as will assist the DSB in making the recommendations or in giving the rulings provided for in the covered agreements. Panels should consult regularly with the parties to the dispute and give them adequate opportunity to develop a mutually satisfactory solution." (emphasis added)

7.345 In this dispute, the terms of the "relevant covered agreements" may have changed during the Panel proceeding, depending on whether Article 13 has expired.<sup>469</sup> However, it is not in dispute that the Panel's mandate in its terms of reference to examine the matter before it "in the light of the relevant provisions of the covered agreements" refers to the relevant provisions of the covered agreements as at the date on which those terms of reference were set, which was the date of its establishment.<sup>470</sup> The Panel's duty is to assess the applicability of and conformity with the relevant covered agreements as of that date. Brazil does not request us to do otherwise.<sup>471</sup> Article 13 is therefore applicable in this dispute.<sup>472</sup>

### **3. Structure of Article 13 of the *Agreement on Agriculture***

7.346 Article 13 sets out certain conditions in the chapeaux of paragraphs (a) and (b) and an additional condition in the proviso in subparagraphs (ii) and (iii) of paragraph (b).

7.347 Paragraph (a) covers domestic support measures that conform fully to the provisions of Annex 2 of the *Agreement on Agriculture*, that is, so-called "green box" measures, which are not subject to reduction commitments. Paragraph (b) covers domestic support measures that conform

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<sup>468</sup> See document WT/DS267/15.

<sup>469</sup> The parties do not agree as to whether the implementation period for the purposes of Article 13 expired during these proceedings. Brazil submits that the implementation period for Article 13 ended on 31 December 2003. The United States refers to the definition of "year" for the purposes of Article 1(f), which is found in Article 1(i), and submits that the end of the 2003 calendar year is not relevant to this dispute because US commitments with respect to cotton are specified by marketing year. The European Communities also refers to Article 1(f) and (i) and asserts that it is still an "open question" whether Article 13(b)(ii) and (c)(ii) will cease to apply by the end of the 2003 calendar year or at a subsequent date during 2004. For the reasons given in paragraph 7.345, the Panel does not need to form its own view as to whether Article 13 expired during these proceedings.

<sup>470</sup> See Brazil's and the United States' respective responses to Panel Question No. 124 and the responses of China, the European Communities and New Zealand to Panel third party Question No. 50. See also the United States' 3 March 2004 comments, footnote 1. The Panel takes note that Argentina and Australia did not agree with this view in their responses to that question.

<sup>471</sup> See Brazil's request for relief in the factual and arguments section of this report.

<sup>472</sup> This implies no view as to whether a panel may apply provisions in a covered agreement that were not in force as at the date of consultations.

fully to the provisions of Article 6, which covers domestic support subject to reduction commitments, and domestic support not subject to reduction commitments in terms of the criteria set out in that article. The chapeau of paragraph (b) confirms that these are so-called "amber box", "blue box", "de minimis" and "S&D box" domestic support measures.

7.348 Paragraph (b) does not cover domestic support measures not subject to reduction in terms of the criteria in Annex 2 and maintained in conformity therewith in accordance with Article 7.1.<sup>473</sup> These are measures that satisfy paragraph (a). The parties agree that these measures are excluded from paragraph (b).<sup>474</sup> We will therefore refer to measures covered by paragraph (b) as "non-green box measures".

7.349 Measures that do not conform fully to the provisions of Annex 2 of the *Agreement on Agriculture* do not satisfy paragraph (a). Therefore, they are subject to reduction commitments, unless they are exempt on the basis of other criteria set forth in Article 6. In either case, they must conform fully to the provisions of Article 6 and, hence, are subject to paragraph (b).

7.350 The conditions that apply to green box measures are set out in the chapeau of paragraph (a). The conditions that apply to non-green box measures are set out in the chapeau of paragraph (b), subject to an additional condition in the proviso in subparagraphs (ii) and (iii) that "such measures do not grant support to a specific commodity in excess of that decided in the 1992 marketing year". Each of these two groups of conditions provides exemptions from actions based on certain provisions, including paragraph 1 of Article XVI of the *GATT 1994* and Articles 5 and 6 of the *SCM Agreement*<sup>475</sup>, under which Brazil has brought claims in the present dispute. Domestic support measures that satisfy *either* of the groups of conditions fall outside the scope of the obligations in these provisions of Article XVI of the *GATT 1994* and Part III of the *SCM Agreement*.<sup>476</sup>

7.351 Therefore, in order to succeed in its claims under the relevant provisions of those agreements, Brazil must first show that the domestic support measures that it challenges satisfy neither group of conditions. That is, it must first show that the measures are not green box, and that they do not satisfy at least one of the conditions in the chapeau of paragraph (b) or the additional condition in the proviso in subparagraph (b)(ii). If they do not satisfy the additional condition in the proviso in subparagraph (b)(ii), they are not exempt from actions, whether or not they satisfy the conditions in the chapeau of paragraph (b).

7.352 This is what Brazil sets out to show. It claims, firstly, that none of the domestic support measures satisfy the conditions set out in paragraph (a) and, secondly, that the sum of them does not satisfy the additional condition in the proviso in subparagraph (b)(ii). It does not claim that measures fail to satisfy the conditions in the chapeau of paragraph (b). The United States responds that certain of its domestic support measures satisfy the conditions set out in paragraph (a) and that the remainder satisfy the additional condition in the proviso in subparagraph (b)(ii).

7.353 Therefore, the logical order in which to consider conformity of the domestic support measures with Article 13 begins with paragraph (a), which will dictate which domestic support measures, if any, are excluded from the sum to be compared under subparagraph (b)(ii).

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<sup>473</sup> Article 6.1 of the *Agreement on Agriculture*.

<sup>474</sup> Brazil's first written submission, para. 129 and the United States' first written submission, para. 49.

<sup>475</sup> Those which satisfy the conditions in paragraph (a) fall outside the whole of Article XVI of the *GATT 1994* and Part III of the *SCM Agreement*.

<sup>476</sup> For the reasons given in Section VII:C of this report.

#### 4. Paragraph (a) of Article 13

##### (a) Introduction

7.354 Paragraph (a) of Article 13 of the *Agreement on Agriculture* applies to domestic support measures that conform fully to the provisions of Annex 2 to that agreement.

7.355 **Brazil** claims that PFC payments and DP payments fail to satisfy these conditions<sup>477</sup> because:

- (i) PFC payments and DP payments are inconsistent with paragraph 6(b) of Annex 2 because the amount of such payments is related to the type of production that is undertaken by United States upland cotton producers after the base period<sup>478</sup>;
- (ii) DP payments do not conform to the provisions of paragraph 6(a) and (b) of Annex 2 because of the updating of the base periods for the DP programme<sup>479</sup>; and
- (iii) PFC and DP payments are inconsistent with the fundamental requirement in paragraph 1 of Annex 2 that they have no, or at most minimal, trade-distorting effects or effects on production.<sup>480</sup>

7.356 The **United States** responds that these measures fully conform to the provisions of Annex 2.<sup>481</sup> It agrees that marketing loan programme payments, user marketing (Step 2) payments to domestic users, market loss assistance ("MLA") payments, crop insurance payments and cottonseed payments are non-green box measures. It does not assert that counter-cyclical ("CCP") payments are green box because they are granted due to low prevailing market prices.<sup>482</sup> It has notified all these types of payments as non-green box domestic support to the WTO Committee on Agriculture (except CCP payments which began in the 2002 marketing year and have not yet been the subject of a notification).<sup>483</sup>

7.357 The parties therefore only disagree as to whether PFC and DP payments conform fully to the provisions of Annex 2 and, hence, satisfy the conditions in paragraph (a) of Article 13. The Panel will therefore turn to these measures, which have been described in Section VII:C of this report. The Panel will consider them in terms of the features which allegedly do not conform fully to the provisions of Annex 2: namely, planting flexibility requirements and updating of base periods, followed by the fundamental requirement in paragraph 1 of Annex 2.

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<sup>477</sup> Brazil claimed in its request for the establishment of a panel that United States domestic support measures were inconsistent with the United States' obligations under Article 7.1 of the *Agreement on Agriculture* but has not pursued that as a separate claim in these proceedings, as explained in paragraph 7.253 of this report. Therefore, the Panel only considers whether measures conform fully to the provisions of Annex 2 for the purposes of its assessment under Article 13 of the *Agreement on Agriculture*.

<sup>478</sup> See Brazil's first written submission, paras. 153 and 174 and its response to Panel Question No. 19.

<sup>479</sup> See Brazil's first written submission, para. 176.

<sup>480</sup> See Brazil's first written submission, paras. 163 and 183. Brazil agrees that these payments meet the first basic criterion in paragraph 1(a) of Annex 2 and does not allege that they are inconsistent with the second basic criterion in paragraph 1(b): see its response to Panel Question No. 30.

<sup>481</sup> See United States' first written submission, para. 55 (regarding DP payments) and rebuttal submission, para. 53 (regarding PFC payments).

<sup>482</sup> See United States' rebuttal submission, para. 102.

<sup>483</sup> See documents G/AG/N/USA/43 (MY 1999 notification) and G/AG/N/USA/51 (MY 2000 and MY 2001 notifications). The United States notified all user marketing (Step 2) payments as domestic support, but see *supra*, footnote 464.

(b) Planting flexibility limitations

(i) *Main arguments of the parties*

7.358 **Brazil** claims that PFC and DP payments and the provisions of the FSRI Act of 2002 and implementing regulations providing for the DP programme are inconsistent with paragraph 6(b) of Annex 2.<sup>484</sup> It submits that the PFC and DP programmes limited and limit the type of production that can receive payments and reduce and even eliminate all payments under those programmes if certain types of production, namely fruits, vegetables (and wild rice in the case of the DP programme), are produced on base acreage. It argues that the effect of the restriction is to funnel production on base acreage to particular types of crops.<sup>485</sup>

7.359 Brazil submits that the European Communities' argument (summarized below), in essence, is that trade distortions for products that traditionally have been subsidized should be permitted in order to prevent trade distortion in markets for non-subsidized products. In Brazil's view, this does not avoid distortions but maintains them, contrary to the object and purpose of the *Agreement on Agriculture*.<sup>486</sup>

7.360 The **United States** responds that PFC and DP payments are decoupled from production because there is no requirement that the farmer engage in any production to receive payment or that the base acreage be used for production.<sup>487</sup> It argues that, under Brazil's analysis, a requirement that a payment recipient produce nothing at all in the current year would be inconsistent with paragraph 6(b) even though it would ensure that such payments met the "fundamental requirement" of paragraph 1 of Annex 2.<sup>488</sup> It also argues that, under Brazil's analysis, the reduction or elimination of payments to producers of illegal crops, such as opium poppy, unapproved biotech varieties or environmentally damaging production, would be inconsistent with paragraph 6(b).

(ii) *Main arguments of the third parties*

7.361 **Argentina** agrees with Brazil.<sup>489</sup> **Australia** argues that the exclusion of fruits and vegetables (other than lentils, mung beans, and dry peas) from the planting flexibility otherwise available in respect of the contract acreage for which PFC payments could be made, related, or connected, PFC payments to the type of production undertaken by the producer in any year after the base period, contrary to the requirements of paragraph 6(a) of Annex 2. Fruits, vegetables (other than lentils, mung beans and dry peas) and wild rice are generally prohibited from being planted on base acreage on which DP payments are made unless the commodity, if planted, is destroyed before harvest except that trees and other perennial plants are prohibited. This relates, or connects, DP payments to the type of production undertaken by the producer, contrary to paragraph 6(a) of Annex 2.<sup>490</sup>

7.362 **Canada** argues that the amount of PFC payments and DP payments are based on the type of commodity produced after the base period. Canada submits that the United States has not addressed in its submission the evidence of implementing legislation and regulations regarding either measure. Its argument that payment recipients are not required to engage in any particular type or volume of production (or any current agricultural production at all) to receive payments fails to address the evidence indicating that the amount of the payment may change based on whether base acreage is used for current production of fruits, vegetables or wild rice. For both measures, the evidence

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<sup>484</sup> Brazil's first written submission, para. 198.

<sup>485</sup> Brazil's oral statement at the first session of the first substantive meeting, para. 66.

<sup>486</sup> Brazil's rebuttal submission, paras. 8-9.

<sup>487</sup> United States' first written submission, paras. 55-57.

<sup>488</sup> United States' oral statement at the first session of the first substantive meeting, para. 19; United States' closing statement at the first session of the first substantive meeting, para. 20.

<sup>489</sup> Argentina's written submission to first session of the first substantive meeting, para. 56.

<sup>490</sup> Australia's written submission to the first session of the first substantive meeting, paras. 41, 44-45.

indicates that the amount of the payment is based on the type of production: payments are full, nil or some amount in between where base acres are used for current fruit, vegetable or wild rice production.<sup>491</sup>

7.363 The **European Communities** submits that an examination of the conformity of a decoupled scheme with the criteria set out in Annex 2 must involve an examination of the scheme as a whole. In that light, the European Communities is not convinced that where, as part of a scheme where no production is required to receive payments, and that the production of any type of crop is permitted, reducing payments where certain crops are produced can be such as to make the scheme, when taken as a whole, related to a type of production. Consequently, the reduction of payment linked to the production of fruit and vegetables must be seen as part of a scheme which permits a farmer to grow any type of crop, or even not to produce at all. Such a scheme, taken as a whole, meets the criteria that payments are not related to a type of production. To find otherwise would not permit a WTO Member wishing to introduce decoupled payments to take account of important elements of internal competition, in an historical perspective, and avoid those farmers receiving decoupled payments from enjoying both the decoupled payments and a privileged position vis-à-vis farmers who are not entitled to such payments. Moreover, the European Communities asserts that such a finding would require a Member to increase its subsidy programmes in order to prevent internal distortions of competition, running directly contrary to the process of reform instituted by the *Agreement on Agriculture*.<sup>492</sup>

(iii) *Evaluation by the Panel*

7.364 The Panel begins by noting that paragraph 6 of Annex 2 of the *Agreement on Agriculture* lists specific criteria according to which certain domestic support, which it describes as "[d]ecoupled income support", may qualify as green box support. It reads as follows:

"Decoupled income support

- (a) Eligibility for such payments shall be determined by clearly-defined criteria such as income, status as a producer or landowner, factor use or production level in a defined and fixed base period.
- (b) The amount of such payments in any given year shall not be related to, or based on, the type or volume of production (including livestock units) undertaken by the producer in any year after the base period.
- (c) The amount of such payments in any given year shall not be related to, or based on, the prices, domestic or international, applying to any production undertaken in any year after the base period.
- (d) The amount of such payments in any given year shall not be related to, or based on, the factors of production employed in any year after the base period.
- (e) No production shall be required in order to receive such payments."

7.365 Paragraph 6 is a list of five criteria that describe decoupled income support. The first four criteria, including paragraph 6(b), focus on the distinction between the base period and the time after the base period, providing that income support may be coupled to factors that occurred during the base period, but not after it.

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<sup>491</sup> Canada's written submission to the first session of the first substantive meeting, para. 23.

<sup>492</sup> European Communities' response to Panel third party Question No. 5.

7.366 The text of paragraph 6(b) refers to the relationship between the amount of decoupled income support payments, on the one hand, and the type of production undertaken by the producer (among other things) after the base period on the other. The ordinary meaning of the word "related" is "[h]aving relation; having mutual relation; connected. (Foll. by *to, with.*)".<sup>493</sup> This is a very general notion. In the text, it can be contrasted with the words "based on". The ordinary meaning of "base" as used in this context is "found, build, or construct (*up*)on a given base, build up *around* a base (chiefly *fig.*)".<sup>494</sup> This is a more specific notion, which denotes that one element in some way precedes or shapes the other. In contrast, "related to" denotes a mere connection between the amount of such payments and the type of production after the base period. This word is not limited to a connection that is positive or negative, or absolute or partial. It appears to include all types of relationship between the amount of such payments and the type of production after the base period, whether the amount increases or decreases and whether the difference in the amount is proportional to the volume of production or not.

7.367 Read in context, we note that paragraph 6(a) mandates requirements, whilst paragraphs 6(b), (c) and (d) prohibit certain programme requirements relating to the years after the base period. Paragraphs 6(a), (c) and (d) do not distinguish between positive and negative programme requirements, in the sense of requirements concerning what the payment recipient must, or must not, do. In particular, they do not distinguish between requirements that channel income support toward, or away from, certain production in the years after the base period. This does not suggest that paragraph 6(b) should be interpreted to prohibit only positive requirements to produce, or to engage in certain types of production, but rather confirms the ordinary meaning of its terms, which also prohibit negative requirements not to engage in certain types of production.

7.368 Paragraph 6(e) does not concern a negative requirement. It only prohibits a positive requirement, i.e. a requirement of production. However, it must be presumed that each of the criteria in paragraph 6 has meaning and effect.<sup>495</sup> If paragraph 6(b) could be satisfied by ensuring that no production was required to receive payments, paragraph 6(e) would be redundant. The drafters would have had no reason to include it in the list of criteria.<sup>496</sup> This confirms that paragraph 6(b) must be interpreted to require more than that one prohibition.

7.369 There are certain similarities between paragraph 6 and the subsequent paragraphs of Annex 2, all of which set out criteria according to which certain domestic support measures may qualify as green box support. Paragraph 11(b) is in identical terms to paragraph 6(b) except for the addition of the phrase "other than as provided for under criterion (e) below". Criterion (e) in paragraph 11 provides as follows:

"(e) The payments shall not mandate or in any way designate the agricultural products to be produced by the recipients except to require them not to produce a particular product."

7.370 Paragraph 11(b) therefore provides, in effect, that the amount of certain payments shall not be related to the type of production undertaken by the producer after the base period except that the payments may require recipients not to produce a particular product. Paragraph 6(b) does not set forth such an exception. There is nothing in the context that would explain why it was necessary to express the exception in paragraph 11(e) if it was already implicit in paragraph 11(b), which is otherwise

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<sup>493</sup> *The New Shorter Oxford English Dictionary*, (1993).

<sup>494</sup> *The New Shorter Oxford English Dictionary*, (1993).

<sup>495</sup> This accords with the principle of effective treaty interpretation. See the discussion in the Appellate Body Report in *US – Gasoline*, page. 23.

<sup>496</sup> The context also includes paragraph 5 which provides that any existing or new type of direct payment other than those specified in paragraphs 6 through 13, shall conform to criteria (b) through (e) in paragraph 6 (in addition to the general criteria set out in paragraph 1), which emphasizes the importance of these four criteria in the scheme of Annex 2.

identical to paragraph 6(b). This confirms that, if the drafters of Annex 2 had intended to permit such a negative requirement in decoupled income support exempt from reduction commitments, they would have done so expressly.

7.371 The object and purpose of Annex 2 is to set out the terms on which certain domestic support measures can be exempt from reduction commitments. The first sentence of paragraph 1 provides that "domestic support measures for which exemption from the reduction commitment is claimed shall meet the fundamental requirement that they have no or at most minimal trade-distorting effects or effects on production". Brazil submits that the chapeau of paragraph 1 of Annex 2 forms part of the context for interpreting paragraph 6(b).<sup>497</sup> The United States submits that the purpose of the criteria in Annex 2 is to determine compliance with that fundamental requirement. Therefore, on either view, that fundamental requirement should be taken into account in interpreting the criterion in paragraph 6(b).

7.372 The United States argues that the interpretation of paragraph 6(b) should permit decoupled income support that requires recipients to engage in production of *no crops at all* "because such a measure necessarily can have no trade-distorting effects or effects on production".<sup>498</sup> In the Panel's view, paragraph 6(b) permits such a condition because it only prohibits the amount of payments being related to the type or volume of production undertaken by the "producer", which by definition excludes those who are required not to produce anything.<sup>499</sup>

7.373 The United States also argues that the interpretation of paragraph 6(b) should permit decoupled income support that prohibits recipients from producing illegal crops, such as opium poppy or unapproved biotech varieties, or engaging in environmentally damaging production.<sup>500</sup> This is not an issue before this Panel and it is not incumbent upon the Panel to decide it.

7.374 There are no other facts or arguments on the record of this dispute which require the Panel to consider its interpretation of paragraph 6(b) further. The Panel will therefore apply that criterion to PFC and DP payments in accordance with the ordinary meaning of the terms it uses, as explained above.

7.375 The parties agree that PFC and DP payment recipients had, and have, flexibility in what they choose to produce on their base acres and in whether they produce anything on their base acres at all. It is agreed that that flexibility was not, and is not, unlimited.<sup>501</sup> The parties disagree as to whether the limitations on that flexibility affect the conformity of the measures at issue to the provisions of Annex 2 of the *Agreement on Agriculture*.

7.376 The planting flexibility provisions applicable to PFC payments were found in section 118 of the FAIR Act of 1996, subsection (a) of which provided as follows:

"Subject to subsection (b), any commodity or crop may be planted on contract acreage on a farm."

7.377 Subsection (b)(1) provided the following limitations:

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<sup>497</sup> Brazil's first written submission, para. 179.

<sup>498</sup> United States' rebuttal submission, para. 41.

<sup>499</sup> The Panel also notes that paragraphs 9 and 10 of Annex 2 deal with producer and resource retirement programmes.

<sup>500</sup> United States' rebuttal submission, para. 43.

<sup>501</sup> See Brazil's first written submission, paras. 159-161 and 174; the United States' oral statement at the first session of the first substantive meeting, para. 19. The Panel also notes the United States' correction to its response to Panel Question No. 26, that payments are made regardless of whether upland cotton is produced, but not regardless of what is currently produced.

"The planting of fruits and vegetables (other than lentils, mung beans, and dry peas)<sup>502</sup> shall be prohibited on contract acreage."

7.378 Subsection (b)(2) provided exceptions to these limitations. The first related to regions with a history of double-cropping of contract commodities (such as upland cotton) with fruits or vegetables. In these regions, double-cropping was permitted. The other two exceptions related to farms with a history of planting fruits or vegetables on contract acreage and producers with an established planting history of a specific fruit or vegetable. It was provided that payments in respect of these farms and to these producers "shall be reduced by an acre for each acre planted to the fruit or vegetable".<sup>503</sup>

7.379 The planting flexibility provisions that form part of the DP programme, under which DP payments are made, are found in section 1106 of the FSRI Act of 2002, subsection (a) of which provides as follows:<sup>504</sup>

"Subject to subsection (b), any commodity or crop may be planted on base acres on a farm."

7.380 Subsections (b)(1), (2) and (3) provide the following limitations:

"(1) The planting of an agricultural commodity specified in paragraph (3) shall be prohibited on base acres unless the commodity, if planted, is destroyed before harvest.

(2) The planting of an agricultural commodity specified in paragraph (3) that is produced on a tree or other perennial plant shall be prohibited on base acres.

(3) Paragraphs (1) and (2) apply to the following agricultural commodities:

(A) Fruits.

(B) Vegetables (other than lentils, mung beans and dry peas).

(C) Wild rice."

7.381 Subsection (c) provides exceptions to these limitations related to historical double-cropping in almost identical terms to those which applied to PFC payments. Subsection (d) created a special rule which allowed fruits, vegetables (other than lentils, mung beans and dry peas) and wild rice to be planted on excess base acres for the 2002 crop year only due to the overlap between PFC and DP payments that year, but provided that DP payments for the 2002 crop year "shall be reduced by an acre for each acre of the excess base acres planted to such an agricultural commodity."<sup>505</sup>

7.382 Regulations implemented and implement the planting flexibility provisions, providing *inter alia*, a non-exhaustive list of over 191 fruit and vegetable crops subject to the limitations.<sup>506</sup>

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<sup>502</sup> Wild rice was added to the list of restricted crops pursuant to the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act, 2000. [Footnote not in original]

<sup>503</sup> Section 118(b)(2)(B) and (C)(ii), reproduced in full in Exhibits BRA-28 and US-22; and 7 CFR 1412.206(e) (1 January 2002 edition), reproduced in Exhibit BRA-31 and explained in USDA Fact Sheet, reproduced in Exhibit BRA-4.

<sup>504</sup> These conditions also form part of the CCP programme.

<sup>505</sup> Section 1106 of the FSRI Act of 2002 is reproduced in full in Exhibits BRA-29 and US-1. 7 CFR 1412.407(d)(3)(ii) (1 January 2003 edition) is reproduced in Exhibit BRA-35.

<sup>506</sup> See 7 CFR 1412.206(f) (1 January 2002 edition) and 7 CFR 1412.407(h) (1 January 2003 edition), reproduced in Exhibits BRA-31 and BRA-35, respectively. There was a special rule for wild rice for PFC

Non-compliance with contract requirements results in termination of the contract and the recipient must refund payments with interest, but in cases of violations of the planting flexibility limitations which are not serious enough to warrant termination, payments may be made in an amount reduced by the sum of the "per-acre market value of the fruits, vegetables (and wild rice)" "times the number of acres in violation" plus the payments.<sup>507</sup> This is equivalent to a zero payment for those acres and a net refund of the market value of the fruits, vegetables and wild rice.

7.383 There is little doubt that *in general* the "amount" of PFC and DP payments is not "related to, or based on, the type or volume of production ... undertaken by the producer in any year after the base period". However, although there is no programme requirement to produce any particular product, where a producer in fact undertakes certain restricted types of production, such as fruits and vegetables, on some or all acres enrolled in the programme in a year after the base period, the amount of the payment which that producer receives may be reduced. Where the farm or the producer meets certain special eligibility criteria, which essentially depend on a history of planting fruits or vegetables, there is a reduction in the amount of the payment, unless the region satisfies the special eligibility criteria, in which case there is no reduction. Where neither the farm nor the producer meets the special eligibility criteria, and the producer undertakes certain restricted types of production, such as fruits and vegetables, on some or all acres enrolled in the programme in a year after the base period, payments are revoked or there is a reduction in the amount of the payment by way of a penalty. It is with respect to these requirements, under which payments are eliminated or reduced, that Brazil claims that PFC and DP payments are not in conformity with the criterion in paragraph 6(b) of Annex 2 of the *Agreement on Agriculture* because the amount of such payments in any given year is related to, or based on, the type and volume of production undertaken by the producer in a year after the base period, and that therefore PFC and DP payments do not qualify for exemption from reduction commitments as decoupled income support.

7.384 It is clear that the planting flexibility limitations at issue provide for the "amount" of PFC and DP "payments" to be reduced or eliminated by reference to the planting of fruit and vegetables (and wild rice) on base acres. Those producers who did not and do not plant fruit and vegetables (or wild rice) on their base acres did not and do not have the amount of their payments reduced. Those producers who did and do plant fruit and vegetables (and wild rice) on their base acres, whether in accordance with special eligibility criteria (with one exception)<sup>508</sup> or not, did and do have the amount of their payments reduced.

7.385 It is also clear that the harvesting of fruit, vegetables and wild rice are "types" of production. The *permitted* crops, which are a very large but not unlimited group, are also "types" of production. The planting flexibility limitations at issue, although they refer to "planting", do in fact apply to types of "production". In the case of PFC payments, they applied to planting, which necessarily included prohibited crops that were harvested and those that were destroyed before harvest. This is not in dispute. In the case of DP payments, the limitations apply to the harvesting of these crops, as those prohibited crops destroyed before harvest are specifically excluded from the limitations. In the case of both PFC and DP payments, the limitations refer to the planting of prohibited crops during the term of a contract, which is after the base period. Therefore, on a plain reading, the amount of all PFC and DP payments were and are related to the type of production undertaken by the producer after the base period.

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payments in fiscal years 1998 through 2002, according to which "for each contract acre on which a producer plants wild rice, 1 acre will not be used in determining the contract payment".

<sup>507</sup> See 7 CFR 1412.401 (1 January 2002 edition) and 7 CFR 1412.601 (1 January 2003 edition), reproduced in Exhibits BRA-31 and BRA-35, respectively.

<sup>508</sup> Other than the exception for *regions* with a history of double cropping: Section 118(b)(2)(A) of the FAIR Act of 1996 and Section 1106(c)(1) of the FSRI Act of 2002.

7.386 The Panel does not need to decide for the purposes of this dispute the extent to which the interpretation of paragraph 6(b) requires a consideration of the trade-distorting effects or effects on production of a measure, in light of the fundamental requirement in paragraph 1. Firstly, the Panel notes that the planting flexibility limitations provide a monetary incentive for payment recipients not to produce the prohibited crops. USDA data presented by Brazil shows that the planting flexibility limitations in this dispute cover a wide range of types of production<sup>509</sup> which represent approximately 22 per cent of farm income from crops in the seventeen states of the United States producing upland cotton, peaking at over 70 per cent in California, a major upland cotton producing state.<sup>510</sup> The United States has not suggested that these farms are covered by the special eligibility criterion which would permit them to plant fruits and vegetables without penalty. These limitations therefore significantly constrain production choices available to PFC and DP payment recipients and effectively eliminate a significant proportion of them. Whilst these programmes permit recipients to produce nothing, this alone does not remove the significant constraint that the planting flexibility limitations have in certain regions on the choices of those PFC and DP payment recipients who do produce something, which the evidence shows is the overwhelming majority.<sup>511</sup>

7.387 Secondly, the Panel asked the United States to indicate the reason for the planting flexibility limitations and to comment on the suggestion by the European Communities that these limitations are designed to avoid unfair competition.<sup>512</sup> The United States informed the Panel of when the limitations were introduced and in what connection but declined to indicate the reason for them or to comment on the European Communities' suggestion. Therefore, there is no evidence before this Panel that these particular planting flexibility limitations in these particular programmes actually promote fair competition or reduce production- or trade-distorting effects in the markets for fruits and vegetables, or the markets for the commodities covered by the programmes or any other market. This does not imply any view as to whether such evidence is relevant to the interpretation of paragraph 6(b).

7.388 For the above reasons, the Panel concludes that PFC payments, DP payments, and the legislative and regulatory provisions that provide for the planting flexibility limitations in the DP programme, do not fully conform with paragraph 6(b) of Annex 2 of the *Agreement on Agriculture*.

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<sup>509</sup> The limitations cover over 191 crops: see 7 CFR 1412.206(f) (1 January 2002 edition) and 7 CFR 1412.407(h) (1 January 2003 edition), reproduced in Exhibits BRA-31 and BRA-35, respectively.

<sup>510</sup> This is a five year average 1997-2001. See USDA Economic Research Service "U.S. and state farm income database, farm cash receipts 1997-2001", reproduced in Exhibit BRA-107, and Brazil's oral statement at the first session of the first substantive meeting, para. 66. This average includes high proportions of farm income in Florida, New Mexico and Virginia which only account for a small amount of upland cotton production, as well as high proportions in Arizona, California and Georgia, which account for a large amount of upland cotton production. National statistics also show that the amount of acreage planted to crops prohibited under the PFC and DP programmes is large: see USDA Fruits and Tree Nuts Yearbook, October 2003, Table A-2, and USDA Vegetables and Melons Yearbook, July 2003, Table 3, reproduced in Exhibits BRA-422 and BRA-423.

<sup>511</sup> See USDA data supplied in December 2003 in Exhibits US-111 and US-112 and corrected in January 2004 as described in Exhibit US-145. See also the testimony before the United States House of Representatives Committee on Agriculture in 2001 by Mr. Robert McLendon, then Chairman of the National Cotton Council's Executive Committee that "I don't think we have a lot of farmers getting their payment and not working the land" set out in Exhibit BRA-41, at page 17; and the statement of Dr. Sumner at pages 11 and 12 in Exhibit BRA-342.

<sup>512</sup> The Panel asked the United States to comment on this suggestion by the European Communities. In its response, the United States informed the Panel that these limitations on planting flexibility came into play with the "flex acre" concept of the FACT Act of 1990 and have continued to apply only to base acres under the 1996 and 2002 legislation. See the United States' response to Panel Question No. 217.

## (c) Updating of base acres

(i) *Main arguments of the parties*

7.389 **Brazil** claims that the DP payments and provisions of the FSRI Act of 2002 and implementing regulations that provide for the DP programme are inconsistent with paragraphs 6(a) and (b) of Annex 2 because they permitted updating of base acres from the PFC programme. It argues that successive decoupled income support programmes with the same structure, design and eligibility criteria must have a fixed and unchanging base period to be consistent with paragraph 6(a). It argues that the updating of base periods captures additional payment acreage for a particular crop and links increased recent volumes of production with the amount of current payments which is inconsistent with paragraph 6(b). It argues that the object and purpose of paragraph 6 is to ensure that Members do not permit payments to increase over time in a manner linked to increases in production over time.<sup>513</sup>

7.390 The **United States** responds that DP payments are made to persons on farms for which payment yields and base acres are established, which are "defined" in the Act and "fixed" for the duration of the legislation – that is, marketing years 2002-2007.<sup>514</sup> The United States does not agree that once a particular type of direct payment under Annex 2 has been made, all subsequent measures providing direct payments must be made with respect to the same base period. There is no textual requirement that all domestic support measures for which exemption from the reduction commitments is claimed utilize the same "defined and fixed period".<sup>515</sup> Although it is irrelevant, PFC and DP payments are not in fact essentially the same.<sup>516</sup>

(ii) *Main arguments of the third parties*

7.391 **Australia** agrees with Brazil.<sup>517</sup> **Canada** submits that the Panel should find that the applicable base period for DP and PFC payments is the same because the structure and payment parameters of the two programmes are essentially the same.<sup>518</sup> **New Zealand** submits that the DP programme is the successor to the PFC programme and to permit an updating of the fixed base period by changing the name of the programme would render the provisions of paragraphs 6(a) and (b) of Annex 2 a nullity.<sup>519</sup>

7.392 The **European Communities** takes note of the United States' explanation that the updating of the base period was necessary in order to bring support for oilseeds production into the DP scheme and saw nothing in paragraph 6 of Annex 2 that prevented different base periods where eligibility was based on previous eligibility for production distorting subsidies. However, the European Communities is concerned that continued updating of reference periods in respect of the same existing decoupled support, creating an expectation that production of certain crops would be rewarded with a greater entitlement to supposedly decoupled payments, tended to undermine the decoupled nature of such payments.<sup>520</sup>

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<sup>513</sup> Brazil's first written submission, paras. 176-180 and response to Panel Question No. 19.

<sup>514</sup> United States' first written submission, para. 67; United States' response to Panel Question No. 24.

<sup>515</sup> United States' rebuttal submission, paras. 30-35.

<sup>516</sup> The United States does not assert that PFC and DP payments are anything but decoupled income support subject to all the requirements in paragraph 6.

<sup>517</sup> Australia's written submission to the first session of the first substantive meeting, paras. 46-48.

<sup>518</sup> Canada oral statement at the first session of the first substantive meeting, para. 5.

<sup>519</sup> New Zealand written submission to the first session of the first substantive meeting, para. 2.26.

<sup>520</sup> European Communities' oral statement at the first session of the first substantive meeting, para. 32.

(iii) *Evaluation by the Panel*

7.393 The Panel has already found that DP payments fail to conform to the provisions of paragraph 6 of Annex 2 due to the planting flexibility limitations. It is therefore unnecessary for the purposes of this dispute to make findings on their conformity with paragraph 6 due to the updating. Therefore, the Panel makes only the following factual findings which aid in understanding the comparison of support under Article 13(b) and later Sections of this report.

7.394 Under the DP programme, owners had to establish base acres and programme yields for all commodities covered by the programme before enrolling. "Base acres" are the quantity of acreage on which payments are calculated.<sup>521</sup> They are calculated as an average of plantings in certain previous years, not plantings in the years when payments are made. The alternative methods of calculating base acres for the DP programme are found in section 1101(a) of the FSRI Act of 2002, which gave owners a one-time opportunity to elect a method of calculation of base acres.

7.395 This provision essentially gave owners three options for calculation of base acres. One option was to choose base acres equal to those that would have been used to calculate the 2002 PFC payment for the commodities covered by both programmes. This was calculated for upland cotton from the three-year average of acreage planted during the 1993 through 1995 crop years.<sup>522</sup> Another was to add oilseeds to base acres used for the PFC payment, using one of three possible methods. The other option was to calculate base acres from the four-year average of acreage planted during the 1998 through 2001 crop years. The USDA described this option as "updating" all base acres.<sup>523</sup>

7.396 The majority of farms with upland cotton base acres did not choose to update all base acres. However, those which did update caused the total upland cotton base acreage to increase in the 2002 marketing year from 15,933,377.9 acres under the PFC programme to 18,558,304.2 acres under the DP programme, an increase of 16.4 per cent.<sup>524</sup> This increase was based on planting that occurred during 1998-2001, which was after the base period 1993-1995. The updating necessarily increased the total amount of payments on upland cotton base acreage over the previous year, because the DP payment rate for upland cotton is not lower than the PFC payment rate for the previous year (it is in fact slightly higher). At the same time, upland cotton planted acreage in the 2002 crop year declined over the 2001 crop year by 1.09 million acres.<sup>525</sup> Therefore, the overall updating of base acres was not linked to an overall increase in production of upland cotton. However, individual updating by certain recipients was linked to increases in plantings of upland cotton in 1998-2001 over 1993-1995. For those recipients, the amount of payments is related to the type or volume of production undertaken by the producer in 1998-2001.

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<sup>521</sup> They were called "contract acreage" in the PFC programme. "Payment acres" are equal to 85 per cent of a recipient's base acres in both the PFC and DP programmes.

<sup>522</sup> Section 102(4) of the FAIR Act of 1996. See 7 CFR 1412.103 (1 January 2002 edition) for the definition of "eligible acreage" and 7 CFR 1413.7 (1 January 1993 edition) relating to deficiency payments, reproduced in Exhibit BRA-26. For covered commodities other than upland cotton and rice, base acreage was generally calculated as the average of acres planted during the previous five years.

<sup>523</sup> USDA side by side comparison of PFC and DP payments in Economic Research Service Features: *"The 2002 Farm Bill: Title I – Commodity Programs"*, printed 16 September 2002, reproduced in Exhibit BRA-27; USDA Agriculture Information Bulletin Number 778, Economic Research Service electronic report: *"The 2002 Farm Act – Provisions and Implications for Commodity Markets"* by Paul C. Westcott, C. Edwin Young and J. Michael Price, November 2002, at page 7; USDA Direct payment and CCP enrolment report dated 19 June 2003; USDA "Cotton Briefing room: Farm Commodity Policy, Updating Base Acres and Payment Yields", USDA Farm Services Agency Newsroom "Veneman reminds farmers to complete DCP sign-up by June 2" dated 29 May 2003; and extract from USDA *"2002 Direct and Counter-Cyclical Program Final Enrolment Report (DCP-01)"*, November 2002 titled "Upland cotton base and yield updating by state and region, marketing year 2002", reproduced in Exhibits BRA-27, BRA-42, BRA-44, BRA-110, BRA-321 and US-94, respectively.

<sup>524</sup> Exhibits US-111 and US-112 and United States' further rebuttal submission para. 82.

<sup>525</sup> Exhibits US-111 and US-112.

7.397 It is clear to the Panel that the DP programme is the successor to the PFC programme. The two programmes were established by successive farm bills, the latter of which provided that DP payments in the 2002 marketing year should be adjusted to take account of the PFC payments for the same fiscal year.<sup>526</sup> Base acreage used for the 2002 PFC payment can be used to calculate base acreage for the DP programme. This relationship is confirmed by the USDA Economic Research Service as follows:

"While the 2002 Farm Act introduces some new policies to the array of agricultural commodity programs, in many ways, it extends provisions of the 1996 Farm Act and the ad hoc emergency spending bills of 1998-2001. For example, the 2002 Act continues marketing assistance loans, which existed under previous U.S. farm law; *direct payments replace production flexibility contract payments* of the 1996 Farm Act; and counter-cyclical payments are intended to institutionalize the market loss assistance payments of the past several years."<sup>527</sup> [emphasis added]

7.398 The fact that they are "successor" programmes does not tell us whether they are or are not the same income support programme for which the base period has been changed. The Panel notes that the PFC and DP programmes share certain structural elements:<sup>528</sup>

- (i) eligible recipients are the same<sup>529</sup>;
- (ii) the payment formula is the same, namely 85 per cent of the recipient's base acres, multiplied by payment yields multiplied by the payment rate for each commodity<sup>530</sup>;
- (iii) payments are made by reference to historical acreage and historical yields, not current production<sup>531</sup>;
- (iv) base acres for the same commodities can be the same, at the owner's election<sup>532</sup>;

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<sup>526</sup> Section 1107 of the FSRI Act of 2002. Adjustment to avoid double payments in itself may only indicate that the recipients are the same, and not that two programmes are structurally similar. For instance, there was a similar provision to adjust PFC payments in the 1996 marketing year to take account of deficiency payments for the same year, although deficiency payments allowed no planting flexibility – see section 114(e) of the FAIR Act of 1996.

<sup>527</sup> USDA Agriculture Information Bulletin Number 778, Economic Research Service electronic report: *"The 2002 Farm Act – Provisions and Implications for Commodity Markets"* by Paul C. Westcott, C. Edwin Young and J. Michael Price, November 2002, page iv, reproduced in Exhibit BRA-42. See also the description of direct payments at page 4.

<sup>528</sup> Brazil also drew attention to the USDA side by side comparison of PFC and DP payments: USDA Economic Research Service Features: *"The 2002 Farm Bill: Title I – Commodity Programs"*, printed 16 September 2002, reproduced in Exhibit BRA-27. The Panel considers that comparison useful in that its contents reveals the structural similarities between the programmes, not because of the choice of format.

<sup>529</sup> Section 102(12) of the FAIR Act of 1996, 7 CFR 718.2 (1 January 2002 edition) and Section 1001(12) of the FSRI Act of 2002 and 7 CFR 1412.202 and 1412.402, reproduced in Exhibits BRA-28, BRA-31, BRA-29 and BRA-35, respectively. The United States emphasized that "the 1996 Act and implementing regulations under both Acts contained identical language" – see its rebuttal submission para. 37.

<sup>530</sup> See 7 CFR 1412.103 (1 January 2002 edition) and 7 CFR 1412.502(e), reproduced in Exhibits BRA-31 and BRA-35, respectively.

<sup>531</sup> Section 114(a) of the FAIR Act of 1996 and Section 1103(b) of the FSRI Act of 2002.

<sup>532</sup> Section 1101(a)(B)(i) of the FSRI Act of 2002, which refers to the "contract acreage (as defined in Section 102 of the [FAIR Act of 1996] used by the Secretary to calculate the fiscal year 2002 payment authorized under section 114 of such Act for the covered commodities on the farm". See Exhibits BRA-29 and US-1.

- (v) payment yields for commodities covered by both programmes are the same<sup>533</sup>;
- (vi) payment rates are fixed for each commodity and unaffected by current market prices<sup>534</sup>;
- (vii) land use requirements are basically the same<sup>535</sup>;
- (viii) planting flexibility and planting flexibility limitations are the same<sup>536</sup>; and
- (ix) payment limitations are the same.<sup>537</sup>

7.399 The two programmes also have certain differences:

- (i) commodity coverage differs. The DP programme includes all commodities covered by the PFC programme plus soybeans, other oilseeds and peanuts<sup>538</sup>;
- (ii) the method of calculating payment rates differs. The DP payment rates are set out in the legislation and fixed on a per unit basis for the entire life of the Act. PFC payment rates are derived from the share of funds allocated to each contract commodity according to percentages specified in the Act;
- (iii) the term of contract differs. DP contracts are annual but PFC contracts ran for up to the entire life of the Act. Payments are annual under both; and
- (iv) actual payment rates differ. DP payment rates for upland cotton are higher than PFC payment rates for 2001 and 2002, but lower than the average PFC rates throughout the life of the PFC programme.

7.400 The United States explained that the reason for allowing producers to calculate base acres for all covered commodities using the 1998-2001 average was due to the fact that oilseeds had not been covered by the PFC programme. Some mechanism was required to bring acreage previously devoted to oilseeds within the scope of the DP programme.<sup>539</sup>

7.401 The Panel observes that such a mechanism is found in section 1101(a)(1)(B), which permitted a recipient to calculate base acres by reference to the base period of the 1993 through 1995 crop years, adding acreage for oilseeds under one of three different options. Section 1101(a)(1)(A), on the other hand, permitted a recipient to update base acres for *all* covered commodities, and not just bring

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<sup>533</sup> See 7 CFR 1412.103 (1 January 2002 edition) and 7 CFR 1412.301 and 1412.302 (1 January 2003 edition), reproduced in Exhibits BRA-31 and BRA-35, respectively.

<sup>534</sup> See 7 CFR 1412.103 (1 January 2002 edition); 7 CFR 1412.502(d) (1 January 2003 edition), and Table 19 of USDA *Agricultural Outlook* (November 2003), reproduced in Exhibits BRA-31, BRA-35 and BRA-394, respectively.

<sup>535</sup> Section 111(a) of the FAIR Act of 1996 and section 1105(a) of the FSRI Act of 2002.

<sup>536</sup> See 7 CFR 1412.206 (1 January 2002 edition) and 7 CFR 1412.407 (1 January 2003 edition), reproduced in Exhibits BRA-31 and BRA-35, respectively.

<sup>537</sup> There was and remains a limitation of \$40,000 per person per crop year. The three entity rule has been retained according to which an individual can receive a full payment directly and up to a half payment from two additional entities: see section 115 of the FAIR Act of 1996 and section 1603 of the FSRI Act of 2002; see also the USDA side by side Comparison of PFC and DP payments at page 12, reproduced in Exhibit BRA-27.

<sup>538</sup> Section 102(5) of the FAIR Act of 1996 and sections 1001(4) and 1103 of the FSRI Act of 2002. Payments are calculated differently with respect to peanuts, as described in Section VII:C of this report.

<sup>539</sup> United States' first written submission, para. 60.

acreage previously devoted to oilseeds within the scope of the DP programme. The United States explained that compelling all recipients to use the 1998-2001 average would have penalized those who had chosen not to produce during the PFC programme.<sup>540</sup> However, this explanation assumes that it was appropriate to use the 1998-2001 average for all covered commodities, which is what is in dispute.<sup>541</sup> The United States could have chosen a separate means to provide support to oilseed producers, instead of incorporating them into this measure and permitting owners to update their base period, but it did not.

7.402 Brazil argues that the possibility of updating encourages producers to plant more acreage to commodities covered by a programme in the expectation that they would be able to update base acreage in the successor programme.<sup>542</sup> It submits that the option of updating base acres in 2002 for all covered commodities "will send a strong signal to producers to use their 'freedom to farm' to protect their 'future base' by at a minimum maintaining existing levels of production and if possible, increase production and yields of program crops."<sup>543</sup> It cites evidence from USDA economists that "[t]hese base acreage and payment yield updates may influence current production choices if farmers expect that future legislation will again allow them to update these program parameters for their farms."<sup>544</sup>

7.403 The United States responds to this argument in relation to its arguments that DP payments comply with the fundamental requirement in paragraph 1. It submits that Brazil's argument rests entirely on theoretical statements and that it does not evaluate the extent of any hypothesized production effect.<sup>545</sup> It submits that Brazil's argument ignores the opportunity costs of planting cotton instead of a crop with a more favourable expected return in the current year and notes that there is no statutory authority for any future base updating.<sup>546</sup>

7.404 The Panel notes that Brazil expresses its argument as a hypothetical: the effect on current production choices depends on "if" farmers expect future updating. However, 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

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<sup>540</sup> United States' first written submission, para. 60.

<sup>541</sup> Brazil drew attention to the comments of an advisor to the Board of the United States National Cotton Council, that: "The new bill also provides the ability to update base acreage and payment yields based on recent history, specifically the years 1998-2001. This will bring a producer's payment production more in line with recent production patterns. The updating will be of particular benefit to growers in the southeast, where recent plantings have exceeded the base established under the 1996 Act." Robert McLendon: *The Six Year World Outlook for Cotton and Peanuts: Implications for Production and Prices*, presentation at the Fourth Annual Symposium on the Future of American Agriculture, University of Georgia College of Agricultural and Environmental Sciences, reproduced in Exhibit BRA-111.

<sup>542</sup> Brazil's first written submission, paras. 179 and 180.

<sup>543</sup> Brazil's first written submission, para. 185.

<sup>544</sup> USDA The 2002 Farm Act, Provisions and Implications for Commodity Markets reproduced in Exhibit BRA-42 at page 19, cited in Brazil's first written submission, paras. 186 and 187.

<sup>545</sup> United States' rebuttal submission, para. 62.

<sup>546</sup> United States' oral statement at the second substantive meeting, paras. 59-66 and response to Panel Question No. 216.

updates, either as a part of ad hoc legislation or as a part of the regularly scheduled new law in 2007."<sup>547</sup>

7.405 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.

(d) The "fundamental requirement"

(i) *Main arguments of the parties*

7.406 **Brazil** claims that PFC and DP payments provided to upland cotton producers are inconsistent with "the fundamental requirement that they have no, or at most minimal, trade-distorting effects or effects on production" pursuant to paragraph 1 of Annex 2.<sup>548</sup> In Brazil's view, measures that do not comply with that fundamental requirement are actionable independently of any failure to comply with the basic or policy-specific criteria in Annex 2. An interpretation of the fundamental requirement as a policy objective that merely informs the rest of Annex 2 would detract from the unambiguous obligation that domestic support measures have no, or at most minimal, trade-distorting effects or effects on production.<sup>549</sup> Brazil presents economic evidence concerning the alleged production effects of these payments.

7.407 However, Brazil submits that any domestic support measures that do not comply with one of the basic or policy-specific criteria in Annex 2 are to be presumed to violate the fundamental requirement. It argues that this conclusion holds regardless of any finding on the character of the fundamental requirement as a stand-alone obligation.<sup>550</sup> Brazil does not challenge PFC and DP payments under either of the basic criteria in paragraphs 1(a) and (b) of Annex 2. It accepts that they comply with the basic criterion that they are provided through a publicly-funded government programme not involving transfers from consumers, and does not allege that they "have the effect of providing price support to producers."<sup>551</sup>

7.408 The **United States** responds that compliance with the fundamental requirement that domestic support measures for which exemption from reduction commitments is claimed have no, or at most minimal, trade-distorting effects or effects on production will be demonstrated by conforming to the basic and policy-specific criteria in Annex 2. Measures that conform to the two basic criteria in paragraph 1 plus the applicable policy-specific criteria and conditions in paragraphs 6 through 13 of Annex 2 will be deemed to meet the fundamental requirement.<sup>552</sup> In the United States' view, the fundamental requirement does not merely set out in hortatory terms the objective of Annex 2.<sup>553</sup> The United States argues that Brazil has not made a prima facie case with respect to the fundamental requirement because its evidence is hypothetical and does not address whether the production effects

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<sup>547</sup> Brazil's response to Panel Question No. 216. It also cited an article by two ABARE economists "2002 U.S. Farm Bill: An Australian Perspective on its Impact", reproduced in Exhibit BRA-81.

<sup>548</sup> Brazil's first written submission, paras. 163-165.

<sup>549</sup> Brazil's response to Panel Question No. 27.

<sup>550</sup> Brazil's response to Panel Question No. 27.

<sup>551</sup> Brazil's response to Panel Question No. 30. The United States submits that the DP programme satisfies both basic criteria, relying on section 1103 of the FSRI Act of 2002 and the fact that DP payments are not made to support any "applied administered price" in the sense of paragraph 8 of Annex 3 of the *Agreement on Agriculture*. See the United States' first written submission, paras. 64-66.

<sup>552</sup> United States' first written submission, para. 50; United States' oral statement at the first session of the first substantive meeting, para. 16

<sup>553</sup> United States' response to Panel Question No. 29.

of these payments are more than minimal. It submits economic evidence in support of its view that these payments in fact do satisfy the fundamental requirement.<sup>554</sup>

(ii) *Main arguments of the third parties*

7.409 **Argentina**<sup>555</sup> and **Australia**<sup>556</sup> submit, in effect, that measures must satisfy the fundamental requirement in paragraph 1 in addition to the criteria in Annex 2 in order to be exempt from reduction commitments.

7.410 The **European Communities** submits that the first sentence of paragraph 1 of Annex 2 does not set out an independent obligation but simply signals the objective of Annex 2.<sup>557</sup>

7.411 **New Zealand** submits that the fundamental requirement and the other criteria in Annex 2 are to be strictly applied to measures in order to obtain exemption from reduction commitments.<sup>558</sup>

(iii) *Evaluation by the Panel*

7.412 The Panel does not decide whether the fundamental requirement in paragraph 1 of Annex 2 is a freestanding obligation or not. In Brazil's view, any domestic support measures that do not comply with one of the basic or policy-specific criteria in Annex 2 are to be presumed to violate the fundamental requirement. In the United States' view, a measure that does not satisfy the basic and policy-specific criteria in Annex 2 may not conform to the provisions of Annex 2 even if it satisfies the fundamental requirement. Therefore, in light of the Panel's finding that the measures do not satisfy a criterion in paragraph 6, it is unnecessary to continue for the purposes of paragraph (a) of Article 13. The Panel makes certain findings on the effects of these measures in Section VII:G of this report.

(e) Conclusion regarding paragraph (a) of Article 13

7.413 In light of the above findings, the Panel concludes that PFC payments, DP payments, and the legislative and regulatory provisions which establish and maintain the DP programme, do not fully conform with paragraph 6(b) of Annex 2 of the *Agreement on Agriculture*. They are not green box measures.

7.414 Consequently, the Panel concludes that these measures do not comply with the condition in paragraph (a) of Article 13 of the *Agreement on Agriculture* and are therefore non-green box measures covered by paragraph (b) of Article 13.

## 5. Paragraph (b) of Article 13

(a) Condition at issue

7.415 **Brazil** asserts that the United States domestic support measures at issue do not satisfy the conditions in paragraph (b) of Article 13 of the *Agreement on Agriculture* for the single reason that they do not comply with the proviso in subparagraph (ii), i.e. because they "grant support to a specific

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<sup>554</sup> United States' rebuttal submission, paras. 60-64. The United States also submits that, on Brazil's reading, if a measure does not conform to the criteria in Annex 2, it still could meet the fundamental requirement of paragraph 1. However, see Brazil's response to Panel Question No. 27 referred to *supra* at footnote 550.

<sup>555</sup> Argentina's response to Panel third party Question No. 9.

<sup>556</sup> Australia's written submission to the first session of the first substantive meeting, paras. 31-32.

<sup>557</sup> European Communities' written submission to the first session of the first substantive meeting, para. 15.

<sup>558</sup> New Zealand's response to Panel third party Question No. 11

commodity in excess of that decided in the 1992 marketing year". It does not pursue any claim that the domestic support measures do not comply with the conditions set out in the chapeau of paragraph (b).

7.416 The **United States** responds that its domestic support measures satisfy all the conditions in paragraph (b), including the proviso in subparagraph (ii).

7.417 The Panel begins by noting that Article 13(b)(ii) provides as follows:

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

(...)

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

(...)

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

(...)

7.418 The task of the Panel is therefore to assess whether the United States domestic support measures grant support to a specific commodity in excess of that decided in the 1992 marketing year. This calls for a comparison. The two quantities to be compared are the extent to which "such measures (...) grant support to a specific commodity" and "that decided during the 1992 marketing year". We will refer to the first half of this comparison as "implementation period support" because the relevant time at which such measures grant support is contemporaneous with the applicability of Article 13.<sup>559</sup> Whether implementation period support is annual support, or some other period of support, is a matter we may consider later. We will refer to the second half of the comparison as the "MY 1992 benchmark".

7.419 The words "in excess of" link the two halves of the comparison grammatically. They indicate that a mathematical comparison has to be made. An excess of implementation period support over the MY 1992 benchmark will show that the domestic support measures at issue are inconsistent with the additional condition in Article 13(b)(ii). There is no requirement to quantify the excess, but the decisive question is whether there is any excess. Thus, it would not be strictly necessary for the Panel to make a precise calculation of the amount of the excess if it is clear that, on the basis of the proper evidentiary standard, there is an excess of some degree.

7.420 The notion of "support" links the two halves of the comparison semantically. Implementation period support refers to "support" to a specific commodity expressly and the MY 1992 benchmark refers to "that' decided", which refers to "support to a specific commodity". Disciplines on "support"

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<sup>559</sup> Discussed below in paragraph 7.529.

are one of the three pillars of the *Agreement on Agriculture*, which uses the word "support" interchangeably with "domestic support".<sup>560</sup> Neither are defined terms, although Articles 3.2, 6.1, 6.3, 7.1 and 7.2(a) clarify their meaning somewhat by referring to "support in favour of domestic producers" or "domestic support in favour of agricultural producers". The subject of the proviso in subparagraph (b)(ii) is "such measures" that conform fully to the provisions of Article 6.

7.421 Annex 3 sets out at great length a methodology for measuring the support granted by those measures which are calculated or can be calculated in an Aggregate Measurement of Support ("AMS"). Paragraph 1 of Annex 3 lists the following types of support:

"market price support, non-exempt direct payments, or any other subsidy not exempted from the reduction commitment ('other non-exempt policies')"

7.422 The residual type of support in this list refers to any "other" subsidy and paragraph 2 refers to "subsidies" under paragraph 1. We can also note that the first two types of support in the list are price and income support, which are terms used in paragraph 1 of Article XVI of the *GATT 1994* to illustrate the word "subsidy".<sup>561</sup> It is clear from all these references that all relevant types of support for the purposes of the *Agreement on Agriculture* are subsidies.

7.423 An important feature of the *Agreement on Agriculture* is that it defines in detail the domestic support measures *exempt* from reduction commitments, rather than those which are *subject* to reduction commitments. It is therefore inappropriate to attempt to give an exhaustive definition of "support". It is also unnecessary to do so due to the detailed methodology for measuring support contained in the text. In any event, for the purposes of this dispute, the parties agree that all of the measures in issue provide "support" in some form.<sup>562</sup>

(b) MY 1992 benchmark

(i) *Interpretation*

i Main arguments of the parties

7.424 **Brazil** argues that the phrase "decided during the 1992 marketing year" refers to some sort of a decision made by a Member between 1 August 1992 and 31 July 1993, but not before and not after. Brazil is aware of no specific legislation or regulation enacted or decided by the United States during the 1992 marketing year with respect to upland cotton. The only decision that could be said to have been made during that year was to provide the appropriations and continued funding for upland cotton pursuant to the FACT Act of 1990.<sup>563</sup> It argues that the interpretation of Article 13(b)(ii) must permit an "apples-to-apples" or "support-to-support" comparison. The word "decided" is neutral, requires no particular type of decision, and must not detract from the meaning of the term "grant" which is the operative verb for implementation period support. The MY 1992 benchmark must include some aspect of "grant" because it is "that" decided in MY 1992, which refers back to "support" and which is connected to the verb "grant".<sup>564</sup>

7.425 The **United States** responds that the key term in this phrase is "decided" which stands in contrast to other provisions in the *Agreement on Agriculture* that use the term "provided". This suggests that the use of the term "decided" was deliberate so as to make the condition in

<sup>560</sup> See the preamble, the definitions of AMS, EMS and Total AMS in Article 1, the methods of calculation of AMS and EMS in Annexes 2 and 3 and Articles 3, 6, 7, 18 and 20.

<sup>561</sup> The text of Article XVI:1 of the *GATT 1994* is set out in Section VII:G of this report.

<sup>562</sup> However, they have sharply differing views on whether they grant "support to a specific commodity" within the meaning of Article 13(b)(ii).

<sup>563</sup> Brazil's first written submission, paras. 139 and 141.

<sup>564</sup> Brazil's oral statement at the first session of the first substantive meeting, para. 31.

Article 13(b)(ii) not dependent on the support actually provided during the 1992 marketing year.<sup>565</sup> United States domestic support measures did not decide on an outlay or expenditure amount in favour of upland cotton, but determined a level of income support. The United States government ensured that upland cotton farmers would receive 72.9 cents per pound of upland cotton.<sup>566</sup>

7.426 **Brazil** argues that a rate of support methodology would allow Members to make huge increases in payments when market prices are falling, as long as they comply with Total AMS reduction commitments. In any event, the 1990 deficiency payments programme rate of support of 72.9 cents per pound must be adjusted downwards for upland cotton not eligible to receive that support, the cost to producers of the requirement to idle part of their base acreage, and other programmes in effect in 1992.<sup>567</sup>

7.427 The **United States** responded that – even allowing for the adjustments proposed by Brazil – the product-specific support granted in marketing years 1999 through 2002 was lower than the rate of support decided in the 1992 marketing year. In any event, the fact that some upland cotton was not eligible to receive the rate of support was due to producer decisions not to participate in the programme, not a decision of the United States government. Land idling and flex acre requirements were decisions taken by the United States government but they affected eligibility and not the rate of support.<sup>568</sup> If these requirements were factored into the rate of support, it would produce a guaranteed producer revenue of 67.7625 cents per pound.<sup>569</sup>

ii Main arguments of the third parties

7.428 **Argentina** considers that the support "decided" refers to a legislative or administrative decision by a Member on the domestic support to be granted during the implementation period in terms of budgetary outlays. If no "decision" was taken in terms of budgetary outlays during the 1992 marketing year, the only support that can have been "decided" during that marketing year is the support granted during that year.<sup>570</sup>

7.429 **Australia** considers that "decided" means the level of non-green box domestic support by a Member in the course of the 1992 marketing year to be provided to the benefit of a specific agricultural commodity in the future. Australia clearly understood in the resumed Uruguay Round agriculture negotiations in 1993 that the words "decided during the 1992 marketing year" had been chosen to incorporate in the text of Article 13(b)(ii) and (iii) the sense of expectations of "conditions of price competition" as interpreted and applied in the *EEC – Oilseeds* dispute. Budgetary outlay figures put forward by Brazil and the rate of payment put forward by the United States would both properly form a part of that assessment, but not the whole.<sup>571</sup>

7.430 **China** does not agree with the United States' rate of support approach because it would prevent any measure involving year end accounting for the calculation of expenditures ever exceeding that decided during the 1992 marketing year. The drafters may have chosen "decided" rather than "granted" to exclude expenditures that cannot be precisely allocated to a specific marketing year or to include certain support payments granted by an administration in 1992 but which did not reach the

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<sup>565</sup> United States' first written submission, paras. 82-87.

<sup>566</sup> United States' first written submission, para. 94.

<sup>567</sup> Brazil's oral statement at the first session of the first substantive meeting, paras. 33 and 36, and Exhibits BRA-103 and BRA-105.

<sup>568</sup> United States' rebuttal submission, paras. 121-124.

<sup>569</sup> United States' rebuttal submission, para. 126.

<sup>570</sup> Argentina's response to Panel third party Question No. 21.

<sup>571</sup> Australia's written submission to the first session of the first substantive meeting, paras. 24-26 and its oral statement at the first session of the first substantive meeting, paras. 6-13.

beneficiaries until later. However, the core intention was to choose the 1992 marketing year to establish a benchmark support level.<sup>572</sup>

7.431 The **European Communities** does not agree with Brazil's budgetary outlays approach because the word "decided" stands out in contrast to "grant" in the same sentence. This is intended to set a benchmark made up of an amount of support adopted by some form of decision (be it political, legislative or administrative) in which support for a specific product is decided and allocated for future years. This text was negotiated in November 1992 when the negotiators could not yet have known the support that would be granted in the whole 1992 marketing year. They used the term "decided" rather than "granted" to refer to decisions taken during 1992 in respect of support which Members intended to grant – not that actually granted. The Panel should use a level of support readily comparable with the support currently granted which may well be the support decided for a particular marketing year. It is not possible that a Member providing subsidies could not have made a relevant decision in the 1992 marketing year since, at the very least, it would have decided, on the basis of its subsidy programmes and the amount of eligible production and/or estimated production, to set aside a specific amount of budgetary appropriations for future years. However, if a Member decided not to provide support to a specific commodity, the level of support for purposes of the comparison would be zero.<sup>573</sup> AMS-like criteria should be used to measure the support decided because it takes into account the reference to AMS as the annual level of "support" yet would also measure the support "decided" rather than granted. AMS-like criteria could be used because it often is possible to establish, for certain measures, a gap between the applied administered price and the internal or external fixed reference price and establish, on the basis of information available to the decision makers, the amount of production which was eligible, or which was estimated. For other measures, it may also be possible to use appropriation or budgetary decisions.<sup>574</sup>

7.432 **New Zealand** does not agree with an approach that focuses solely on a guaranteed price per pound. The comparison must take into account the totality of payments to upland cotton producers in order to reflect the true nature of the support that is being granted, which the United States' rate of support approach ignores. A rate per pound alone ignores the actual levels of domestic support represented by budgetary outlays that must be granted in order to maintain those rates and the other payments received. The clear overarching intention of the negotiators of the *Agreement on Agriculture* was that such distortions would be reduced, consistent with the long term objective of correcting and preventing restrictions and distortions in world agriculture markets.<sup>575</sup>

### iii Evaluation by the Panel

7.433 The Panel notes that the proviso in subparagraph (ii) of paragraph (b) reads as follows:

"provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year"

7.434 The MY 1992 benchmark is expressed as "that decided during the 1992 marketing year". The words "that decided" refer back to the phrase "support to a specific commodity" which is discussed in relation to implementation period support below.<sup>576</sup> The words "that decided" therefore mean "that [support to a specific commodity] decided". This occurrence of the verb "decided" with the direct object "support" is unique in the *WTO Agreement*. It is not defined and is a curious usage of the verb

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<sup>572</sup> China's response to Panel third party Question No. 21.

<sup>573</sup> European Communities' oral statement at the first session of the first substantive meeting, paras. 16, 19-20 and its responses to Panel third party Questions Nos. 21 and 27.

<sup>574</sup> European Communities' response to Panel third party Question No. 22.

<sup>575</sup> New Zealand's written submission to the first session of the first substantive meeting, paras. 2.06-2.09 and its oral statement at the first session of the first substantive meeting, para. 6.

<sup>576</sup> See the Panel's findings in paragraphs 7.494 and following.

"decide" which rarely takes a direct object such as "support" without a preposition such as "on". The word "decide" can be defined as follows:

"Come to a determination or resolution *that, to do, whether.*"<sup>577</sup>

7.435 In its context, the use of the verb "decided" stands in contrast to the use of the verb "grant" in relation to the same noun "support" in the same proviso. Yet despite the contrast, the proviso calls for a comparison which necessarily requires the two halves of the comparison to be expressed in the same units of measurement.

7.436 A difference between the support that a government decides and the support that its measures grant is that one is expressed in terms of prior determinations of levels of support and the other in terms of subsequent support provided. (The word "grant" in the English version of the text also has connotations that "provided" does not). Decisions on support are often expressed in terms of appropriations of specific amounts of money, which may exceed the amount subsequently granted. Decisions on support can also be expressed in terms of payments of specific amounts, which are identical to the amount granted. Decisions on support are often expressed in terms of rates or methods to calculate payments, so that the amounts outlaid are not known until later. Decisions on price and income support also include eligibility criteria for production or producers, which are not captured separately in the notion of support granted. In the Panel's view, all of these decisions would delimit "that [support to a specific commodity] decided".

7.437 Another difference between the choice of the verbs "decided" and "grant" is that, where the benchmark is established by reference to a specific period of time, the relevant acts were the decisions on support, and not the grant of support, during that period of time. The text spells out that the relevant time for the establishment of the benchmark was "during the 1992 marketing year". This is one of only two domestic support benchmarks or base periods referred to in the *Agreement on Agriculture*. Both were periods during the negotiations, the other being "the years 1986 to 1988" for the purposes of calculation of the AMS.<sup>578</sup> Although the "marketing year" varies, it is a very specific period of time for a specific commodity and Member. The parties agree that the marketing year for upland cotton in the United States begins on 1 August, and that the 1992 marketing year ran from 1 August 1992 to 31 July 1993.<sup>579</sup>

7.438 The period "during the 1992 marketing year" is a very specific limitation on the establishment of the benchmark which the Panel is obliged to apply. The Panel must examine what decisions were made by the United States during the 1992 marketing year concerning support for upland cotton, and at no other time. The time at which support was granted as a result of those decisions is not addressed in the text. Decisions taken during the 1992 marketing year could have related to support granted in the same marketing year or in a later marketing year or in several marketing years. The text does not preclude any of these possibilities.

7.439 Brazil submitted that this portion of Article 13 first appeared in the Uruguay Round text following the second US/EC Blair House agreement of December 1993, and that it was drafted to provide a safe harbour for the European Community's Common Agricultural Policy ("CAP") reform

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<sup>577</sup> *The New Shorter Oxford English Dictionary* (1993). The parties agree that it means "determine". The United States adds that it can mean "pronounce".

<sup>578</sup> See paragraphs 9 and 11 of Annex 3.

<sup>579</sup> Brazil's first written submission, para. 139 and United States' response to Panel Question No. 69. See 7 CFR 1413.3 (1 January 1993 edition), reproduced in Exhibits BRA-26 and US-3, for the definition of "marketing year". USDA information provided in the Exhibits often refers to "crop year" for upland cotton which the United States delegation advised the Panel orally during the first session of the first substantive meeting was the same as the marketing year for upland cotton. The United States also used these terms interchangeably in its response to Panel Question No. 125(6).

"decided during the 1992 marketing year".<sup>580</sup> The United States is not aware of any written negotiating history that would shed light on why this proviso was added to Article 13(b)(ii).<sup>581</sup> The European Communities also submitted that Article 13(b) was negotiated in November 1992 and designed to protect support which Members had "decided during 1992" to grant<sup>582</sup> and submitted copies of two EC regulations reforming the CAP adopted during 1992 which lowered target prices for cereals commencing in the 1993/94 marketing year and offset loss of income through direct aid per hectare for arable farmers.<sup>583</sup>

7.440 The Panel notes that the text of subparagraph (ii) as it is currently drafted appeared in the Uruguay Round text following the first US/EC Blair House agreement of November 1992.<sup>584</sup> It was therefore negotiated during the 1992 marketing year itself, at which time some decisions may already have been taken by individual Members concerning support, and at which time they may not have known the value of the support that they would grant during that marketing year. This does not alter the Panel's interpretation in this dispute.

7.441 The proviso in subparagraph (ii) itself does not "protect support" but rather sets forth an additional condition besides those in the chapeau of paragraph (b) with which measures must comply in order to benefit from the exemptions from actions. However, within that additional condition, in choosing to define the benchmark as support "decided" rather than, say, "granted" during the 1992 marketing year, the drafters may well have intended to protect certain decisions which had already been taken or were proposed to be taken during that marketing year. However, that intention is not clear from the wording of the provision, nor the negotiating history provided to the Panel.

7.442 The two EC regulations submitted to the Panel show that they were both "done" on 30 June 1992. This appears to mean that the decisions to adopt those regulations were taken on that day, although they entered into force the following day. Both define the marketing year for the relevant products as beginning on 1 July and ending on 30 June of the following year<sup>585</sup> so that, for those products and the European Communities, the 1992 marketing year did not begin until 1 July 1992. Therefore, on their own terms, neither regulation appears to have been decided "during the 1992 marketing year" and, as such, they do not assist the Panel in its interpretation in this particular dispute.

7.443 The Panel also takes note of Australia's proposed interpretation of Article 13(b)(ii) and (iii) which reads elements of actions based on non-violation nullification and impairment into the conditions of Article 13. This interpretation is based on the premise that the additional condition in those subparagraphs should be capable of application in a non-violation complaint. In the Panel's view, that premise is false because Article 13 sets out conditions which provide exemption from certain types of actions and does not set out conditions which must be applied in the actions from which it provides exemption.

7.444 In any event, however the MY 1992 benchmark is defined, an essential feature of the additional condition in Article 13(b)(ii) and (iii) is that it sets forth the only condition in Article 13 of the *Agreement on Agriculture* as finally agreed that links the exemptions from actions for domestic support to specific commodities. It effectively replaced proposed product-specific and sector-wide

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<sup>580</sup> See Brazil's first written submission, para. 140 citing Terence P. Stewart (editor): *The GATT Uruguay Round: A Negotiating History*, Vol. IV, pp.24-25, reproduced in Exhibit BRA-75.

<sup>581</sup> See United States' response to Panel Question No. 50.

<sup>582</sup> See European Communities' response to Panel third Party Question No. 21.

<sup>583</sup> See European Communities' response to Panel third party Question No. 24 and Exhibits EC-3 and EC-4.

<sup>584</sup> See the draft Article which formed part of that agreement in Exhibit EC-1.

<sup>585</sup> Council Regulation (EEC) No. 1765/92 establishing a support system for producers of certain arable crops, Article 1, and Council Regulation (EEC) No. 1766/92 on the common organization of the market in cereals, Article 2, reproduced in Exhibits EC-4 and EC-3, respectively.

AMS reduction commitments in the draft agriculture text as the benchmark for the purposes of this condition.<sup>586</sup>

(ii) *Relevant decisions*

i Main arguments of the parties

7.445 **Brazil** and the **United States** both submitted that a variety of decisions, mentioned below, was taken by the United States concerning its domestic support for upland cotton during the 1992 marketing year.<sup>587</sup> Both parties' arguments also referred to levels of support during the 1992 marketing year itself, although they measured such support differently.

ii Evaluation by the Panel

7.446 The Panel observes that no statute deciding domestic support for upland cotton was enacted by the United States during the 1992 marketing year. The legislative basis for the then-current marketing loan, deficiency payments and user marketing (Step 2) programmes was the FACT Act of 1990.<sup>588</sup> That Act provided a formula to calculate the marketing loan rate subject to a minimum of not less than 50 cents per pound.<sup>589</sup> The Act set a target price for deficiency payments for upland cotton of "not less than" 72.9 cents per pound and also set forth conditions for the user marketing (Step 2) payments.<sup>590</sup> The OBRA Act of 1990 played a role in establishing the elements which are incorporated into the FACT Act of 1990 provisions implemented by the United States.<sup>591</sup> The next major piece of legislation determining programme structures was the FAIR Act of 1996.<sup>592</sup> Brazil has drawn the Panel's attention to the OBRA Act of 1993<sup>593</sup>, which was amending legislation, but this was enacted in August 1993, not during the 1992 marketing year for upland cotton and is therefore irrelevant.

7.447 Regulations relevant to domestic support for upland cotton were published during the 1992 marketing year. The United States relied on the Secretary of Agriculture's determination of the 1992 loan rate but this was decided during the 1991 marketing year and is therefore irrelevant.<sup>594</sup> The

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<sup>586</sup> This section of the drafting history is discussed at paragraphs 7.495 and following. Total AMS commitments replaced the proposed product-specific and sector-wide commitments for the purposes of compliance with the domestic support disciplines of the *Agreement on Agriculture* and the chapeau of paragraph b) of Article 13.

<sup>587</sup> Brazil's and the United States' respective responses to Panel Question No. 54.

<sup>588</sup> Public Law 101-624, enacted on 28 November 1990 - see Section VII:C of this report.

<sup>589</sup> 7 USC 1444-2(a)(3), (1992 Supplement dated 4 January 1993), reproduced in Exhibit US-5, and explained in USDA Economic Research Service: "Cotton: Background for 1995 Farm Legislation", April 1995, reproduced in Exhibit BRA-12.

<sup>590</sup> 7 USC 1444-2(c)(1)(B)(ii) (1992 Supplement dated 4 January 1993), reproduced in Exhibit US-5.

<sup>591</sup> Omnibus Budget Reconciliation Act of 1990, Public Law 101-508 enacted on 5 November 1990 and explained in USDA Economic Research Service: "Cotton: Background for 1995 Farm Legislation", April 1995, pages 15-17, and "Provisions of the Agricultural Improvement and Reform Act of 1996, Appendix III: Major Agricultural and Trade Legislation, 1933-96", pages 133-134, reproduced in Exhibits BRA-12 and BRA-24.

<sup>592</sup> Federal Agriculture Improvement and Reform Act of 1996, Public Law 104-127. This Act amended the Agricultural Act of 1949. Title I, the Agricultural Market Transition Act, is reproduced in Exhibits BRA-28 and US-22.

<sup>593</sup> See the statement of Dr. Sumner, para. 7, in Exhibit BRA-105, referring to the Omnibus Budget Reconciliation Act of 1993, Public Law 103-66. The Bill for this Act was not passed by the House of Representatives until 5 August 1993 and was not signed by the President of the United States until 10 August 1993. This law amended the Agriculture Act of 1949 and the FACT Act of 1990, *inter alia*, replacing the deficiency payments 50/92 programme option with the 50/85 programme option.

<sup>594</sup> United States' first written submission, para. 101, citing 57 FR 14326 published on 20 April 1992 (during the 1991 marketing year), reproduced in Exhibit US-2. The loan rate had already been announced on

United States also mentioned regulations published on 24 March 1993, which determined the price support rate (i.e. the loan rate) with respect to the 1993 crop of upland cotton at 52.35 cents per pound and the Acreage Reduction Program percentage ("A.R.P."<sup>595</sup>) for the 1993 crop of upland cotton at 7.5 per cent (down from 10 per cent for the 1992 crop). It also provided that a Paid Land Diversion Program would not be implemented for the 1993 crop of upland cotton.<sup>596</sup> The final rates had been announced on 2 November 1992, after publication of a proposed rule on 29 September 1992. Therefore, these decisions on the marketing loan rate and A.R.P. for the 1993 crop of upland cotton were taken during the 1992 marketing year. The regulations classified the impact of these two decisions in monetary terms as follows:

"This rule has been reviewed under USDA procedures established in accordance with Executive Order 12291 and provisions of Departmental Regulation 1512-1 and has been classified as "major". It has been determined that an annual effect on the economy of \$100 million or more may result from implementing of the provisions of this final rule."<sup>597</sup>

7.448 Brazil drew the Panel's attention to a range of other operational decisions including implementation of the 50/92 programme option, decisions on the deficiency payment rate (20.3 cents per pound),<sup>598</sup> determination of the upland cotton acreage base, a weekly adjusted world price for the marketing loan programme, the weekly Step 2 payment rate and decisions on individual crop insurance policies.<sup>599</sup> These operational decisions affected payments but they only produced some of the parameters in payment calculations. Other essential parameters in those calculations, such as the loan rate and target price for the 1992 crop, were not decided during the 1992 marketing year but earlier, as required by legislation. Therefore, these operational decisions do not represent support decided during the 1992 marketing year. Two decisions on the loan rate and A.R.P. were taken during the 1992 marketing year but they related to the 1993 crop, as required by legislation. They did not affect any payments affected by the operational decisions taken during the 1992 marketing year. Therefore, taken together, these decisions do not add up to support decided.<sup>600</sup>

7.449 The Panel sees no evidence of any other policy decision that could be relevant to the MY 1992 benchmark. The United States Congress set the minimum target price and loan rates in 1990 for the 1991 through 1995 marketing years and delegated authority to the Secretary of Agriculture to set and announce the actual loan rate for each marketing year. The loan rate for the 1992 crop of upland cotton was published in regulations on 20 April 1992.<sup>601</sup> The final rate had been announced on 31 October 1991 following publication of a proposed rule on 13 September 1991.<sup>602</sup> That was not a decision taken during the 1992 marketing year.

7.450 The United States argues that the Secretary of Agriculture decided to maintain the target price and loan level during the 1992 marketing year for the 1992 crop and that these decisions were

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31 October 1991. The FACT Act mandated the Secretary to decide the marketing loan rate applicable for each of the 1991 to 1995 crops and the permanent law provided that the loan level for the 1992 crop of upland cotton be determined in accordance with a specific formula and announced not later than 1 November 1991.

<sup>595</sup> The A.R.P. is explained below at footnote 774. It has nothing to do with the ARP Act of 2000.

<sup>596</sup> Published at 58 Federal Register 15755 and reproduced in Exhibit US-146. See the United States' responses to Panel Questions No. 54 (at footnote 63) and 214.

<sup>597</sup> Exhibit US-146 see *supra*, footnote 596.

<sup>598</sup> Exhibit BRA-4.

<sup>599</sup> Brazil's response to Panel third party Question No. 54 and 22 August comments on the United States' response to Panel Question No. 54.

<sup>600</sup> This is so regardless of whether a rate of support is an appropriate measurement of support.

<sup>601</sup> The Regulation was published on 20 April 1992 at 57 Federal Register 14326 and is reproduced in Exhibit US-2. It established a loan rate of 52.35 cents per pound.

<sup>602</sup> See United States' response to Panel Question No. 54.

reflected in the 1992 Supplement to the United States Code,<sup>603</sup> the 1 January 1993 edition of the Code of Federal Regulations<sup>604</sup> and a USDA fact sheet published in September 1993.<sup>605</sup> However, the legislation prohibited any change to the loan rate during the 1992 marketing year after it was announced in the preceding calendar year.<sup>606</sup> It is less clear to what extent the Secretary had authority to change the target price but, in any event, the 1992 Supplement to the United States Code and the 1 January 1993 edition of the CFR published the target prices for all five years covered by the FACT Act of 1990, including the 1991 marketing year which had completely elapsed.<sup>607</sup> This indicates that no decision had been taken to change the target price in 1992 and suggests that these publications simply reprinted or reformatted the decision regarding the target price enacted in legislation in 1990. The USDA fact sheet simply reported what had already been decided. The United States argued that the Secretary did not exercise his discretion to alter the effective price in the 24 March 1993 regulations. That is an accurate statement. In fact, those regulations do not mention the target price, or deficiency payments, at all. Therefore, in the Panel's view, the evidence does not show that any decision was taken during the 1992 marketing year with respect to target prices, or with respect to the loan rate for the 1992 crop of upland cotton. There is no justification for interpreting the MY 1992 benchmark as the target price of 72.9 cents per pound.

7.451 In view of this evidence, the MY 1992 benchmark might be thought to be the loan rate of 52.35 cents per pound, subject to reduction of the A.R.P of 7.5 per cent. Neither of the parties submitted that the Panel should treat this as the MY 1992 benchmark. Although it is dictated by the apparently deliberate choice of an unusual word in this context, i.e. "decided" to contrast with "granted", rather than, say, "provided", it appears to lead to an absurd result. It reflects only the timing of certain discrete decisions but not the total level of support decided for upland cotton over time. This is all the more curious given that the final decisions on the loan rate and the A.R.P. were taken only three weeks before the wording of the condition in Article 13(b)(ii) was negotiated. Brazil suggested that the condition was negotiated with the European Communities' domestic support measures in mind, but it is unnecessary for the Panel to take a view on that suggestion for the purposes of this dispute.

7.452 The only other decisions on support for upland cotton in the United States during the 1992 marketing year were decisions to make particular payments under programmes to support upland cotton. Each of those was a "determination" of a recipient's entitlement to a payment, in a particular amount, according to the programme and payment conditions, and hence a "decision" on "support" taken "during the 1992 marketing year". Those determinations involved consideration by the United States government of its obligations or authority to make payments, and matters such as eligibility criteria, compliance with acreage conditions, relevant rates and prices, and volume of upland cotton harvested and used, as set out in the applicable laws and regulations. There is no evidence that payments determined by these decisions involved substantial delays from the time these decisions were taken such that they were made in a different marketing year from that in which the payments were made. The sum of these decisions represents an amount of support that can be compared meaningfully with implementation period support and which can be measured according to the same methodology. In the Panel's view, this is the correct measure of the MY 1992 benchmark in this dispute.

7.453 Brazil submits that there were four types of support to upland cotton in the 1992 marketing year: deficiency payments, marketing loan programme payments, user marketing (Step 2) payments

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<sup>603</sup> Reproduced in Exhibit US-5.

<sup>604</sup> Reproduced in Exhibit US-3.

<sup>605</sup> Reproduced in Exhibit US-17.

<sup>606</sup> 7 USC §1444-2(a)(3) (1992 Supplement) (4 January 1993), reproduced in Exhibit US-5.

<sup>607</sup> 7 USC §1444-2(c)(1)(B)(ii) (1992 Supplement) (4 January 1993), reproduced in Exhibit US-5 and 7 CFR §1413.104(a), reproduced in Exhibit US-3.

and crop insurance payments.<sup>608</sup> The United States accepts that deficiency payments, marketing loan programme payments and user marketing (Step 2) payments are relevant for the purposes of the comparison under Article 13(b)(ii).<sup>609</sup> Its objection to the inclusion of crop insurance payments is that they are non-product-specific.<sup>610</sup> However, the evidence shows that upland cotton was an agricultural commodity for which the Federal Crop Insurance Corporation Act was authorized to offer crop insurance in that year.<sup>611</sup> All four types of payments granted support specifically to upland cotton.

7.454 The United States argues that this ignores how it decided support for upland cotton during the 1992 marketing year, which was in terms of a rate of support. No amount of outlays was "decided" during the 1992 marketing year since outlays or expenditures that are needed to provide this level of income support were neither known nor completed until after the marketing year ended and market prices reported.<sup>612</sup>

7.455 The Panel agrees that the United States did not adopt a discrete decision on the dollar amount of total outlays or expenditures that it would make for upland cotton during the 1992 marketing year. However, in the first place, the text of Article 13(b)(ii) *does not* require such a decision. The form of the decision or decisions by which support was decided is not addressed, which permits a comparison of a series of operational decisions (which are, relevantly, decisions) that determined the support; and secondly, the text of Article 13(b)(ii) *does* indicate that the relevant decision or decisions are those taken "during the 1992 marketing year". The target price for upland cotton was not such a decision, as it was taken during 1990, which prohibits the Panel from basing its comparison on that decision.

7.456 In summary, therefore, the Panel will include in the MY 1992 benchmark decisions made during the 1992 marketing year to make the following payments:

- (i) deficiency payments;
- (ii) marketing loan programme payments;
- (iii) user marketing (Step 2) payments to domestic users<sup>613</sup>; and
- (iv) crop insurance payments.

(c) Implementation period support

(i) *Interpretation*

i Main arguments of the parties

7.457 **Brazil** submits that the measures relevant to the implementation period support are all those which it has challenged. It submits that they in fact deliver support to upland cotton. These are the

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<sup>608</sup> Brazil's first written submission, paras. 143-144.

<sup>609</sup> See the United States' first written submission, paras. 100-104, confirming that the first three types of payments constitute product-specific support to cotton. At para. 102 of that submission, the United States submits that deficiency payments ensured cotton farms would realize income support of 72.4 cents per pound through the following legislation: 7 CFR 1413 (1 January 1993 edition), 7 CFR 1413.6 (1991 edition) and 7 U.S.C. 1444-2 (1992 supplement), reproduced in Exhibits US-3, US-4 and US-5, respectively. See also the United States' rebuttal, paras. 110, 111 and table.

<sup>610</sup> See the United States' rebuttal submission, paras. 93-98.

<sup>611</sup> See FCIC "Crop Year Statistics" reproduced in Exhibit BRA-57.

<sup>612</sup> United States' first written submission, paras. 93-94; United States' oral statement at the first session of the first substantive meeting, paras. 10-11.

<sup>613</sup> A meaningful comparison requires the exclusion of user marketing (Step 2) payments to exporters from the MY 1992 benchmark support, as they are also excluded from the implementation period support.

marketing loan programme payments, user marketing (Step 2) payments to domestic users<sup>614</sup>, PFC, MLA, DP and CCP payments, crop insurance payments and cottonseed payments.

7.458 Brazil submits that the ordinary meaning of Article 13(b)(ii) read in its context, requires the Panel to tabulate any non-green box domestic support payments that are linked in some manner to the production of upland cotton, and that there is nothing in the text of Article 13(b)(ii) limiting the support that must be tabulated to only that provided to a single commodity.<sup>615</sup>

7.459 The **United States** responds that the measures relevant to the implementation period support are only those which deliver product-specific support to upland cotton, namely benefits under the marketing loan programme, user marketing (Step 2) payments and, to the extent that they are within the Panel's terms of reference, cottonseed payments. It submits that "[t]he *measures* to be included in the calculation are identified by the phrase "support to a specific commodity".<sup>616</sup>

7.460 The United States argued that the phrase "grant support to a specific commodity" means "product-specific support", which it argued was defined as "support provided for an agricultural product in favour of the producers of the basic agricultural product", one of the components of the definition of AMS in Article 1(a) of the *Agreement on Agriculture*.<sup>617</sup>

7.461 **Brazil** disagreed with the United States' interpretation of "product-specific" in light of the components of the definition of AMS in Article 1(a) of the *Agreement on Agriculture*. It submitted that support provided "in favour of agricultural producers in general" was "non-product-specific" and that all other domestic support, including support provided for only a limited number of agricultural commodities, must be deemed "product-specific".<sup>618</sup>

7.462 The **United States** agreed that non-product-specific support is support in favour of agricultural producers in general but argued that the "precise definition" of product-specific support in Article 1(f) ensures that non-product-specific support is the residual category of support, covering those measures that do not fall within the phrase "support provided for an agricultural product in favour of the producers of the basic agricultural product" in Article 1(a). It also argued that recipients of decoupled payments *are* "producers in general" because they are free, with limited exceptions, to plant any commodity and are free, without exception, to undertake other agricultural activities.<sup>619</sup>

7.463 The United States argued that the allocation to one commodity of a share of any non-product-specific support has no basis in the *Agreement on Agriculture* and would erase the fundamental distinction between product-specific and non-product-specific support.<sup>620</sup> These categories are *sui generis* and may not be rendered inutile by the application of *SCM Agreement* concepts of subsidy, benefit and subsidized product which are not used in, nor directly applicable to, Article 13 of the *Agreement on Agriculture*. Brazil's approach treats a payment calculated with respect to base acreage historically planted to one crop as support to that crop and any other programme crop at the same time which is not support "to a specific commodity" but support to multiple commodities.<sup>621</sup> It factors in producer decisions about what to plant and how to spend decoupled payments, which would rob Members of their ability to comply with the conditions in Article 13(b).<sup>622</sup>

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<sup>614</sup> See *supra*, footnote 464.

<sup>615</sup> Brazil's rebuttal submission, para. 14.

<sup>616</sup> United States' 3 March 2004 comments, para. 14, second bullet.

<sup>617</sup> United States' first written submission, paras. 77-78 and its rebuttal submission, para. 73

<sup>618</sup> Brazil's rebuttal submission, para. 21 and its response to Panel Question No. 38.

<sup>619</sup> United States' rebuttal submission, para. 83, comments on Brazil's response to Panel Question No. 258 and its 11 February 2004 comments, paras. 7-14.

<sup>620</sup> United States' rebuttal submission, paras. 76 and 79.

<sup>621</sup> United States' comments on Brazil's response to Panel Question No. 258.

<sup>622</sup> United States' closing statement at second substantive meeting, para. 25.

## ii Main arguments of the third parties

7.464 **Argentina** argues that the relevant support under Article 13(b)(ii) is made up of payments for a specific commodity (including the revenue foregone under Article 1(c) of the *Agreement on Agriculture*), whether those payments are classified as product-specific or non-[product] specific, as well as other forms of domestic support in monetary terms as set forth in Annex 3.<sup>623</sup>

7.465 **Australia** agrees with Brazil that support "to a specific commodity" is support granted to an individual agricultural commodity covered by Annex 1 of the *Agreement on Agriculture*, such as upland cotton, whether through product specific or non-product-specific support. Had the negotiators intended that "support to a specific commodity" in the context of Article 13(b)(ii) and (iii) mean product-specific AMS only, they would have said so in the text. The portions of the direct payment and counter-cyclical payment programmes that benefit upland cotton should be included in the calculation of "support to a specific commodity" within the meaning of Article 13(b)(ii).<sup>624</sup>

7.466 **Canada** submits that "specific commodity" means a commodity that is clearly and explicitly defined. Article 13(b)(ii) requires an examination of all support that is not exempt under Annex 2 and that benefits a "precise", "exact" or "defined" commodity, which may be provided either through product-specific or non-product-specific support programmes. Deletion of the word "specific" would imply an examination of support benefiting a potentially broader product class, a result that is not supported by the text of Article 13(b)(ii).<sup>625</sup>

7.467 **China** argues that where support measures are generally available to a number of products including upland cotton, the term "specific commodity" requires breaking up and attributing general budgetary outlay to each specific product for comparison under the proviso. For the purpose of this case, only the portion of outlay that was used for upland cotton is relevant for that comparison. Outlays broken up for other products covered by the same programme is not at issue before this Panel.<sup>626</sup>

7.468 The **European Communities** agrees with the United States' approach that the correct comparison is between product-specific support decided in the 1992 marketing year and product-specific support currently granted. It argues that support which is provided to a number of crops cannot at the same time be considered "support to a specific commodity". Such support is support to several commodities or support to more than one commodity. There is no reason that the support granted should not be calculated on the basis of the AMS methodology set out in Annex 3. Indeed, Article 1(a) of the *Agreement on Agriculture* refers to AMS as the annual level of *support*.<sup>627</sup>

7.469 **New Zealand** disagrees with the United States' argument that "support granted to a specific commodity" should be read as meaning "product-specific support". Members listed in detail domestic support measures potentially exempt in the chapeau to Article 13(b) and they used the phrase "product-specific" at least five times elsewhere in the Agreement. Had they intended to exclude non-product-specific support or limit Article 13(b)(ii) to "product specific" support, they would have said so. There is no basis on which support to a specific commodity should be excluded simply because other commodities may receive similar support, since support provided through generally available programmes is still support received for the individual products. Brazil proposes an approach in relation to domestic support which is no more than what the United States has done in relation to export credit guarantees – where it allocates export credit administrative costs to the specific product

<sup>623</sup> Argentina's response to Panel third party Question No. 21.

<sup>624</sup> Australia's written submission to the first session of the first substantive meeting, para. 23 and its oral statement at the first session of the first substantive meeting, paras. 21-25.

<sup>625</sup> Canada's response to Panel third party Question No. 17.

<sup>626</sup> China's response to Panel third party Question No. 14.

<sup>627</sup> European Communities' oral statement at the first session of the first substantive meeting, paras. 21, 24 and its response to Panel third party Question No. 22.

of upland cotton. The same arguments can be made with respect to the payments under the crop insurance programmes.<sup>628</sup>

### iii Evaluation by the Panel

7.470 The Panel begins its analysis by noting that the parties agree that the chapeau of paragraph (b) refers to all non-green box domestic support measures that comply with the obligations in the *Agreement on Agriculture*. The chapeau of paragraph (b) and subparagraph (ii) form part of a single sentence. The chapeau is incomprehensible without the subparagraphs, and subparagraph (ii) is incomprehensible without the chapeau. The words in subparagraph (ii) "exempt from actions based on paragraph 1 of Article XVI of GATT 1994 or Articles 5 and 6 of the Subsidies Agreement" are a predicate of the subject in the chapeau. The proviso "provided that such measures do not grant support to a specific commodity in excess of that decided during the 1992 marketing year" is a subordinate clause of the same sentence. It is not a stand-alone provision even though it creates an additional condition.

7.471 The subject of the proviso is "such measures", not "measures", which refers back to those measures which are the subject of paragraph (b), that is, all non-green box domestic support measures that conform fully to the provisions of Article 6 of the *Agreement on Agriculture*.<sup>629</sup> These are product-specific domestic support, non-product-specific domestic support, both including *de minimis* support, plus blue box and S&D box support. All such measures are relevant to the condition in the proviso and can potentially be taken into account in assessing implementation period support. An interpretation which excluded any of these categories of support from the assessment of implementation period support, would be inconsistent with the wording and grammar of the sentence in paragraph (b) of Article 13, including the proviso.<sup>630</sup>

7.472 The subject of the proviso "such measures" therefore indicates which *are* the relevant measures. The verb and object in the proviso refer to what those measures *do*: namely, grant support to a specific commodity. All of such measures must be included in the calculation of support for the purposes of the proviso to the extent that each one grants support to a specific commodity. This will exclude such measures that only grant support to *other* specific commodities not at issue as well as such measures that do not grant support to *any* specific commodity.

7.473 The Panel must interpret the phrase "grant support to a specific commodity" as it is used in subparagraph (ii). We begin by noting that the term "product-specific support" is not used.<sup>631</sup>

7.474 This use of the verb "grant" with "support" is unique in the English version of the *Agreement on Agriculture* which, except for this provision, only uses the verb "provide" with domestic support.<sup>632</sup> However, the same distinction is not made in the French and Spanish versions which generally use "*accorder*" and "*otorgar*", respectively, with domestic support. The word "grant" can be defined as follows:

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<sup>628</sup> New Zealand's written submission to the first session of the first substantive meeting, paras. 2.21-2.26.

<sup>629</sup> Brazil has not claimed that these measures do not conform fully to those provisions. The Panel makes no findings in respect of those provisions.

<sup>630</sup> But see footnote 629.

<sup>631</sup> That term does not, in fact, appear anywhere in the *Agreement on Agriculture*, although the term "product-specific domestic support" is used in Article 6.4(a)(i), and the term "product-specific" is used in paragraph 2(b) of Annex 2, paragraph 1 of Annex 3 and paragraphs 2 and 3 of Annex 4.

<sup>632</sup> The English version also uses "grant" in relation to export subsidies in Articles 9.2(ii) and 10.3.

"To bestow or confer (a possession, right, etc.) by a formal act. Said of a sovereign or supreme authority, a court of justice, a representative assembly, etc. Also, in *Law*, to transfer (property) from oneself to another person, especially by deed."<sup>633</sup>

7.475 This definition was also cited by the Appellate Body in *Brazil – Aircraft* in a different context in relation to the phrase the "level of export subsidies granted" in a certain year in footnote 55 to Article 27.4 of the *SCM Agreement*. The Appellate Body interpreted "grant" to mean "something actually provided":

"(...) To us, the word 'granted' used in this context means "something actually provided". Thus, to determine the amount of export subsidies 'granted' in a particular year, we believe that the actual amounts *provided* by a government, and not just those *authorized* or *appropriated* in its budget for that year, is the proper measure. A government does not always spend the entire amount appropriated in its annual budget for a designated purpose. Therefore, in this case, to determine the level of export subsidies for the purposes of Article 27.4, we believe that the proper reference is to actual expenditures by a government, and not to budgetary appropriations."<sup>634</sup>

7.476 This interpretation is consistent with our earlier observation that the word "decided" is contrasted with "granted" in Article 13(b)(ii) of the *Agreement on Agriculture*<sup>635</sup>. "Decided" refers to what the government determines, but "grant" refers to what its measures provide.

7.477 The direct object of the verb "grant" is "support", which we have discussed at paragraphs 7.420 to 7.423 above.

7.478 The indirect object of "grant" is "a specific commodity" which is not a defined term and is used nowhere else in the *Agreement on Agriculture*. This is significant because the same agreement does define the similar term "basic agricultural product" in Article 1(b) which it uses in the definitions of AMS, EMS and Total AMS in Article 1(a), (d) and (h), respectively, and in numerous places in the respective methodologies for calculation of AMS and EMS in Annexes 3 and 4, as well as in the provision on calculation of *de minimis* "product-specific domestic support" in Article 6.4(a)(i). It is especially significant since those provisions are all used in the calculation of support to determine whether domestic support measures conform fully to the provisions of Article 6, which is the principal condition set out in the chapeau of paragraph (b) of Article 13. In the Panel's view, the choice of a different term in all three authentic versions of the text in relation to the same measures in the proviso in subparagraph (b)(ii) indicates that it is not appropriate to calculate an AMS on a product-specific basis for the purposes of the additional condition in Article 13(b)(ii). Rather, a bespoke measurement is required.

7.479 The Panel will interpret the words "a specific commodity" in the usual way.<sup>636</sup> The ordinary meaning of a "commodity" can be defined as follows:

"A thing of use or value; *spec.* a thing that is an object of trade, *esp.* a raw material or agricultural crop."<sup>637</sup>

7.480 The word "commodity" must be read in the context of Article 2 of the *Agreement on Agriculture* which provides that the agreement applies to the products listed in Annex 1 to the

<sup>633</sup> *The New Shorter Oxford English Dictionary*, (1993).

<sup>634</sup> Appellate Body Report, *Brazil – Aircraft*, para. 148.

<sup>635</sup> We noted this contrast at paragraph 7.435 of this report.

<sup>636</sup> The Panel will apply the general rule of interpretation set out in Article 31 of the Vienna Convention on the Law of Treaties and, if appropriate, have recourse to the supplementary means of interpretation set out in Article 32.

<sup>637</sup> *The New Shorter Oxford English Dictionary*, (1993).

Agreement. The product coverage of the Agreement is narrower than this dictionary definition, because it covers only agricultural products and not all things of use or value nor all things that are the object of trade nor all raw materials. The product coverage of the Agreement is broader than an agricultural crop because it covers products such as livestock, meat, dairy products and wool. All products within the coverage of the Agreement are covered by the chapeau of paragraph (b) and there is no reason to assume that support to any of them is excluded from the scope of the condition in subparagraph (ii). Therefore, we will treat the word "commodity", in this context, as basically synonymous with one of the "agricultural products" defined in Article 2 and Annex 1 but it cannot be assumed that any provision which refers to "agricultural products", as defined, necessarily applies to a commodity within the meaning of Article 13(b)(ii).

7.481 The word "specific" qualifies "commodity". The ordinary meaning of "specific" in this context can be defined as "clearly or explicitly defined; precise, exact; definite".<sup>638</sup> It indicates that the commodity to which support is granted should be clearly or explicitly defined. The question is where? There is no reduction commitment per commodity nor any notification obligation under Article 13(b)(ii). In this dispute, the commodity at issue with respect to domestic support is "upland cotton" which is clearly and explicitly defined in the Panel's terms of reference. However, the place in which commodities will always be defined is in the measures themselves under which the support is granted. In the Panel's view, that is the place where a commodity must be specified for it to be relevant to the additional condition in Article 13(b)(ii). Therefore, the additional condition requires a comparison of support granted by all measures covered by paragraph (b) of Article 13, i.e. non-green box measures, that clearly or explicitly define a commodity as one to which they bestow or confer support.

7.482 Another definition of "specific" is "specially or peculiarly pertaining to a particular thing or person, or a class of these; peculiar (*to*)". This definition is appropriate in a different context, such as "job-specific" or "product-specific" where the word "specific" together with the other term such as "job" or "product" qualifies another noun. However, in the context of Article 13(b)(ii) it is inappropriate because here it alone qualifies "commodity".

7.483 There is no reason to assume that the relevant measures may specify only one commodity. The measures may clearly and explicitly define various commodities. The subject of the proviso is "such measures" which includes all non-green box measures, including any which specify more than one commodity. A key feature of the additional condition in subparagraphs (b)(ii) and (iii) is that it relates support to individual commodities, which distinguishes it notably from the reduction commitments expressed in terms of Total AMS that are cross-referenced in the chapeau of paragraph (b). There is no reason to identify measures that deliver support to only one commodity for the purpose of Article 13(b)(ii) or (iii). If a measure specifies more than one commodity, it would be appropriate to measure the amount of support granted to each of them in accordance with the terms of the measure itself.

7.484 Support granted in accordance with a volume of current production should be measured in that way. Measures which grant support in accordance with other parameters, such as volume of historical production, may not be subject to paragraph (b) of Article 13 at all. If they conform fully to the provisions of Annex 2, they are exempt from reduction commitments and are protected by paragraph (a) of Article 13. If they do not so conform, they are covered by paragraph (b) of Article 13. In the Panel's view, where these measures identify and allocate support based on an express linkage to specific commodities, they provide support to those commodities within the meaning of subparagraph (b)(ii), read in its context and in the light of its object and purpose. Where, for example, these measures specify commodities in the eligibility criteria and payment rates, they constitute support to the commodities specified in that way. This applies *a fortiori* where the payments are determined according to, or are related to, current market prices of the specific

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<sup>638</sup> *The New Shorter Oxford English Dictionary*, (1993).

commodities. Support granted in this way should be measured in the same way as the actual payments are determined.

7.485 The United States argues that "support" in the phrase "support to a specific commodity" in Article 13(b)(ii) and in the term "product-specific support" in Article 1(a) refers to support to a crop, not a farmer, so that programmes that do not oblige a farmer to grow a particular crop cannot be "support" in this sense.<sup>639</sup>

7.486 The Panel notes that its interpretation refers to the domestic support measures which specify commodities to which support is provided. In any event, all "support" referred to in Article 6.1 and 6.3 and included in Article 1(a), is provided in favour of "producers".<sup>640</sup> Even support provided "for" an agricultural product is provided "in favour of" the producers of the basic agricultural product. All such support is covered by paragraph (b) of Article 13 and, hence, subparagraph (ii). It is clear that "support" in this context, although granted "to" a specific commodity, is also provided "in favour of" producers.

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

7.488 This consideration is manifest in the domestic support disciplines of the *Agreement on Agriculture*. Domestic support is often provided in a way dependent on market prices, either in the form of market price support or direct payments dependent on a price gap. Market prices of agricultural products are generally beyond the control of a government. The *Agreement on Agriculture* provides a methodology to measure domestic support which filters out the fluctuations in market prices, by using the gap between a fixed external reference price and the applied administered price multiplied by the quantity of production eligible to receive the applied administered price ("price gap methodology").<sup>641</sup> It does not filter out changes in the volume of eligible production. This confirms that a prime consideration of the drafters was to ensure that Members had some means of ensuring compliance with their commitments despite factors beyond their control.

7.489 The Panel also notes that in *Canada – Dairy (Article 21.5 – New Zealand and US II)*, the Appellate Body considered that an examination of conformity with another provision of the *Agreement on Agriculture* should reflect the fact that the provision was an international obligation imposed on Members. It considered that the data on producers' actions that was relevant in that dispute should be treated in a way that could be used to assess a Member's compliance with that obligation.<sup>642</sup>

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<sup>639</sup> United States' 3 March 2004 comments, para. 18.

<sup>640</sup> Articles 3.2 and 7.2(a) of the *Agreement on Agriculture* also refer to domestic support "in favour of domestic producers" and "in favour of agricultural producers" respectively.

<sup>641</sup> Paragraphs 8 and 10 of Annex 3 to the *Agreement on Agriculture*.

<sup>642</sup> Appellate Body report in *Canada – Dairy (Article 21.5 – New Zealand and US II)*, para. 96, concerning Article 9.1(c) of the *Agreement on Agriculture*. We do not consider it material that the provision under consideration referred to "payments [...] financed by virtue of governmental action".

7.490 The United States submits that the phrase "do not grant support to a specific commodity" means "do not grant product-specific support" although it admits that "[i]t is not possible to determine exactly why the drafters of Article 13(b)(ii) did not use the term "product-specific support".<sup>643</sup> At the same time, the United States submits that the fact that the drafters did not use the term "AMS" when it was readily available and a key concept, indicates that they did not intend the Article 13(b)(ii) comparison to require the use of product-specific AMS.<sup>644</sup>

7.491 The Panel notes that its interpretation of "support to a specific commodity" bears some similarity to product-specific domestic support. However, the phrase "support to a specific commodity" is unique to Article 13(b). The phrase "product-specific domestic support" (not "product-specific support") appears in the *de minimis* provision in Article 6.4(a)(i) and the phrase "support ... provided for an agricultural product in favour of the producers of the basic agricultural product" appears in the definition of AMS in Article 1(a). Both those concepts are relevant to Article 13(b) but the class of measures which is covered by paragraph (b) is broader than either of them. The choice of a different phrase in Article 13(b)(ii) and (iii) indicates that the other two are not pertinent to the additional condition in the proviso.<sup>645</sup>

7.492 The object and purpose of the additional condition in subparagraphs (ii) and (iii) are to provide an additional condition linking the domestic support commitments and disciplines of the *Agreement on Agriculture*, on the one hand, to the actionable subsidies obligation in Articles 5 and 6 of the *SCM Agreement* and Article XVI:1 of the *GATT 1994* and non-violation complaints arising from tariff concessions, on the other hand. Our interpretation of the phrase "support to a specific commodity" is consistent with that object and purpose. Nothing indicates that the purpose of the additional condition is to focus on product-specific domestic support.

7.493 The treatment of domestic support measures in paragraph (b) of Article 13 can be contrasted with that of export subsidies in paragraph (c). Both paragraphs (b) and (c) link commitments in the *Agreement on Agriculture* with the *SCM Agreement*, both set out conditions that are substantive obligations of the *Agreement on Agriculture*, yet paragraph (c) contains no additional condition applicable to export subsidies analogous to that applicable to domestic support measures under the proviso in subparagraphs (ii) and (iii) of paragraph (b). Export subsidies are subject to commitments in respect of individual products - there are specific commitments in respect of scheduled products and, effectively, zero commitments for unscheduled products. An additional condition in terms of individual products is therefore unnecessary in Article 13(c) since the substantive obligations themselves are expressed in terms of specific products and not in the aggregate.

7.494 The Panel therefore considers that the phrase "grant support to a specific commodity", as used in Article 13(b)(ii):

- (i) means all non-green box support measures that clearly or explicitly define a commodity as one to which they bestow or confer support; and
- (ii) does not mean "grant product-specific domestic support".

7.495 This interpretation is confirmed by the drafting history.<sup>646</sup> The text of subparagraphs (ii) and (iii) of paragraph (b) appeared in the Uruguay Round text following the first US/EC Blair House agreement of November 1992.<sup>647</sup> During 1990 and 1991 the agriculture negotiators considered

<sup>643</sup> See United States' response to Panel Question No. 37.

<sup>644</sup> United States' first written submission, paras. 86-87.

<sup>645</sup> The term "product-specific subsidy" is also used in paragraph 3 of Annex 4.

<sup>646</sup> The Panel has recourse to supplementary means of interpretation in accordance with Article 32 of the Vienna Convention on the Law of Treaties in order to confirm the meaning resulting from the application of the general rule of treaty interpretation in Article 31 of that convention.

<sup>647</sup> See the draft Article which formed part of that agreement in Exhibit EC-1.

expressing reduction commitments in terms of AMS "per product" or "per commodity" with a sector-wide AMS for non-product-specific support.<sup>648</sup> The agriculture text in the draft final Act of December 1991 had provided domestic support reduction commitments in just these terms. Draft Article 6.1 provided *in fine*:

"These [domestic support] commitments are expressed in terms of Aggregate Measurements of Support and of equivalent commitments."

7.496 Draft Article 6:3 provided that:

"A participant shall be considered to be in compliance with its domestic support reduction commitments in any year where the sector-wide and product-specific AMS values for support, or the equivalent commitments, do not exceed the corresponding annual commitment levels specified in the Schedule of domestic support commitments of the participant concerned."<sup>649</sup>

7.497 In contrast, the *Agreement on Agriculture* as finally agreed substituted Total AMS commitments for the product-specific commitments. It provides in Article 6.1 *in fine* and in Article 6.3 as follows:

"The commitments are expressed in terms of Total Aggregate Measurement of Support and "Annual and Final Bound Commitment Levels."; and

"A Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule."

7.498 Draft Article 6:4 had provided for *de minimis* exclusions from domestic support commitments in the case of both "product-specific support" and the "sector-wide AMS".<sup>650</sup> Article 6.4 as finally agreed provides for *de minimis* exclusions from Current AMS, to be calculated according to whether support is "product-specific domestic support" or "non-product-specific domestic support".

7.499 Draft Article 12 had provided that:

"Where reduction commitments on domestic support and export subsidies are being applied in conformity with the terms of this Agreement, the presumption will be that they do not cause serious prejudice in the sense of Article XVI:1 of the General Agreement."<sup>651</sup>

7.500 This was replaced by Article 13 in the *Agreement on Agriculture* as finally agreed. The presumption was replaced with the exemptions from actions, among other things, discussed above in Section VII:C. The conditions still include the reduction commitments – now expressed in terms of Total AMS – in the chapeau of paragraph (b), but they also include an additional condition regarding "support to a specific commodity" in subparagraphs (ii) and (iii).

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<sup>648</sup> See Negotiating Group on Agriculture documents "Framework Agreement on Agriculture Reform Programme", Draft Text by the Chairman, document MTN.GNG/NG5/W/170, dated 11 July 1990, para. 5, reproduced in Exhibit US-25; "Options in the Agriculture Negotiations", Note by the Chairman, document MTN.GNG/AG/W/1 dated 24 June 1991, para. 17, reproduced in Exhibit US-26; and an addendum in document MTN.GNG/AG/W/1/Add.1 dated 2 August 1991, reproduced in Exhibit US-27.

<sup>649</sup> Document MTN.TNC/W/FA, page L.7, reproduced in Exhibit US-29.

<sup>650</sup> Document MTN.TNC/W/FA, page L.7, reproduced in Exhibit US-29.

<sup>651</sup> Document MTN.TNC/W/FA, page L.9, reproduced in Exhibit US-29.

7.501 The drafting history shows three things: (1) the additional condition referring to "support to a specific commodity" ensures that there is still a domestic support condition (although not an obligation) in the *Agreement on Agriculture*<sup>652</sup> which is defined on an individual product basis despite the disappearance of per product domestic support commitments from the draft text; (2) the drafters had not limited the proposed presumption in serious prejudice cases to product-specific support but had envisaged that the presumption could apply to non-product-specific support depending on whether it complied with the proposed sector-wide reduction commitment, which was later removed; and (3) the drafters chose to retain the term "product-specific" when they revised draft Article 6:4, where it now appears in context with "non-product-specific", but they chose not to use it when they replaced draft Article 6:3 and inserted the additional condition in Article 13(b)(ii) and (iii). This supports the Panel's interpretation to the extent that the drafters did not intend to exclude from this condition any support that was granted to a specific commodity, irrespective of whether it was "product-specific" domestic support or not.

7.502 The Panel's interpretation maintains the distinction between green box and non-green box domestic support which is fundamental to Article 13. It also maintains the identity between the subject of the chapeau of paragraph (b) and subparagraph (b)(ii). It respects the wording of the proviso by comparing support that is granted to a specific commodity with the benchmark relevant to that specific commodity and excluding all other support, which either grants support to other specific commodities or does not grant support to any specific commodity. Brazil acknowledges this implicitly in that it does not challenge very widely available support, such as infrastructure and irrigation subsidies, some of which, presumably, deliver support to upland cotton either directly or indirectly.<sup>653</sup>

7.503 The Panel is not required to interpret the difference between the terms "product-specific domestic support" and "non-product-specific domestic support" used in Article 6.4(a) nor the difference between the phrases "support ... provided for an agricultural product in favour of the producers of the basic agricultural product" and "non-product-specific support provided in favour of agricultural producers in general" used in Article 1(a). Those differences are not relevant to the sole condition that Brazil alleges that the United States' non-green box domestic support measures do not satisfy. It suffices for us to observe that, to the extent that non-product-specific domestic support can specify commodities to which support is in some way delivered (a question which we do not decide), an interpretation of Article 13(b)(ii) that excluded all non-product-specific domestic support would create a novel and potentially large category of support which did not fall within Article 13(a), nor fully within Article 13(b), which would be subject to the chapeau of Article 13(b) but not the additional condition in the proviso. This would ignore the subject of the proviso which is "such measures" without any basis in the text or context nor any justification in the object and purpose of the provision. This would be some unknown kind of "pale amber", non-product-specific box which the drafters clearly did not intend to create.

7.504 The Panel notes that the four types of support with planting flexibility, namely PFC, MLA, DP and CCP payments, have, in turn, followed deficiency payments under the FACT Act of 1990. The parties agree that deficiency payments form part of the MY 1992 benchmark. The replacement of deficiency payments, which were product-specific, with these other types of support is the principal difference between the support delivered to upland cotton during the implementation period under the 1996 and 2002 farm bills, and the period immediately prior to that under the 1990 farm bill.<sup>654</sup> If implementation period support were limited to product-specific support, the comparison under Article 13(b)(ii) would primarily be a comparison of deficiency payments, which were tied to the production of specific commodities, and the later measures, which are principally tied to production

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<sup>652</sup> Besides the *de minimis* provision in Article 6.4(a)(i) which is relevant to calculation of Current Total AMS.

<sup>653</sup> See Brazil's response to Panel Question No. 41 and the United States' rebuttal submission, para. 79.

<sup>654</sup> The United States agrees with this view: see its 11 February 2004 comments, paras. 15-16.

of those specific commodities in a base period. The text of Article 13 and the architecture of the *Agreement on Agriculture* make clear that such a shift should only be determinative where the change in method of delivery is a shift to green box support or to support that is not granted to a specific commodity. Therefore, the Panel's interpretation does not "rob" Members of their ability to shift to decoupled payments and still comply with the Article 13. Decoupled payments that conform fully to the provisions of Annex 2 automatically comply with the conditions in Article 13(a), and others that conform fully with Article 6 and the additional condition in Article 13(b)(ii), also comply with Article 13.

7.505 The Panel's interpretation does not "erase the distinction" between product-specific and non-product-specific support. That distinction remains essential to the calculation of Total AMS for the purposes of reduction commitments, which is germane to the chapeau of paragraph (b) of Article 13, but not the additional condition in subparagraph (ii). No reason has been advanced in these proceedings that would explain why the drafters would have distinguished between product-specific and non-product-specific domestic support when they determined the additional condition under which measures which could be exempt from certain types of actions. In fact, in a prior draft of the *Agreement on Agriculture* which did distinguish between the two methods of delivery, they expressly proposed parallel conditions under which both would be exempt from such actions.

7.506 The United States acknowledges the "simple fact" that non-product-specific support delivers support to various agricultural commodities.<sup>655</sup> Without accepting that these programmes are non-product-specific, from the Panel's perspective, the only question is how to include only the amount of support that the programmes at issue grant to any specific one of those agricultural commodities. Such an allocation is not required for the calculation of AMS or Total AMS because non-product-specific support is calculated separately from product-specific support. However, that is relevant only to the reduction commitments which are referred to in the chapeau of paragraph (b) of Article 13, not the additional condition in subparagraphs (ii) and (iii). There is no reason to assume that an allocation of support delivered by a single measure to more than one agricultural commodity cannot be called for under the *Agreement on Agriculture*. Indeed, allocation of the extent to which a measure delivers support to a particular product is not alien to the Agreement, since support measures directed at agricultural processors are included in measurements of support only to the extent that such measures benefit the producers of the basic agricultural product.<sup>656</sup>

(ii) *Relevant measures*

i Main arguments of the parties

7.507 **Brazil** claims that all of the measures at issue are relevant and should be included as measures which grant support to the specific commodity of upland cotton.

7.508 The **United States** accepts that marketing loan programme payments, user marketing (Step 2) payments and cottonseed payments are product-specific support. It does not accept that PFC, MLA, DP, CCP and crop insurance payments grant support to a specific commodity.

ii Evaluation by the Panel

7.509 The Panel recalls its finding at paragraph 7.494 and will examine each of the domestic support measures at issue in turn to determine whether they clearly and explicitly define upland cotton as a commodity to which they bestow or confer support.

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<sup>655</sup> United States' 3 March 2004 comments, para. 4.

<sup>656</sup> Paragraph 7 of Annex 3 and paragraph 4 of Annex 4 of the *Agreement on Agriculture*. The Panel agrees with the United States that this does not suggest any methodology that would allocate non-product-specific support as "support to a specific commodity" - see the United States' 3 March 2004 comments, para. 13.

7.510 Under the marketing loan programme, producers on a farm are eligible for a marketing assistance loan for any quantity of a "loan commodity" produced on the farm<sup>657</sup> and the Secretary may make loan deficiency payments ("LDPs") available to producers on a farm eligible to obtain a marketing assistance loan with respect to a "loan commodity".<sup>658</sup> Upland cotton is defined specifically as a "loan commodity".<sup>659</sup> The current legislation specifies a loan rate of "in the case of upland cotton, \$0.52 per pound" and the former legislation specified a formula to establish "the loan rate for a marketing assistance loan (...) for upland cotton", which was published in a regulation annually.<sup>660</sup> There is a special provision in the repayment rate for upland cotton and rice<sup>661</sup> and a special provision on the adjustment of the prevailing world market price for upland cotton.<sup>662</sup>

7.511 User marketing (Step 2) payments are made under a provision titled "Special marketing loan provisions for upland cotton". They are available only to domestic users and exporters of "upland cotton" and are contingent upon certain price quotations for upland cotton.<sup>663</sup>

7.512 Cottonseed payments were made to assist producers and first handlers of the 2000 crop of "cottonseed".<sup>664</sup> Cottonseed is a part of harvested raw cotton. The evidence shows that approximately 97 per cent of the annual United States cotton crop is from upland cotton.<sup>665</sup>

7.513 PFC payments were made in respect of cropland covered by a contract. Eligible cropland had to satisfy very specific eligibility criteria, in that it had to be land that, for at least one of the 1991 through 1995 crops, was enrolled in the acreage reduction programme authorized for a crop of seven contract commodities or was considered planted or subject to a conservation reserve contract.<sup>666</sup> Upland cotton was specified as one of those contract commodities.<sup>667</sup> The legislation made allocations for specific commodities from the amounts appropriated to PFC contracts, including the following:

"(b) ALLOCATION. - The amount made available for a fiscal year under subsection (a) shall be allocated as follows:

(...)

(6) for upland cotton, 11.63 per cent"<sup>668</sup>

7.514 The legislation provided a formula to determine the payment rate for upland cotton and each other contract commodity, which was published in regulations. The rate depended on the acreage enrolled as upland cotton base and the yield which was also specific to upland cotton.<sup>669</sup>

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<sup>657</sup> Sections 1201-1204 of the FSRI Act of 2002, and sections 131-134 of the FAIR Act, respectively.

<sup>658</sup> Section 1205 of the FSRI Act of 2002 and section 135 of the FAIR Act of 1996, respectively.

<sup>659</sup> Section 1001(8) of the FSRI Act of 2002 and section 102(5) and (10) of the FAIR Act of 1996, respectively.

<sup>660</sup> Section 1202 of the FSRI Act and section 132(c) of the FAIR Act of 1996, respectively.

<sup>661</sup> Section 1204(b) of the FSRI Act of 2002 and section 134(b) of the FAIR Act of 1996, respectively.

<sup>662</sup> Section 1204(e) of the FSRI Act of 2002 and section 134(e) of the FAIR Act of 1996, respectively.

<sup>663</sup> Section 1207 of the FSRI Act of 2002 and section 136 of the FAIR Act of 1996, respectively.

<sup>664</sup> Section 204(e) of the ARP Act of 2000, section 6 of Public Law 107-25, and 7 CFR 1427.1100 (1 January 2002 edition), reproduced in Exhibits BRA-137, BRA-138 and BRA-32, respectively.

<sup>665</sup> USDA Economic Research Service Briefing Room Cotton document, reproduced in Exhibit BRA-13.

<sup>666</sup> Section 111(d) of the FAIR Act of 1996.

<sup>667</sup> Section 102(5) of the FAIR Act of 1996.

<sup>668</sup> Section 113(b)(6) of the FAIR Act of 1996.

<sup>669</sup> Section 114 of the FAIR Act of 1996.

7.515 MLA payments were intended as additional PFC payments to respond to low prevailing prices of commodities, including upland cotton. They were paid proportionally in accordance with entitlements to PFC payments.<sup>670</sup>

7.516 DP and CCP payments are available in respect of acreage planted on a farm which has to satisfy very specific eligibility criteria, which begin with the criterion that it was planted to one of nine covered commodities for the 1998 through 2001 crop years.<sup>671</sup> Upland cotton is one of the covered commodities.<sup>672</sup> The legislation provides for a DP payment rate as follows: "upland cotton, \$0.0667 per pound".<sup>673</sup> The legislation provides that CCP payments are paid when the effective price for the covered commodity is less than the target price for the covered commodity<sup>674</sup> and provides for a target price in the 2002 and 2003 crop years, as well as subsequent crop years as follows: "upland cotton, \$0.7240 per pound".<sup>675</sup>

7.517 With respect to crop insurance payments, the Federal Crop Insurance Corporation ("FCIC") is authorized to offer insurance or reinsurance for insurers of, producers of "agricultural commodities" grown in the United States under one or more plans determined by the FCIC to be adapted to the agricultural commodity concerned.<sup>676</sup> "Cotton" is specified as an "agricultural commodity".<sup>677</sup> The major plan type (actual production history) is available for approximately 100 agricultural commodities, and specifies upland cotton as one of them.<sup>678</sup> The other four plan types (group risk, crop revenue coverage, income protection and revenue assurance) are available only for a limited number of eight commodities or less and they each specify upland cotton as one of them. The proportion of the premium borne by the FCIC is set out in each plan. USDA maintains separate accounts for the amount of premium payments borne by the FCIC for each crop, including one that is specific to cotton.<sup>679</sup> Certain sample policy provisions specify cotton crops.<sup>680</sup> The legislation contains "Special Provisions for Cotton and Rice" which require the FCIC to offer plans of insurance that cover losses of upland cotton, ELS cotton and rice resulting from failure of irrigation water supplies due to drought or saltwater intrusion.<sup>681</sup>

7.518 In view of the above, the Panel finds that Brazil has made a prima facie case that each of these measures clearly and explicitly specifies upland cotton or, in the case of crop insurance

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<sup>670</sup> See Brazil's first written submission, paras. 60-61, and its rebuttal submission, para. 29 and the United States' rebuttal submission, paras. 99-101 and its response to Panel Question No. 43.

<sup>671</sup> Section 1101 of the FSRI Act of 2002, which contains other eligibility criteria, notably with respect to oilseed acreage.

<sup>672</sup> Section 1001(4) of the FSRI Act of 2002.

<sup>673</sup> Section 1103(b)(6) of the FSRI Act of 2002.

<sup>674</sup> Section 1104(b) of the FSRI Act of 2002.

<sup>675</sup> Section 1104(c)(1)(F) and (2)(F) of the FSRI Act of 2002.

<sup>676</sup> Section 508 of the FCIC Act.

<sup>677</sup> Section 518 of the FCIC Act.

<sup>678</sup> See USDA Risk Management Agency lists of crops covered under the 2002 and 2003 crop years crop insurance programmes, reproduced in Exhibits BRA-62 and BRA-57, respectively; Brazil's rebuttal submission, para. 55, and United States' 27 August 2003 comments, footnote 48.

<sup>679</sup> Examples for the 1992 and 1999 through 2003 marketing years are reproduced in Exhibit BRA-57. See also Brazil's oral statement at the first session of the first substantive meeting, para. 63 and its rebuttal submission, paras. 50 and 53. The United States also supplied data presented by year and plan type showing the amount and percentage of upland cotton acreage coverage, premiums paid by upland cotton producers and insurance indemnity payments to upland cotton producers; see Exhibits US-65, US-66 and US-67, respectively.

<sup>680</sup> See "Income Protection – Cotton Crop Provisions" USDA FCIC, 2000-321 and "Cotton Crop Provisions" USDA FCIC, 99-021, reproduced in Exhibits BRA-174 and BRA-175.

<sup>681</sup> Section 508(a)(8) of the *Federal Crop Insurance Act*, 7 USC 1508(a)(8), inserted by section 162 of the *Agricultural Risk Protection Act of 2000* applicable since the 2001 crops.

payments and cottonseed payments, cotton<sup>682</sup>, as a commodity to which they grant support within the meaning of Article 13(b)(ii).

7.519 The United States argues that the four types of support with planting flexibility do not grant support to upland cotton because they are not product-specific support and because they contain no requirement to produce.

7.520 The Panel does not consider that the United States has rebutted Brazil's case for two reasons: (1) the "product-specific" criterion is not based in the text of Article 13; and, therefore, (2) the result of the United States' argument would be that these types of support – which total several billion dollars for specific covered commodities – are not in fact support to any commodity.

(iii) *Payments under expired programmes*

i Main arguments of the parties

7.521 The parties agree that PFC and MLA payments, as well as cottonseed payments for the 2000 crop, were made under expired programmes.<sup>683</sup>

7.522 The **United States** argues that the present tense phrasing of "do not grant support" rather than the past tense ("did not grant") or the future tense ("will not grant"), indicates that determining whether measures currently in effect are exempt from actions depends upon the support which they currently grant.<sup>684</sup>

7.523 **Brazil** replies that the United States' interpretation would create a sweeping limitation on the right of WTO Members to challenge any domestic support payments not "currently" provided. It calls this a "statute of limitations" approach under which a subsidizing Member would be absolved of any responsibility for serious prejudice caused by domestic support provided during the prior marketing year, so long as the measures have not been challenged prior to the 1 August marketing year deadline for upland cotton. It argues that Article 13(b)(ii) does not address the time when domestic support measures can no longer be subject to challenge during the implementation period, just as Article 1.1 of the *SCM Agreement* does not address the time at which a "financial contribution" and/or "benefit" must be shown to exist.<sup>685</sup>

ii Main arguments of the third parties

7.524 **Argentina** emphasizes that in the Spanish text of Article 13(b)(ii) the present tense of the subjunctive mode is used, indicating the conditional or possible nature and expressing syntactic subordination. According to Argentina, the Spanish text coincides with the verbal tense used in the French version in which the present subjunctive is also used. Consequently, Argentina disagrees with the United States' contention that the present tense criterion in Article 13(b)(ii) implies that the only support the Panel may consider is current support.<sup>686</sup>

7.525 **China** argues that Article 13 (b) cannot be limited to a comparison only of measures currently in effect. Although China recognizes that it is indeed written in the present tense, the sentence is led by the key word "provided" in a strong limitation and demanding style. According to China, the

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<sup>682</sup> Upland cotton accounts for approximately 97 per cent of United States cotton production: see USDA Economic Research Service, Briefing Room – Cotton, and background paper dated July 2001 reproduced in Exhibits BRA-13 and BRA-46, respectively. It does not include extra long staple ("ELS") cotton.

<sup>683</sup> See the preliminary ruling in this regard in Section VII:B of this report.

<sup>684</sup> United States' first written submission, paras. 79 and 90.

<sup>685</sup> Brazil's oral statement at the first session of the first substantive meeting, paras. 40-44, citing the Appellate Body Report, *US – Lead and Bismuth II*.

<sup>686</sup> Argentina's response to Panel third party Question No. 26.

intention of such tense is to ensure that support levels beyond those in 1992 are not to be protected by the Peace Clause.<sup>687</sup>

7.526 The **European Communities** considers that the present tense of the phrase "do not grant support" makes it clear that the comparison for the purpose of Article 13(b) must be between the level of support decided in the 1992 marketing year and that granted by virtue of the measures being challenged, which would typically mean the most recent marketing year.<sup>688</sup>

7.527 **Paraguay** submits that the Spanish text expresses the conditionality of Article 13(b)(ii) in even clearer terms than the English text through the words '*à condición de que no otorguen*'. Although Paraguay considers that both texts indicate the present tense, the Spanish version of the sentence stresses conditionality, which must be given considerable weight in order to arrive at a correct interpretation. Paraguay is of the view that it is the Panel's task to consider the period it deems suitable for determining the effects of this type of measure on world trade.<sup>689</sup>

iii Evaluation by the Panel

7.528 The Panel considers the proper interpretation of the tense of this phrase to be quite straightforward. Article 13(b) is made up of two clauses. The principal clause is "domestic support measures ... shall be exempt from actions based on (...)". The subordinate clause is "provided that such measures do not grant support in excess of that decided during the 1992 marketing year." The principal clause is in the future tense, and the subordinate is in the present simple tense to express an open condition which also relates to the future.<sup>690</sup> The future time (as of the time of its signature on 15 April 1994) to which the clauses relate is stated at the beginning of Article 13: "During the implementation period", i.e. the nine-year period commencing in 1995. The meaning of the present simple tense can be illustrated by the sentence: "The meeting will begin at 10 o'clock provided that the parties are not late." The verb "are", although in the present, does not refer to lateness at the time of speaking, but to lateness in the future, i.e. at 10 o'clock. It does not matter whether the parties are late *now*; it only matters if they are late at 10 o'clock. This is clearer in the Spanish version of Article 13(b) in which the principal clause is in the future indicative and the subordinate clause is in the present subjunctive which indicates that the verb "grant" expresses a condition. The French version also uses the future indicative and present subjunctive for the same reason.

7.529 Consequently, the tense of the proviso "provided that such measures do not grant ..." does not limit the scope of Article 13(b) to measures which are currently in effect. It refers to any domestic support measures covered by paragraph (b) which are or have been in force during the implementation period of nine years commencing in 1995. Therefore, the Panel finds that these payments under expired measures can be taken into account in the examination of consistency of the United States domestic support measures with Article 13(b)(ii).

7.530 The Panel notes that Brazil's claims regarding expired programmes only concern payments made under them, in order to seek relief from their allegedly present effects under the *SCM*

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<sup>687</sup> China's response to Panel third party Question No. 12.

<sup>688</sup> European Communities' oral statement at the first session of the first substantive meeting, para. 13. This is also relevant to the reference period, considered at para. 7.591 below. In response to a question from the Panel as to whether there was any difference in the Spanish text which might aid the Panel in interpreting these words, the European Communities noted only that "both the French and Spanish text also use the present tense". See European Communities' response to Panel third party Question No. 26.

<sup>689</sup> Paraguay's response to Panel third party Question No. 26.

<sup>690</sup> See John Eastwood: *Oxford Guide to English Grammar*, Oxford University Press, 1994, sections 77, 257 and 259.

*Agreement*. Brazil does not make claims regarding any expired legislation *per se* (unlike its claims regarding current measures).<sup>691</sup>

(iv) *Measures outside the Panel's terms of reference*

i Main arguments of the parties

7.531 **Brazil** submits that support outside the Panel's terms of reference should be included in the calculation of implementation period support if it was made in respect of the 2002 marketing year. Specifically, it refers to the cottonseed payments for the 2002 crop, which the Panel has ruled are not within its terms of reference.<sup>692</sup>

7.532 The **United States** maintains that cottonseed payments are not within the scope of this dispute.<sup>693</sup>

ii Evaluation by the Panel

7.533 Cottonseed payments for the 1999 and 2002 crops are outside the Panel's terms of reference, for the reasons given in Section VII:B of this report. The Panel notes that subparagraphs (b)(ii) and (iii) of Article 13 provide conditional exemptions from certain actions. Those actions involve recourse to dispute settlement procedures based on the listed provisions, as discussed in Section VII:C of this report. Measures outside a panel's terms of reference in those procedures may not be the subject of claims under Articles 5 and 6 of the *SCM Agreement* and Article XVI:1 of the *GATT 1994*, considered in Section VII:G of this report. However, measures outside the terms of reference may be relevant as evidence.

7.534 The purpose of the Panel's examination as to whether measures satisfy the conditions in Article 13 is not to determine whether or not they are consistent with obligations in the *SCM Agreement* or Article XVI of the *GATT 1994*. A finding that measures do or do not satisfy the conditions in Article 13 does not lead to any recommendation or relief. Rather, it determines whether or not measures benefit from particular exemptions from actions. This is a matter of evidence, not terms of reference.

7.535 The treaty text requires the Panel to include in the comparison under subparagraph (b)(ii) of Article 13 all those measures put in evidence which fall within the terms of the chapeau of paragraph (b) and which grant support to a specific commodity, in this case, upland cotton, either in the reference period or within the MY 1992 benchmark. That is the appropriate comparison. A complaining party is not required to request the establishment of a panel in respect of any and all domestic support measures other than those in respect of which it seeks relief.

7.536 In the present dispute, cottonseed payments for the 1999 and 2002 crops constitute non-green box domestic support granted specifically to upland cotton in the period under review. The Panel will therefore include them in the comparison of support under Article 13(b)(ii). Where the Panel finds that all such domestic support measures, including these cottonseed payments, do not satisfy the additional condition in that provision, then it must find that they are not exempt from actions. However, the Panel may only continue to examine those measures which are within its terms of reference for conformity with Articles 5 and 6 of the *SCM Agreement* and Article XVI:1 of the *GATT 1994*.

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<sup>691</sup> Brazil's response to Panel Question No. 19.

<sup>692</sup> Brazil's response to Panel Question No. 17.

<sup>693</sup> United States' rebuttal submission, paras. 106-110.

(v) *Summary of implementation period support*

7.537 In summary, the Panel will include the following in its measurement of implementation period support:<sup>694</sup>

- (i) marketing loan programme payments (including interest and storage payments where appropriate);
- (ii) user marketing (Step 2) payments made to domestic users;<sup>695</sup>
- (iii) PFC, MLA, DP and CCP payments;
- (iv) crop insurance payments; and
- (v) cottonseed payments for the 1999, 2000 and 2002 crops.

7.538 The Panel can only include payments made in the 1999 through 2002 marketing years because these are the only years for which the parties have provided evidence.

(d) Measurement of support

(i) *Methodology*

i Main arguments of the parties

7.539 **Brazil** tabulates both implementation period support and the MY 1992 benchmark in terms of actual expenditures for support to upland cotton in each marketing year.<sup>696</sup> At the Panel's request, it also presented this information on a per pound basis.<sup>697</sup> Brazil submits that budgetary expenditures are the most natural measure of support, which are straightforward to apply and allow a ready and accurate comparison.<sup>698</sup>

7.540 Brazil does not consider that an AMS calculation is appropriate because Article 13(b)(ii) does not use the term "AMS", "product-specific" or "non-product-specific". However, the best approach besides using actual expenditures is to apply an AMS-like methodology using rules in Annex 3 of the *Agreement on Agriculture* to all "support provided to a specific commodity" in the sense of Article 13(b)(ii). Price-gap methodology is appropriate only for deficiency payments whilst budgetary outlays are appropriate for all other support because that was the approach that the United States used to calculate its AMS reduction commitments and make its domestic support notifications with respect to upland cotton.<sup>699</sup> Any rate of support methodology should be based on budgetary expenditures.<sup>700</sup>

7.541 Brazil also drew attention to the United States' 1994 Statement of Administrative Action submitted to the United States Congress with the proposed Uruguay Round Agreements Act, which stated as follows:

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<sup>694</sup> This is without prejudice to their specificity within the meaning of Article 2 of the *SCM Agreement*, considered in Section VII:G of this report.

<sup>695</sup> The Panel excludes user marketing (Step 2) payments to exporters, as mentioned in *supra*, footnote 464.

<sup>696</sup> Brazil's first written submission, paras. 143 and 146.

<sup>697</sup> Brazil's response to Panel Question No. 60.

<sup>698</sup> Brazil's response to Panel Question No. 59.

<sup>699</sup> Brazil's rebuttal submission, para. 87 and its 27 August comments on United States' rebuttal submission, paras. 10-15.

<sup>700</sup> Brazil's rebuttal submission, para. 87.

"Under Article 13(b)(ii) and (iii), governments may not initiate adverse effects, serious prejudice or non-violation nullification and impairment challenges in the WTO in respect of this type of domestic support measure unless the AMS for the particular commodity exceeds the level decided in the 1992 marketing year. (For example, direct payments decided upon in 1992 as part of the EU's Common Agricultural Policy would be covered by this exemption.) Accordingly, even though rules applying to reduction commitments do not require a WTO member to reduce support for any particular product and may even permit a government to increase support for a particular product, a WTO member will not be protected by the peace clause if its support for the product is above that decided during the 1992 marketing year."<sup>701</sup>

7.542 The **United States** compares implementation period support and the MY 1992 benchmark in terms of a rate of support. It submits that the rate of product-specific support for upland cotton decided during the 1992 marketing year (72.9 cents per pound) is greater than the rate of product-specific support that challenged United States non-green box measures currently grant to upland cotton (52 cents per pound).<sup>702</sup> The rate of support methodology permits an *ex ante* comparison of the support because the rate is known at the outset (or even in advance) of the relevant crop year in which payments are made and thereby permits a rapid challenge.<sup>703</sup>

7.543 The United States does not consider that Article 13(b)(ii) calls for an AMS calculation because "support" does not mean "AMS", which is one particular way of measuring support. Had Members intended the comparison to *require* the use of product-specific AMS, calculated in total monetary value terms, they could have used that term in Article 13(b)(ii).<sup>704</sup> Nor does it permit an *ex ante* calculation which means that a Member cannot know with certainty whether support exceeds that decided in the 1992 marketing year. However, within the context of an AMS calculation, it submits that a price gap calculation provides an appropriate methodology because it eliminates the effect of changes in prevailing market prices on the calculation of support and thereby reflects changes in the level of support decided by a Member.<sup>705</sup>

7.544 The United States does not consider that the *Agreement on Agriculture* permits measurement of support in terms of an AMS-like methodology using rules in Annex 3. Annex 3 specifically provides that non-product-specific support must be kept separate from product-specific support for purposes of AMS calculation, and therefore they must be kept separate for purposes of the Article 13 analysis.<sup>706</sup>

## ii Main arguments of the third parties

7.545 **Argentina** considers that implementation period support must be linked to budgetary outlays.<sup>707</sup>

7.546 **Australia** considers that the term "support" in Article 13(b)(ii) was not intended to have the same meaning as "AMS". It does not agree that the interpretation of "grant support" should be limited to either budgetary outlays or a rate of support. The same proviso is used in subparagraph (iii) of

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<sup>701</sup> Statement of Administrative Action, H.R. 5110, H.R. Doc. 316, Volume 1, 103d Congress, 2nd Session, 656 (1994), quoting from page 67, reproduced in Exhibit BRA-102. The SAA "represents an authoritative expression by the Administration concerning its views regarding the interpretation and application of the Uruguay Round agreements". (SAA, p. 656).

<sup>702</sup> United States' first written submission, para. 76.

<sup>703</sup> United States' response to Panel Question No. 33.

<sup>704</sup> United States' first written submission, para. 86.

<sup>705</sup> United States' rebuttal submission, paras. 116 to 118, and its 27 August 2003 comments, paras. 5-9.

<sup>706</sup> United States' comments on Brazil's response to Panel Question No. 258.

<sup>707</sup> Argentina's response to Panel third party Question No. 23.

Article 13(b) so it must be interpreted in a manner capable of application in a non-violation complaint, which requires the application of a conditions of price competition test.<sup>708</sup>

7.547 **China** considers that budgetary outlays as exemplified by the AMS calculation method is the approach adopted by the drafters.<sup>709</sup>

7.548 The **European Communities** considers that implementation period support should be calculated on the basis of the AMS methodology set out in Annex 3 to the *Agreement on Agriculture*, which is not necessarily in terms of budgetary outlays. The MY 1992 benchmark should be calculated using "AMS-like criteria" on the basis of information available to the decision makers, such as eligible production, production estimates or budgetary acts.<sup>710</sup>

7.549 **New Zealand** considers that there is nothing to suggest that budgetary outlays should not be a component of the calculation of "support" under Article 13(b)(ii).<sup>711</sup>

iii Evaluation by the Panel

7.550 The Panel observes that the *Agreement on Agriculture* does not state in Article 13(b)(ii) how to measure support. However, elsewhere the Agreement provides in great detail methodologies to measure support, namely the AMS and, where the calculation of a particular component of AMS is not practicable, the EMS. The AMS methodology has a striking degree of overlap with Article 13(b)(ii), notably: (1) the definition of AMS in Article 1(a) indicates that it measures "support" that is "provided", which is synonymous with the extent to which measures "grant" "support";<sup>712</sup> (2) the AMS measures support during the implementation period (and later); (3) the purpose of Total AMS is to measure support provided against a fixed benchmark level; (4) the AMS measures domestic support subject to reduction commitments, which is one of the relevant components of support covered by paragraph (b) of Article 13 and, therefore, "such measures" which are the subject of subparagraph (b)(ii); and (5) the AMS does not measure green box support, which is also excluded from paragraph (b) of Article 13.

7.551 However, there are two reasons dictated by the treaty text why an AMS *per se* cannot be an appropriate measurement under Article 13(b)(ii). These are: (1) Blue box support is excluded from a Current Total AMS calculation, *de minimis* support, although measured in terms of an AMS, may be excluded from Current Total AMS under Article 6.4, as may S&D box support under Article 6.2, yet all are covered by paragraph (b) of Article 13 and, hence, subject to subparagraph (b)(ii); and (2) Non-product-specific support is excluded from an AMS calculated on a product-specific basis for a basic agricultural product but it is covered by paragraph (b) of Article 13 and, hence, subject to subparagraph (b)(ii).

7.552 Nevertheless, the drafters of the *Agreement on Agriculture* evidently considered that the AMS reflected basic principles of the measurement of support. In the Panel's view, AMS methodology can be used to measure both the MY 1992 benchmark and implementation period support under Article 13(b)(ii), subject to two modifications dictated by the treaty text: (1) the AMS methodology should be applied to the corpus of implementation period support measures subject to Article 13(b), to the extent relevant, and not just to support subject to reduction commitments; and (2) it is not appropriate to calculate an AMS on a product-specific basis for a basic agricultural product and total non-product-specific support separately. Therefore, the Panel will apply the principles of AMS

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<sup>708</sup> Australia's response to Panel third party Question No. 28. The Panel has dealt with this argument in paragraph 7.443 above.

<sup>709</sup> China's response to Panel third party Question Nos. 22 and 23.

<sup>710</sup> European Communities' response to Panel third party Question Nos. 22 and 23.

<sup>711</sup> New Zealand's response to Panel third party Question No. 22.

<sup>712</sup> The French and Spanish versions use the same term in Articles 1(a), 1(d) and 13(b)(ii) and (iii). We will simply refer to the AMS as it is not argued that the EMS is appropriate in the circumstances of this case.

methodology to measure the MY 1992 benchmark and implementation period support, subject to these two modifications, for the purposes of Article 13(b)(ii).

7.553 It is not disputed that all of the types of measures which the Panel includes in its measurement of support must be included in the calculation of Current Total AMS, except that the United States excludes PFC and DP payments as green box support and includes user marketing (Step 2) payments to exporters as domestic support. The Panel includes the former as non-green box and excludes the latter as export subsidies for the reasons set out in this Section VII:D, and Section VII:E, respectively.

7.554 The AMS expresses support in monetary terms.<sup>713</sup> It measures subsidies, including both budgetary outlays and revenue foregone by governments or their agents<sup>714</sup>. Non-exempt direct payments dependent on a price gap can be measured in terms of a "price gap methodology", which filters out the effect of fluctuations in market prices, or in terms of budgetary outlays.<sup>715</sup> Non-exempt direct payments based on factors other than price must be measured in terms of budgetary outlays.<sup>716</sup> Where calculation of the market price support and other components of AMS is not practicable, an EMS shall be calculated, which also involves multiplying prices by quantities of eligible production or budgetary outlays.<sup>717</sup> There is no reason why these basic principles of measurement of support under the *Agreement on Agriculture* would be inappropriate to measure implementation period support under Article 13(b)(ii).

7.555 Therefore, the AMS provides a choice between a methodology based on budgetary outlays only, or a price gap combined with budgetary outlays. Brazil submits that the Panel should use budgetary outlays, making an AMS-like calculation of all relevant support. The Panel notes that this methodology is consistent with the United States' notifications of all its domestic support for the purposes of its AMS reduction commitments, including all those measures at issue, with the exception of deficiency payments which were not granted during the reference period.<sup>718</sup> The United States submitted that, if the Panel made an AMS calculation, it should use a price gap methodology. Ultimately, this Panel does not need to decide if one of these methodologies is less appropriate than the other because, for the purposes of Article 13(b)(ii), it is only necessary to assess whether there is or is not an "excess" of support over that decided in the 1992 marketing year. It is not necessary to calculate the value of the excess and, in this dispute, both methodologies lead to the same result.

7.556 The United States argues that its budgetary outlays for domestic support are not known ahead of time which creates a problem for a Member who wishes to claim that implementation period support, measured in terms of budgetary outlays, is in excess of the MY 1992 benchmark. In contrast, rates of support are set out in United States domestic support legislation and regulations, which

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<sup>713</sup> Article 1(a) and paragraphs 1 and 6 of Annex 3 of the *Agreement on Agriculture*.

<sup>714</sup> Paragraph 2 of Annex 3 of the *Agreement on Agriculture*.

<sup>715</sup> Paragraph 10 of Annex 3 of the *Agreement on Agriculture* provides as follows:

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

<sup>716</sup> Paragraph 12 of Annex 3 of the *Agreement on Agriculture*.

<sup>717</sup> There is no allegation that any of the measures at issue constitute market price support.

<sup>718</sup> In the supporting material relating to agricultural commitments in its Schedule, the United States calculated deficiency payments using price gap methodology and all other relevant support using budgetary outlays – see document G/AG/AGST/USA, reproduced in Exhibit BRA-191. In its notifications to the Committee on Agriculture, the United States notified only deficiency payments for the 1995 marketing year as "blue box" support using price gap methodology and all other support relevant to this dispute for the 1999-2001 marketing years using budgetary outlays – see document G/AG/N/USA/10 and G/AG/N/USA/43, reproduced in Exhibits BRA-150 and BRA-47, respectively and G/AG/N/USA/51 for the 2000 and 2001 marketing years.

permits a Member to mount a rapid challenge and perhaps obtain panel findings before a crop year is over.<sup>719</sup>

7.557 The Panel notes that this is precisely the situation that applies to the assessment of compliance with all domestic support commitments under the *Agreement on Agriculture* and, for that matter, actionable subsidies obligations and non-violation complaints based on tariff concessions. There is no reason to assume that the situation was intended to be different with respect to the additional condition under Article 13(b)(ii) and (iii), particularly given that the text indicates that implementation period support must be measured in terms of support that measures "grant", rather than what was budgeted or estimated.

7.558 The United States argues that support under Article 13(b)(ii) should be measured in terms of a rate of support expressed in cents per pound. This rate represents the level of support guaranteed by the government to producers. When market prices exceed the guaranteed rate, the government makes no payments. When market prices fall below the guaranteed rate, payments by the government increase to maintain the gap between the prices and the guaranteed rate.

7.559 The Panel makes the following observations on the United States' rate of support methodology:

- (a) With respect to the MY 1992 benchmark:
  - (i) the target price for deficiency payments was not in fact decided during the 1992 marketing year, for the reasons given above.
- (b) With respect to implementation period support:
  - (i) a rate of support does not appear to capture the actual amounts granted or provided by a government, rather than those authorized or appropriated in its budget for that year;
  - (ii) a rate of support expressed in cents per pound is not expressed in monetary terms, but in a combination of monetary and quantitative terms;
  - (iii) a rate of support is neither a budgetary outlay nor measured in terms of a price gap;
  - (iv) the rate of support for marketing loan programme payments does not include support provided under the other domestic support at issue, namely, user marketing (step 2) payments, PFC, MLA, DP and CCP payments and cottonseed payments;
  - (v) the rate of support for CCP payments takes into account DP payments, and is only applicable under the FSRI Act of 2002. There was no rate of support under the FAIR Act of 1996 for PFC and MLA payments. The rate of support methodology is therefore unworkable for the 1999 through 2001 marketing years;
  - (vi) a second rate of support can be used to measure user marketing (step 2) payments, but a comparison of the combination of two rates of support across different years to determine whether one combination is in excess of

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<sup>719</sup> United States' response to Panel Question No. 33.

the other is only possible if they both trend in the same direction, or one remains constant; and

- (vii) no rate of support includes cottonseed payments, or crop insurance payments, which can only be measured in terms of budgetary outlays, either in total monetary value terms or on a per unit of production basis.

7.560 Consequently, the rate of support approach proposed by the United States does not represent the MY 1992 benchmark and is incapable of measuring the implementation period support. It is therefore an inappropriate measurement methodology for the comparison under Article 13(b)(ii) in this dispute.

(ii) *Payments dependent on a price gap*

7.561 The AMS permits either the use of a price gap methodology or budgetary outlays for non-exempt direct payments dependent on a price gap.<sup>720</sup> Three types of support relevant to the comparison fall into this category: (1) marketing loan programme payments, which form part of both the MY 1992 benchmark and the implementation period support, are dependent on the difference between the loan rate and the adjusted world price; (2) deficiency payments, which form part of the MY 1992 benchmark only, were also dependent on a price gap; and (3) CCP payments, which form part of the implementation period support only, are dependent on a price gap but are also calculated in respect of base acreage. Therefore, the amount of CCP payments is calculated below at paragraph 7.582.

7.562 Marketing loan programme payments form part of the measurement of support in the benchmark and every year under review. There is no practical impediment to using either price gap methodology or budgetary outlays to measure them. The difference is that the use of a price gap filters out the effect of changes in market prices up to the loan rate on the calculation of this one component of support. However, other components of support have changed since the MY 1992 benchmark and within the implementation period so that they effectively involve a comparison of payments under different programmes. Deficiency payments were followed by PFC and MLA payments under the 1996–2001 farm legislation and DP and CCP payments under the FSRI Act of 2002. Of these later programmes, only CCP payments are dependent on a price gap, but the parties have not suggested an appropriate methodology to calculate this support in terms of a price gap, so the Panel considers it appropriate to use a methodology based on budgetary outlays to measure them. As a result, the use of a price gap to measure deficiency payments, whilst possible, may not produce an appropriate comparison with later measures, all of which are measured in terms of budgetary outlays. The use of budgetary outlays for all but deficiency payments is also consistent with the United States' notifications of its support to the WTO Committee on Agriculture for the purpose of domestic support reduction commitments.<sup>721</sup> Therefore, the Panel for these reasons as well as those set out above, considers it appropriate to use a methodology based on budgetary outlays for these two payments which are dependent on a price gap. This does not imply any view as to whether price gap methodology is inappropriate.

7.563 The parties agree on the amount of budgetary outlays for both marketing loan programme payments<sup>722</sup> and deficiency payments,<sup>723</sup> although the United States does not accept that this is the

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<sup>720</sup> Paragraph 10 of Annex 3 of the *Agreement on Agriculture*.

<sup>721</sup> The Panel notes that although the notifications were made with respect to reduction commitments, not Article 13(b)(ii), they also used AMS methodology. None of the adjustments to AMS methodology dictated by the text of Article 13(b)(ii) affect the appropriateness of using either price gap or budgetary outlays.

<sup>722</sup> Brazil's and the United States' respective responses to Panel Question No. 67, citing USDA and other sources including, Exhibits BRA-4, BRA-55 and BRA-76. Updated information on the 2002 marketing year is set out in the United States' response to Panel Question No. 196.

appropriate methodology. Marketing loan programme payments calculated using budgetary outlays include storage payments and interest subsidies, which the Panel ruled within its terms of reference in Section VII:B of this report. Accordingly, marketing loan programme payments were valued as follows: MY 1992: \$866 million; MY 1999: \$1,761 million; MY 2000: \$636 million; MY 2001: \$2,609 million; and MY 2002: \$897.8 million. Deficiency payments for MY 1992 were valued at \$1,017.4 million.

7.564 The parties agree on the amount of \$867 million for deficiency payments calculated using price gap methodology consistent with the United States' notifications.<sup>724</sup> They include basic deficiency payments of approximately \$832 million plus 50/92 payments of \$35 million calculated as follows. The target price was 72.9 cents per pound and the fixed reference price for 1986-88 was 57.9 cents per pound, giving a price gap of 15 cents per pound. Production eligible for basic deficiency payments was 5,544 million pounds (9.226 million acres times the average programme yield of 601 pounds per acre). Production eligible for 50/92 payments was 254 million pounds (404 000 acres times the average programme yield of 50/92 programme participants of 628 pounds per acre).<sup>725</sup>

7.565 The United States calculated an amount for marketing loan programme payments using price gap methodology.<sup>726</sup> This does not include storage payments and interest subsidies, in accordance with paragraphs 8 and 10 of Annex 3. It entered a zero figure for all crop years under review but indicated that the price gap was always negative because the average adjusted world price for 1986-1988 was 53.65 cents per pound and thereby higher than the loan rate for each of the years in the reference period.<sup>727</sup>

7.566 Brazil objected to the use of price gap methodology for marketing loan programme payments on the grounds that the United States has used and notified marketing loan programme payments (to the WTO Committee on Agriculture) through a budgetary outlays methodology and that price gap methodology would transform millions of dollars of payments to negative values.<sup>728</sup>

7.567 For the reasons given below, it is unnecessary for the purposes of this dispute for the Panel to decide whether the price gap methodology is inappropriate.

(iii) *Measures directed at agricultural processors*

7.568 The AMS methodology provides that measures directed at agricultural processors shall be included only to the extent that such measures benefit the producers of the basic agricultural products.<sup>729</sup> Two types of support at issue in this dispute are directed wholly or partly at processors: user marketing (step 2) payments made to domestic users; and cottonseed payments which are made

<sup>723</sup> USDA Fact Sheet for Upland Cotton, January 2003, reproduced in Exhibit BRA-4, referred to in Brazil's first written submission, para. 144. Up to date figures for the 2002 marketing year are found in the United States' response to Panel Question No. 196 and Exhibit BRA-373.

<sup>724</sup> Brazil's and the United States' respective responses to Panel Question No. 198. In its response, and its 27 August 2003 comments, the United States also suggested an alternative approach, but it is based on eligible "acreage", rather than eligible "production".

<sup>725</sup> See the United States' calculations including an adjustment factor as per its notification in the United States rebuttal submission, para. 115, footnote 144, revised in its 27 August 2003 comments at para. 8, footnote 14. See Exhibit US-39 entitled "USDA announces Final Compliance Figures for 1992 Acreage Reduction Programme".

<sup>726</sup> United States' rebuttal submission, para. 115 and footnotes 144 and 148.

<sup>727</sup> See the United States' rebuttal submission, para. 116, footnote 148. The Panel has calculated that, using negative values, the marketing loan programme payments would be: MY 1992: \$-84 million; MY 1999: \$-133 million; MY 2000: \$-136 million; MY 2001: \$-162 million and MY 2002: \$-130 million.

<sup>728</sup> Brazil's 27 August comments, para. 10 and Brazil's 28 January 2004 comments on United States' response to Panel Question No. 208.

<sup>729</sup> Paragraph 7 of Annex 3.

to first handlers of the cottonseed crop, who are ginners, and are obliged to share the payments with producers to the extent that the revenue from the sale of the cottonseed was shared with the producer.

7.569 The United States agrees that user marketing (step 2) payments are support in favour of agricultural producers<sup>730</sup> and that cottonseed payments are "product-specific" support for cotton.<sup>731</sup> It is possible that some part of these payments does not actually benefit producers, but it is unnecessary for the purposes of this dispute to quantify the precise amounts since the values of these payments do not alter the potential for an excess over the MY 1992 benchmark, as explained below. The United States' included the full amount of user marketing (step 2) payments (together with user marketing (step 2) payments to exporters) and the full amount of cottonseed payments in its calculations.<sup>732</sup> This is also consistent with its notifications of the full amounts to the WTO Committee on Agriculture, for the purposes of its reduction commitments.<sup>733</sup>

7.570 The parties agree on the calculation of payments to user marketing (step 2) payments to domestic users.<sup>734</sup> The Panel notes that this data is gathered in terms of fiscal years, not marketing years, which differ by two months for upland cotton. Nothing indicates that this materially affects the result of the Panel's comparison. Accordingly, user marketing (Step 2) payments to domestic users are as follows: MY 1992: \$102.7 million; MY 1999: \$165.8 million; MY 2000: \$260 million; MY 2001: \$144.8 million; and MY 2002: \$72.4 million.

7.571 The parties also agree on the calculation of cottonseed payments<sup>735</sup>, although they do not agree on whether they are within the Panel's terms of reference nor on whether any outside the Panel's terms of reference should be included in the measurement of support.<sup>736</sup> Accordingly, cottonseed payments are as follows: MY 1999: \$79 million; MY 2000: \$184.7 million; and MY 2002: \$50 million.

(iv) *Payments calculated in respect of base acreage*

7.572 PFC, MLA, DP and CCP payments are calculated with respect to a recipient's "base acres". The acreage actually planted to upland cotton or any other crop in the years in which payments are made is referred to as "planted acres".<sup>737</sup>

7.573 **Brazil** initially submitted that implementation period support included all payments under these four programmes as indicated in a USDA fact sheet summary of the 2002 Commodity Loan and

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<sup>730</sup> United States' response to Panel Question No. 108.

<sup>731</sup> United States' response to Panel Question No. 67 and its rebuttal submission, para. 109.

<sup>732</sup> United States' response to Panel Question No. 67.

<sup>733</sup> See, for example, documents G/AG/N/USA/10 and 43, reproduced in Exhibits BRA-150 and BRA-47, respectively and G/AG/N/USA/51.

<sup>734</sup> United States' response to Panel Question No. 104 and Brazil's rebuttal submission, para. 73, footnote 172. The amounts of user marketing (Step 2) payments to exporters are also set out in the United States' response to Panel Question No. 104.

<sup>735</sup> The authorizing statutes are reproduced in Exhibits BRA-135, BRA-136, BRA-137 and BRA-138, respectively. All but the statute authorizing cottonseed payments for the 1999 crop appropriated a specific amount. The amount of payments for each crop, including the 1999 crop, is agreed: see Brazil's and the United States' respective responses to Panel Question No. 17. See also Brazil's first written submission, para. 106.

<sup>736</sup> The Panel ruled in Section VII:B that only those cottonseed payments for respect of the 2000 crop are within its terms of reference, and in paragraph 7.536 of this Section VII:D that all cottonseed payments for the 1999, 2000 and 2002 crops must be included in its measurement of support for the purposes of Article 13 of the *Agreement on Agriculture*. Without prejudice to whether they were relevant, the United States, as well as Brazil, included the cottonseed payments for each crop in the calculation of support granted in the same marketing year: see, for example, their respective responses to Panel Question No. 67. See also, United States' rebuttal submission, para. 106 and USDA News Release: "USDA issues \$ 50 million in Payments for 2002 Crop Cottonseed Program", reproduced in Exhibit BRA-129,

<sup>737</sup> See the description of measures in Section VII:C of this report.

Payment Program. The payments listed in that fact sheet represent all payments on upland cotton base acreage.<sup>738</sup>

7.574 Brazil then adjusted these calculations by dividing the total annual upland cotton planted acreage by total upland cotton base acreage in each programme. It explained in notes to its calculations that this adjustment was necessary because only the portion of upland cotton payments under the programmes that actually benefits acres planted to upland cotton can be considered support to upland cotton.<sup>739</sup> It called this methodology the "14/16ths methodology".<sup>740</sup> It considered that this was a "reasonable proxy" since actual data collected by the United States concerning the amount of payments to upland cotton producers was not available and cited various factors to support an assumption that these revised figures were appropriate.<sup>741</sup> It set out a detailed summary of the evidence available at that time which, it argued, suggested that the amount of payments could best be calculated by finding that United States upland cotton producers received those payments using upland cotton base acreage.<sup>742</sup>

7.575 Brazil also cited data generated by the Environmental Working Group ("EWG") to support its assumption, which had matched recipients of marketing loan programme payments (who must harvest some quantity of upland cotton to be eligible for payment) to recipients of PFC, MLA, DP and CCP payments.<sup>743</sup> The EWG database is publicly available on the internet and shows dollar amounts of payments received by individuals and corporations calculated in respect of base acreage for each crop under these programmes.

7.576 The **United States** submits that it would be erroneous to attribute to upland cotton or upland cotton producers all payments calculated according to upland cotton base acreage due to the production flexibility which allows recipients not to produce upland cotton.<sup>744</sup> It disputes Brazil's 14/16ths methodology and submitted that Brazil had provided no evidence to support its assumptions that every acre of upland cotton was planted by a holder of upland cotton base acreage, and that no such base acreage holder planted more upland cotton than his or her base acres.<sup>745</sup> The United States declined to suggest an alternative approach to payments made in respect of base acreage because the issue of what payments may be attributed to upland cotton production was fundamentally part of Brazil's burden to present evidence substantiating the amount of the subsidy that it is challenging.<sup>746</sup> It also identified alleged shortcomings in the EWG data.<sup>747</sup>

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<sup>738</sup> Brazil's first written submission, para. 148, citing USDA fact sheet, reproduced in Exhibit BRA-4.

<sup>739</sup> Brazil's responses to Panel Question No. 60, notes 2-5 to table.

<sup>740</sup> This name reflects the fact that, according to data available to Brazil at that time, in the 2002 marketing year, total upland cotton planted acreage was over 14 million acres and total upland cotton base acreage was over 16 million acres. The actual proportions of planted acres to base acres are 88.7 per cent, 94.3 per cent, 95.1 per cent and 84.98 per cent in each of the 1999 through 2002 marketing years (under the PFC and MLA programmes), and 73 per cent in the 2002 marketing year (under the DP and CCP programmes). See Brazil's response to Panel Question No. 67, notes to table in para. 97 and footnote 58 to its further rebuttal submission.

<sup>741</sup> The factors included the geographical spread of crops and relative costs of production of different covered commodities: see Brazil's response to Panel Question No. 125(2)(a), (2)(c), (3) and (8).

<sup>742</sup> Brazil's closing statement at the resumed session of the first substantive meeting, para. 8, and Annex I.

<sup>743</sup> Brazil's 28 January 2004 comment on United States' response to Panel Question No. 205. See also statement of Christopher Campbell of EWG and EWG Dtabae table of results, reproduced in Exhibits BRA-316 and BRA-317, respectively.

<sup>744</sup> United States' response to Panel Question No. 67*bis* and United States' further submission, para. 75

<sup>745</sup> United States' response to Panel Question No. 125(e).

<sup>746</sup> United States' response to Panel Question No. 125(e).

<sup>747</sup> United States' response to Panel Questions Nos. 195 and 205.

7.577 After obtaining the planting data by category, **Brazil** submitted that the Panel should apply Brazil's methodology to this data<sup>748</sup>, and that it no longer relied on its 14/16ths methodology.<sup>749</sup> It also submitted calculations based on two versions of the methodology in Annex IV of the *SCM Agreement*.

7.578 After providing the planting data, the **United States** indicated that for the marketing years before 2002 the data was based on crop reports that were not generally required. The United States argued that Brazil's methodology is invented and lacks any basis in any WTO agreement or in economic logic. Brazil's methodology inappropriately conflates product-specific and non-product-specific support. *SCM Agreement* concepts of subsidy, benefit and subsidized product are not used in nor are directly applicable to Article 13. However, internal inconsistencies in the methodology have implications for both the serious prejudice claim and for the interpretation of Article 13 since, on Brazil's approach, it is necessary to identify the subsidy benefit in order to determine the "support to" upland cotton. There is no basis for attributing only part of a payment to some crops rather than across all production on a farm.<sup>750</sup> The United States submits that the Panel should not have to adopt a reasonable methodology to allocate support under Article 13 because the drafters would not have left the methodology undefined, and because Article 13 itself provides a methodology to calculate support to a specific commodity, namely product-specific support.<sup>751</sup> The United States rejected Brazil's calculations based on Annex IV of the *SCM Agreement* because, in its view, Brazil's version was inconsistent with Annex IV and Brazil's calculations of the United States' version did not reflect the United States' interpretation of Annex IV.<sup>752</sup>

7.579 The Panel recalls its finding that all non-green box support measures that clearly or explicitly define a commodity as one to which they bestow or confer support must be included in the calculation of implementation period support. In this case, the relevant commodity is upland cotton. The Panel's task is not to measure only product-specific support.

7.580 The Panel calculates these payments, like other support directed at producers, as specified in the domestic support measures themselves. The measures provide for payments to recipients who have enrolled cropland in the programme on the basis of upland cotton production, at a rate specific to upland cotton, according to a yield specific to upland cotton. This methodology is used by USDA and was the original approach submitted by Brazil. It includes all payments calculated with respect to upland cotton base acres.

7.581 The Panel will measure these payments in accordance with the principles of AMS methodology set out in Annex 3 to the *Agreement on Agriculture*. PFC, MLA and DP payments are non-exempt direct payments based on factors other than price. The Panel therefore uses budgetary outlays to measure them in accordance with paragraph 12 of Annex 3. For the reasons given in paragraph 7.562 above, the Panel will use budgetary outlays to measure CCP payments as well.

7.582 The parties agree on the total amount of payments calculated in respect of upland cotton base acreage, although they do not agree that all such payments are support to upland cotton.<sup>753</sup> The total amounts are as follows:

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<sup>748</sup> Set out in the Attachment at the end of this Section.

<sup>749</sup> Brazil's 10 March 2004 comments, para. 3.

<sup>750</sup> United States' comments on Brazil's response to Question No. 258, its 11 February 2004 comments on US data, generally and its 3 March 2004 comments, paras. 37-44.

<sup>751</sup> United States' 3 March 2004 comments, para. 14.

<sup>752</sup> United States' 15 March 2004 comments, paras. 30-36 and its 3 March 2004 comments, paras. 45-56.

<sup>753</sup> USDA Fact Sheet on Upland Cotton, reproduced in Exhibit BRA-4 and the United States' response to Panel Question No. 196 for the 2002 marketing year.

**Table 1: Payments calculated in respect of upland cotton base acreage**

<b>\$ million</b>	<b>MY1999</b>	<b>MY2000</b>	<b>MY2001</b>	<b>MY2002</b>
PFC payments	616	574.9	473.5	436
MLA payments	613	612	654	
DP payments				181
CCP payments				1309

7.583 The Panel notes that the evidence in this dispute shows a strongly positive relationship between recipients who currently plant upland cotton and those whose payments are calculated with respect to upland cotton base acres and whose payments are therefore calculated at the upland cotton-specific payment rate.<sup>754</sup> The Panel makes certain factual findings with respect to that relationship and also with respect to Brazil's allocation of an amount of the total payments under these programmes to upland cotton in the Attachment to Section VII:D.

(v) *Payments calculated with respect to insurance*

7.584 Brazil submitted official Federal Crop Insurance Corporation ("FCIC") calculations of the amounts of crop insurance payments borne by the FCIC with respect to insurance offered relating to upland cotton.<sup>755</sup> The United States does not agree that they are relevant but does not contest their accuracy.<sup>756</sup> The Panel will therefore rely on the FCIC calculations. Accordingly, the amounts are as follows: MY 1992: \$26.6 million; MY 1999: \$169.6 million; MY 2000: \$161.7 million; MY 2001: \$262.9 million; and MY 2002: \$194.1 million.

(e) Comparison of support

(i) *Reference period*

i Main arguments of the parties

7.585 **Brazil** challenges domestic support payments for the production and use of upland cotton, which were and continue to be made between the 1999 marketing year to the present and those scheduled to be made from the present through the 2007 marketing year pursuant to the statutes and regulations listed in its request for establishment of a panel. It also challenges legal instruments under which these payments are made "as such".<sup>757</sup>

7.586 Brazil submits that if measures fail to meet one of the relevant conditions in Article 13 in any year – be it the current year or an earlier year during the implementation period – those measures can no longer be considered to "fully conform" or to not "grant support" "in excess of" the MY 1992 benchmark. Consequently, those measures are not exempt from actions.<sup>758</sup>

7.587 The **United States** is of the view that failure by a Member to comply in a given year with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) would only lift

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<sup>754</sup> This does not imply any view on whether such an allocation of support is appropriate under the *Agreement on Agriculture*.

<sup>755</sup> See FCIC Summary of Business Report as of 16 June 2003, reproduced in Exhibit BRA-57 and referred to in Brazil's response to Panel Question No. 67, footnote 8, and with respect to the 2002 crop year, as of 8 December 2003, reproduced in Exhibit BRA-374.

<sup>756</sup> The United States does contest the value of crop insurance net indemnities with respect to upland cotton in the 2002 marketing year. See Brazil's response to Panel Question No. 196, footnote 13 and the United States' 28 January 2004 comments on Panel Question No. 196, para. 20, footnote 9.

<sup>757</sup> Brazil's response to Panel Question No. 19.

<sup>758</sup> Brazil's response to Panel Question No. 35.

the exemption from action for those measures for the year of that breach. Measures, i.e. subsidies, in a later year would remain exempt from action so long as those measures in the given year comply with the conditions in Article 13(b)(ii). Because the fundamental commitment under Article 6 is to limit domestic support as measured by the Current Total AMS to a Member's final bound commitment level, and that commitment is judged on a year-by-year basis, a Member may breach its commitments under Article 6 in one year and come back into compliance in the following year. Thus, conformity with this element of Article 13 must be judged on a year-by-year basis.<sup>759</sup>

7.588 The United States goes on to argue that if the Peace Clause is breached in any particular year, a Member could bring an action against such measure, i.e. subsidy, but only for the year of the breach. For example, where subsidies were provided on a yearly basis, a Member could breach the Peace Clause in one year in which the support such measures grant is in excess of that decided during the 1992 marketing year, but could be in conformity in the following year, if support were again within the 1992 marketing year level. Only the subsidies for the year in which the Peace Clause were breached would not be exempt from actions.<sup>760</sup>

ii Main arguments of the third parties

7.589 **Argentina** contends that excess support granted during any one of the years of the period of implementation suffices to cancel the protection provided by the Peace Clause. A year-on-year comparison cannot be inferred from Article 13 or from its context. Otherwise, at the beginning of each marketing year the Member that had exceeded the level of support in the previous year would be covered by the Peace Clause once again and their measures would be exempt from any claims.<sup>761</sup> In Argentina's view, the failure by a Member to comply in a given year with either the chapeau of Article 13(b) or the proviso in subparagraph (ii) of Article 13(b) results in the loss of the protection granted by the Peace Clause.<sup>762</sup>

7.590 **China** is of the view that a Member's failure to comply in a given year with the chapeau of Article 13(b) will not impact its entitlement to benefit in an earlier or a later year from exemption from actions. The chapeau requires that domestic support measures conform fully to provisions of Article 6. Articles 6.1 and 6.3 in turn provide that all non-green box domestic support measures of a Member are considered to be in compliance with Article 6 if the Member's "Current Total AMS does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule". The word "exceed" requires a comparison. The words "current", "corresponding" and "annual" indicate that the comparison is to be made on an annual basis between the level of support actually provided in a given year and the annual bound commitment level in the same year as indicated in the Member's Schedule. A Member's actual level of support varies from year to year, so does a Member's annual bound commitment level. Therefore, a factual comparison between the two in a given year shall not have any bearing on a comparison of different support levels in an earlier or later year.<sup>763</sup>

7.591 The **European Communities** agrees with the United States that Brazil's argument that any breach of the 1992 level during the nine-year implementation period removes the protection of Article 13 is incorrect. The present tense of the phrase "do not grant support" makes this clear. The comparison for the purpose of Article 13(b) must be between the level of support decided in the 1992 marketing year and that granted by virtue of the measures being challenged. This would typically mean the most recent marketing year.<sup>764</sup> The European Communities considers that Article 13(b)

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<sup>759</sup> United States' response to Panel Question No. 35.

<sup>760</sup> United States' response to Panel Question No. 35.

<sup>761</sup> Argentina's response to Panel third party Question No. 12.

<sup>762</sup> Argentina's response to Panel third party Question No. 13.

<sup>763</sup> China's response to Panel third party Question No. 13.

<sup>764</sup> European Communities' oral statement at the first session of the first substantive meeting, para. 13.

permits, but does not require, a year-on-year comparison, because support is generally expressed in annual amounts. In order to benefit from the protection of Article 13, a measure must conform to the provisions of Article 6 and must not "grant support" in excess of that decided in during the 1992 marketing year. The European Communities considers that the Panel has some discretion in choosing a specific period, although it is clear it must be as close as possible to the time of the dispute. However, since the Panel must consider the support granted it must choose a period for which data is complete. Given Article 1(i) of the *Agreement on Agriculture*, the period chosen may well be based on the calendar, financial or marketing year of the Member complained against.<sup>765</sup>

7.592 **New Zealand** argues that Article 13(b)(ii) and (iii) require a comparison with 1992 of any year in which injury, nullification or impairment or serious prejudice is alleged to have occurred.<sup>766</sup> New Zealand is of the view that the nature of non-compliance at issue may be such that it does impact on a Member's entitlement to benefit in an earlier or later year from the exemption from action provided by Article 13(b) on a case-by-case basis.<sup>767</sup>

iii Evaluation by the Panel

7.593 The Panel notes that there is nothing in the text of the *Agreement on Agriculture* or any other covered agreement that indicates the length of the reference period for the comparison under Article 13(b)(ii). However, in this dispute, the decisions on support taken during the 1992 marketing year related to one year only. Therefore, a meaningful comparison of the implementation period support requires it to be compared by year as well.

7.594 It is not necessary for the purposes of this dispute to decide how many years during the implementation period must show an excess over the MY 1992 benchmark for measures not to be exempt from actions because the comparison in each year for which there is evidence shows the same result. The Panel has already found that the chapeau of paragraph (b) and subparagraph (ii) share the same subject.<sup>768</sup> It suffices for the purposes of this dispute for the Panel to add that, in view of that finding, measures which grant support during the implementation period in excess of the MY 1992 benchmark fail to satisfy Article 13(b), and it is not simply that amount of support in excess of the MY 1992 benchmark which is exposed to actions under Articles 5 and 6 of the *SCM Agreement* and paragraph 1 of Article XVI of the *GATT 1994*. Neither party has suggested otherwise. This does not imply any view as to whether the grant of support in any one year in excess of the MY 1992 benchmark would result in that Member's implementation period support for other years failing to comply with Article 13(b).

7.595 In any case, the issue of which measures do or do not satisfy the conditions of Article 13 and which are or are not exempt from actions concerns the *actions*, not the substance of the allegations raised in connection with those actions. Therefore, if a measure is not exempt from actions based on Articles 5 and 6 of the *SCM Agreement* and paragraph 1 of Article XVI of the *GATT 1994*, there is no bar to a claim that the measure threatens to cause serious prejudice at some future time. It is not necessary to prove that the measures are not exempt at that future time.

(ii) *Table showing comparison*<sup>769</sup>

7.596 In light of the foregoing analysis and measurement of support for each of the 1992, 1999, 2000, 2001 and 2002 marketing years, the Panel tabulates the MY 1992 benchmark and implementation period support using budgetary outlays to permit a comparison as follows:

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<sup>765</sup> European Communities' response to Panel third party Question No. 12.

<sup>766</sup> New Zealand's response to Panel third party Question No. 12.

<sup>767</sup> New Zealand's response to Panel third party Question No. 13.

<sup>768</sup> See paragraph 7.471 above.

<sup>769</sup> See Brazil's and the United States' respective responses to Panel Question No. 67.

**Table 2: Comparison of support in accordance with Article 13(b)(ii)**

<b>\$ million</b>	<b>MY1992</b>	<b>MY1999</b>	<b>MY2000</b>	<b>MY2001</b>	<b>MY2002</b>
Marketing loan programme	866	1761	636	2609	897.8
User marketing (step 2)	102.7	165.8	260	144.8	72.4
Deficiency payments	1017.4	0	0	0	0
PFC payments	0	616	574.9	473.5	436
MLA payments	0	613	612	654	0
DP payments	0	0	0	0	181
CCP payments	0	0	0	0	1309
Crop insurance payments	26.6	169.6	161.7	262.9	194.1
Cottonseed payments	0	79	184.7	0	50
<b>TOTAL</b>	<b>2012.7</b>	<b>3404.4</b>	<b>2429.3</b>	<b>4144.2</b>	<b>3140.3</b>

7.597 The comparison shows that implementation period support exceeds the MY 1992 benchmark in every year under review. Implementation period support also exceeds the MY 1992 benchmark in every year under review where (1) the marketing loan programme payments and deficiency payments are both calculated using a price gap; and (2) where the marketing loan programme payments are calculated using a price gap but deficiency payments are calculated using budgetary outlays in order to provide a more appropriate comparison with the measures which succeeded them. This is the case whether marketing loan programme payments: (a) are shown as zero; or (b) are calculated using negative values.<sup>770</sup>

7.598 Therefore, taking into account all the evidence above, the Panel considers that Brazil has discharged its burden to show that the United States domestic support measures at issue grant support to a specific commodity in excess of that decided during the 1992 marketing year.

(iii) *Rate of support*<sup>771</sup>

7.599 The Panel has observed that a rate of support methodology is unable to measure implementation period support.<sup>772</sup> The Panel has also found that the rate of support of 72.9 cents per pound was not in fact decided during the 1992 marketing year and therefore cannot constitute the MY 1992 benchmark.<sup>773</sup> The United States has not submitted that any other rate of support constituted the MY 1992 benchmark. Therefore, this methodology is inappropriate for the comparison under Article 13(b)(ii).

7.600 The only rate of support that appears to have been decided during the 1992 marketing year was the rate of 52.35 cents per pound for the marketing loan programme, subject to the Acreage Reduction Percentage ("A.R.P.") of 7.5 per cent.<sup>774</sup> Neither party submitted that this was an

<sup>770</sup> See calculations under the "measurement of support", above.

<sup>771</sup> United States' rebuttal submission, paras. 121-126.

<sup>772</sup> See paragraph 7.560 above.

<sup>773</sup> See paragraph 7.449 above.

<sup>774</sup> The A.R.P. programme obliged farmers to idle a set portion of their base acreage of upland cotton and other specific commodities as a condition of eligibility for marketing loans and deficiency payments. The goal was to reduce supplies, thereby raising market prices. It reduced the amount of production and hence the amount of support guaranteed to upland cotton producers by the loan rate, and reduced the amount of acres eligible for deficiency payments. A.R.P. can be contrasted with set-aside programmes which based reductions on current year plantings and did not require farmers to reduce their plantings of specific crops. The programme was not reauthorized in the FAIR Act of 1996. See USDA Economic Research Service "Commodity Program Entitlements: Deficiency Payments" (May 1993), reproduced in Exhibit BRA-417 and statement of Dr. Sumner, para. 8 in Exhibit BRA-105.

appropriate rate of support to measure the MY 1992 benchmark. However, in order to pursue the rate of support approach to its logical conclusion, the Panel finds that the loan rate in each of the 1999-2002 marketing years was 51.92 cents per pound<sup>775</sup>, and under the FSRI Act of 2002 in the 2002 marketing year was 52 cents per pound<sup>776</sup> (and the target price for CCP payments in the 2002 marketing year was 72.4 cents per pound). None of these rates were subject to an A.R.P. or any other land idling requirements. Therefore, these rates of 51.92 and 52 cents per pound, free of reductions, granted support in excess of 52.35 cents per pound subject to an A.R.P. reduction of 7.5 per cent.

7.601 Further, the target price for deficiency payments of 72.9 cents per pound, which was not decided during the 1992 marketing year, did not represent "support decided" either. First, support guaranteed by this target price was subject to an A.R.P. of 10 per cent for the 1992 crop, which reduced the amount of acres eligible for payments, as well as "normal flex acres" conditions, according to which deficiency payments were not paid for 15 per cent of base acreage.<sup>777</sup> These were decisions by the United States government<sup>778</sup> creating mandatory conditions that reduced the guaranteed revenue to producers delivered by the target price. The target price adjusted for A.R.P. and normal flex acres, according to United States calculations, produces a rate of support decided of 67.7625 cents per pound.<sup>779</sup> Second, this adjusted target price does not capture user marketing (step 2) payments, which the United States accepts are part of the MY 1992 benchmark.<sup>780</sup> Prior to the 2002 marketing year, these payments were triggered when a certain quote exceeded another by

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<sup>775</sup> The range of 50 cents to 51.92 cents per pound was established by s.132(c)(2) of the FAIR Act of 1996. See *USDA Agricultural Outlook*, November 2003, reproduced in BRA-394.

<sup>776</sup> Section 1202(a)(6) of the FSRI Act of 2002.

<sup>777</sup> The Omnibus Budget Reconciliation Act of 1990 "made 15 per cent of each program crop acreage base ineligible for deficiency payments. This change was intended to reduce program spending and to increase producers' planting flexibility." - see USDA Economic Research Service "Commodity Program Entitlements: Deficiency Payments" (May 1993), reproduced in Exhibit BRA-417. See also the statement of Dr. Sumner, paras. 10 and 12, in Exhibit BRA-105.

<sup>778</sup> There were also eligibility criteria that reduced the amount of upland cotton receiving the support which the United States argues should not be taken into account because they were decisions by producers, not the United States government. However, it also argues that the A.R.P. and normal flex acres should be disregarded because adjusting the rate of support for these would assume unrealistically that producers would have produced on 100 per cent of base acres. Paradoxically, those are decisions by producers not the United States government and, on the United States' approach, such decisions should not be taken into account in using the rate of support as the benchmark. See the United States' rebuttal submission, para. 126.

<sup>779</sup> Maximum deficiency payments rate (20.55 cents per pound) reduced by 10 per cent A.R.P. and 15 per cent normal flex acres, yields an adjusted maximum deficiency payment rate of 15.4125 cents per pound. This rate, plus the marketing loan rate of 52.35 cents per pound, gives guaranteed producer revenue of 67.7625 cents per pound. If the maximum deficiency payment rate were reduced by 10 per cent A.R.P. only, it would yield an adjusted maximum deficiency payment rate of 18.495 cents per pound. This rate, plus the marketing loan rate, gives guaranteed producer revenue of 70.845 cents per pound. See the United States' rebuttal submission, para. 126, and "Calculating the Per-Unit Rate of Support" by Dr. Glauber, reproduced in Exhibit US-24. The Panel takes note of Dr. Glauber's observation that in 1992 producers could plant other crops on their flex acres (Exhibit US-24, p.1). This did not affect the mandatory idling of ten per cent of programme base. Further, the extent to which producers chose to exercise that flexibility was not a decision of the United States government which, consistent with the United States' approach, should not be taken into account in calculating the rate of support decided for upland cotton producers. The Panel also takes note of Dr. Glauber's statement that "[i]f a significant proportion of the abandoned area were declared as idled acreage for program reporting purposes, this would imply that the amount of upland cotton eligible for marketing loans in 1992 was close to 100 per cent" (Exhibit US-24, p.2). This is speculation that, in the six to eight week period between survey estimates and programme reports, almost 2 million abandoned acres were reported as idled. There is no evidence before the Panel that this possibility was anything but remote.

<sup>780</sup> The United States submits that it also decided to provide support in the form of user marketing (Step 2) payments in 1992 under the FACT Act of 1990: see United States' first written submission, para. 104.

more than 1.25 cents per pound, and payments were made equal to the difference between the two quotes minus the 1.25 per cents per pound threshold.<sup>781</sup>

7.602 The corresponding rates of support during the implementation period exceed both the adjusted target price and the user marketing (step 2) support. No meaningful comparison with implementation period support is possible for the 1999, 2000 and 2001 marketing years because there was no target price in those years. However, in the 2002 marketing year, there was a target price for CCP payments of 72.4 cents per pound, but not subject to A.R.P. or any set aside requirements. This exceeds the adjusted target price for deficiency payments of 67.7625 cents per pound. In the 2002 marketing year, user marketing (step 2) payments conditions have remained basically constant but are not subject to the 1.25 cents per pound threshold. This exceeds support guaranteed under the user marketing (step 2) programme in the 1992 marketing year. Therefore, implementation period support in the 2002 marketing year exceeds the MY 1992 benchmark even on the approach proposed by the United States. In the alternative, to the extent that differences between the programmes in the 1992 and 2002 marketing years prevent a meaningful comparison, the approach proposed by the United States is unworkable in all years under review.

7.603 The United States commented that the CCP target price ceases to be paid when the farm price rises about 65.73 cents per pound.<sup>782</sup> It is true that CCP payments cease to be paid at that price because DP payments make up the difference to 72.4 cents per pound, but the guaranteed level of support to producers with upland cotton base acres remains 72.4 cents per pound, calculated with respect to base acres and yields.

7.604 Brazil argued that the rate of support in the MY 1992 benchmark should be adjusted for the limitation that deficiency payments were made only on 85 per cent of base acres. However, this is also a programme feature of PFC, MLA, DP and CCP payments, and does not affect the comparison in terms of a rate of support.<sup>783</sup>

7.605 Brazil argued that the Panel should also take into account changed eligibility requirements. Marketing loan programme payments in the 1996 to 2002 marketing years were only available to cropland enrolled in the PFC programme (estimated by Brazil at 97 per cent<sup>784</sup>) but that restriction was removed in the FSRI Act of 2002 so that from the 2002 marketing year 100 per cent of United States production of upland cotton was eligible to receive marketing loan benefits.<sup>785</sup> Brazil also argued that the Panel should take into account optional land idling features, including optional flex acres and the 50/92 option.<sup>786</sup> In light of our findings, it is not necessary to decide whether these decisions on participation by producers and exercise of options are properly part of the MY 1992 benchmark support.<sup>787</sup>

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<sup>781</sup> See the description of measures in Section VII:C of this report. The importance of this change is illustrated by the fact that during MY 2001, Step 2 payments were zero during 15 weeks but, after the abolition of the threshold, in MY 2002 they were zero during only five weeks. See the weekly step 2 certificate values in Exhibits BRA-350.

<sup>782</sup> United States' further rebuttal submission, para. 91.

<sup>783</sup> See statement of Dr. Sumner, para. 17, in Exhibit BRA-105.

<sup>784</sup> See Brazil's oral statement at the first session of the first substantive meeting, statement of Dr. Sumner, Annex 2, p.4.

<sup>785</sup> Section 1201(b) of the FSRI Act of 2002, reproduced in Exhibits BRA-29 and US-1.

<sup>786</sup> See 7 CFR 1427.4(a)(3) and 7 CFR 1413 (1992 edition), reproduced in Exhibit US-3. Brazil's estimate of eligible production is set out in Brazil's oral statement at the first session of the first substantive meeting, statement of Dr. Sumner, Annex 2, p.3.

<sup>787</sup> See statement of Dr. Sumner, pages 2-7, in Annex 2 to Exhibit BRA-105. See also Brazil's oral statement at the first session of the first substantive meeting, para. 36, in Exhibit BRA-103 and Brazil's 22 August comments on United States' response to Panel Question No. 57.

7.606 The United States argued that the adjusted rate of support approach would not allow it to know *ex ante* what its obligations are under Article 13(b)(ii). This may not be factually accurate as the United States support decided during the 1992 marketing year for upland cotton was decided and provided before the entry into force of the *Agreement on Agriculture*: the deficiency payments target price, marketing loan rate, user marketing (step 2) payments formula and mandatory land idling requirements for 1992 and 1993 were all decided before the end of the Uruguay Round. In any event, the drafters chose to require Members to schedule precise AMS reduction commitments but did not choose to specify the MY 1992 benchmark, either in Members' schedules, notifications to the WTO Committee on Agriculture or in any negotiating document which has been submitted to the Panel. There is no reason to find that they considered *ex ante* precision critical to the interpretation of the additional condition in Article 13(b)(ii). This is not at all unusual. Members have differing views about the interpretation of many obligations in the covered agreements which can be resolved through consultations and resort to the WTO dispute settlement system.

7.607 For these reasons, the Panel considers that, even accepting the United States' rate of support approach to the comparison under Article 13(b)(ii), United States domestic support measures grant support to a specific commodity in excess of that decided during the 1992 marketing year. In light of this, and the Panel's rejection of the United States' interpretation of Article 13(b)(ii), the United States has not presented sufficient evidence and arguments to show that its domestic support measures satisfy the conditions in Article 13(b). This is without prejudice to the Panel's view that Brazil bears the initial burden of proving that they do not satisfy those conditions, for the reasons set out in Section VII:C of this report.

(f) Conclusion regarding Article 13(b)

7.608 In light of the above findings, the Panel concludes that the United States domestic support measures listed in paragraph 7.1107 grant support to a specific commodity in excess of that decided during the 1992 marketing year and that, therefore, they are not exempt from actions based on paragraph 1 of Article XVI of the *GATT 1994* or Articles 5 and 6 of the *SCM Agreement*.

(g) Brazil's requests that the Panel draw adverse inferences

7.609 The procedural record of the Panel's requests for information pursuant to Article 13.1 of the *DSU* is set out in Section VII:A of this report. The Panel indicated in its request for information dated 12 January 2004 and again in its supplementary request dated 3 February 2004 that a refusal to provide the information as requested without an adequate explanation may lead to adverse inferences being drawn. The United States provided the information requested in response to the supplementary request for information on 3 March 2004.

7.610 On 28 January 2004, **Brazil** requested the Panel to draw the following adverse inferences: (1) that its methodology<sup>788</sup> for allocating PFC, MLA, DP and CCP payments to current producers of upland cotton for the 1999 through 2002 marketing years using United States-controlled data would have resulted in higher payments than those estimated by Brazil's 14/16<sup>th</sup> methodology; (2) that the application of the United States methodology for allocating PFC, MLA, DP and CCP payments to current producers of upland cotton for the 1999 through 2002 marketing years using United States-controlled data would have resulted in higher payments than those estimated by Brazil's 14/16<sup>th</sup> methodology; and (3) that the information would have been detrimental to the United States

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<sup>788</sup> See Brazil's response to Panel Question No. 258. See Brazil's earlier comments on this issue in its response to Panel Question, No. 125 (5) and further rebuttal submission, para. 49 and footnote 57.

arguments that PFC, MLA, DP and CCP payments are not support to cotton within the meaning of Article 13(b)(ii), or alternatively, "non-product-specific support".<sup>789</sup>

7.611 Brazil argues that in light of the Appellate Body's findings in *Canada – Aircraft* and *US – Wheat Gluten* regarding the legal basis for drawing adverse inferences, the following facts support the Panel drawing the three aforementioned adverse inferences: (1) the United States was aware of: (a) Brazil's latest estimates of its 14/16ths methodology<sup>790</sup>; (b) the results of the EWG database tabulations; and (c) it had access to all farm-specific data; (2) the United States was fully capable of calculating the amount of payments allocable to current United States producers of upland cotton; (3) the consistent misleading information provided by the United States concerning its possession of data regarding acreage and payment information for contract payments; and (4) the refusal of the United States to provide information regarding alleged "decoupled" contract payments paid to current upland cotton producers.<sup>791</sup> Brazil also approvingly cites *Argentina – Textiles and Apparel*, where it asserts that the Panel used the best information available when the complainant refused to provide documents within its exclusive control.<sup>792</sup> According to Brazil, applying these concepts to the allocation issues involved in the Peace Clause portion of this dispute indicates that the Panel has more than sufficient evidence in the record to support a reasonable estimate of the amount of contract payment support provided to upland cotton in the 1999-2002 marketing years.<sup>793</sup>

7.612 Brazil further submits that the Panel should bear in mind that if a Member can easily block a panel's request for information without any consequences, then it will effectively undermine and circumvent WTO disciplines. Brazil also argues that any adverse inferences drawn by the Panel become part of the evidence on which the Panel must make an objective assessment of the facts pursuant to Article 11 of the *DSU*.<sup>794</sup>

7.613 The **United States** responds that there is no basis for an "inference" of any kind, adverse or otherwise, regarding its non-disclosure of farm-specific planting information in the format requested by the Panel because the United States did not have authority to provide that data as requested and because it had provided data that would permit the Panel to assess "total" payments to farms planting upland cotton, which the United States interpreted to include payments in respect of non-upland cotton base acres as well.<sup>795</sup>

7.614 The United States submits that under Article 11 of the *DSU* the Panel cannot make claims for a party, nor develop evidence for a party. The Appellate Body explained in *Japan – Agricultural Products II* that it is for the complaining party to bring forward sufficient evidence and arguments to carry its burden of establishing a prima facie case.<sup>796</sup>

7.615 On 13 February 2004, **Brazil** submitted that if the United States provided the data requested in the Panel's supplementary request pursuant to Article 13.1 of the *DSU*, most of its comments on

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<sup>789</sup> Brazil's 28 January 2004 comments and requests regarding data provided by the United States on 18/19 December 2003, paras. 57 and 108.

<sup>790</sup> Brazil stated after receiving the data submitted by the United States on 3 March 2004 that it would no longer be appropriate to rely on its 14/16ths methodology in view of that data. See Brazil's 10 March 2004 comments, para. 3.

<sup>791</sup> Brazil's 28 January 2004 comments and requests regarding data provided by the United States on 18/19 December 2003, paras. 58-64.

<sup>792</sup> Brazil's 28 January 2004 comments to the United States' response to Panel Question No. 256, para. 234.

<sup>793</sup> Brazil's 28 January 2004 comments to the United States' response to Panel Question No. 256, para. 235 and Brazil's 10 March 2004 comments, para. 34.

<sup>794</sup> Brazil's 28 January 2004 comments and requests regarding data provided by the United States on 18/19 December 2003, paras. 65-66.

<sup>795</sup> United States' letter to the Panel dated 20 January 2004, p.3.

<sup>796</sup> United States' response to Panel Question No. 256.

28 January 2004 would be rendered moot. The purpose of those comments was to demonstrate the inadequacy of the United States' data production, to request the drawing of adverse inferences and, in the absence of the actual data, to supply the inadequate summary data.<sup>797</sup>

7.616 On 3 March 2004, the **United States** provided data in response to the Panel's supplementary request.

7.617 On 10 March 2004, **Brazil** argued that the data produced by the United States was incomplete, for certain specific reasons. It requested the Panel to rely on the calculations which Brazil made based on that data, as any shortcoming in these results stemmed from the United States' refusal to produce farm-specific data as requested. The "refusal" of the United States to produce complete data would permit the Panel to draw the adverse inferences that this information would have shown even higher payments being allocated to upland cotton.<sup>798</sup>

7.618 The **United States** submits that the information which it provided was not incomplete but complied with the terms of the Panel's supplementary request for information, by including farms with no upland cotton planted acres and not including contract yield and payment units information and payments to producers (not farms) with upland cotton plantings.<sup>799</sup> It notes that Brazil considers the data which the United States provided as "the best information available before the Panel", and that Brazil had also stated that the United States had produced "complete summary base and complete summary planted data covering all crops for which data was requested by the Panel and all farms covered by the Panel's request". Therefore, according to the United States, Brazil has implicitly conceded that there is no basis to draw adverse inferences.<sup>800</sup>

7.619 The Panel recalls that after the first session of the first substantive meeting, we asked the United States in writing to state the annual amount granted by the United States government in each of the 1999 through 2002 marketing years to United States upland cotton producers under each of the PFC, MLA, DP and CCP programmes ("Question 67 *bis*").<sup>801</sup>

7.620 The United States stated that it consulted with the USDA, including personnel from the Farm Services Agency, in preparing its response to the Panel's question.<sup>802</sup> It provided a lengthy written response in which it stated that "[t]he United States does not maintain and cannot calculate this information".<sup>803</sup> The United States explained that it tracked total expenditures with respect to base acres but that it is not possible to derive from these payments whether the payment is being received by an upland cotton producer.<sup>804</sup>

7.621 The USDA Farm Services Agency maintains detailed information tracked by individual farms under these programmes, including payment, base acres and planting information. Planting information is not publicly available. The United States did not mention that the Farm Services Agency tracks planting information, as well as total expenditures, on a farm-specific basis. It did not mention that its earlier response was dependent upon a definition of "producer" that excludes a person who plants but does not harvest.

7.622 At the resumed session of the first substantive meeting, the Panel orally asked the United States whether it also had information available on production or planted acreage. The head of the United States delegation sought and received clarification that the Panel referred to how much of the

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<sup>797</sup> Brazil's letter dated 13 February 2004, page 5.

<sup>798</sup> Brazil's 10 March 2004 comments, para. 10, footnote 14.

<sup>799</sup> United States' 15 March 2004 comments, paras. 17-20.

<sup>800</sup> United States' 15 March 2004 comments, para. 16.

<sup>801</sup> See the United States' response to Panel Question No. 67 *bis*.

<sup>802</sup> See the United States' response to Panel Question No. 195.

<sup>803</sup> Panel Question No. 67 *bis* and the United States' response.

<sup>804</sup> See the United States' response to Panel Question No. 67 *bis*.

payment was received by the recipient who also produces cotton. He then replied that this information was not available. The next day, the head of the United States delegation modified his response and informed the Panel orally that there was a mandatory reporting requirement under section 1105(c) of the FSRI Act of 2002, which generally requires recipients to report the uses of the cropland. He did not mention detailed planting information maintained in respect of previous years.

7.623 At the resumed session of the first substantive meeting, the Panel asked the United States in writing whether the acreage report requirement pursuant to the FSRI Act of 2002 indicates or assists in determining the number or proportion of acres of upland cotton planted on upland cotton base acres and whether a similar reporting requirement existed for upland cotton during the 1996 through 2002 marketing years.<sup>805</sup> The United States replied that the acreage reports filed under the FSRI Act of 2002 indicate what crops are planted on a farm but do not indicate the quantity of base acres on the farm because the acreage reports are filed after the planting season but before harvest and do not contain information on the quantity of production on each farm. The United States provided a statistic "based on a very preliminary review of a sampling of marketing year 2002 acreage reports" which showed that approximately 47 per cent of individual farms with upland cotton base had ceased to plant upland cotton.<sup>806</sup> It also indicated to the Panel that acreage reports for the period of the 1996 Act were incomplete.<sup>807</sup>

7.624 At the second substantive meeting, Brazil presented evidence that the USDA Farm Services Agency maintains detailed planting information tracked by individual farms. This information had been obtained in a Freedom of Information Act request by a private citizen assisting the Brazilian delegation from a USDA Farm Services Agency office in Kansas City.<sup>808</sup>

7.625 After the second substantive meeting, the Panel asked the United States whether it wished to modify its response to Question 67 *bis*.<sup>809</sup> The United States declined, saying that its original response remained accurate because Question 67 *bis* had inquired about annual amounts granted to upland cotton producers. It confirmed that the relevant payments are not tracked by whether the recipient produces upland cotton and indicated that the United States does not collect production data based on actual harvesting figures reported by farmers.<sup>810</sup>

7.626 Later, in January 2004, the Panel requested information pursuant to Article 13.1 of the *DSU* in order to permit an assessment of the total expenditures under the relevant programmes to upland cotton "producers". The United States noted that it had previously provided data that permits calculation of total expenditures to farms "planting" upland cotton.<sup>811</sup>

7.627 The Panel asked the United States how this reply could be reconciled with the United States' earlier view that requests for information on production did not relate to information on planting.<sup>812</sup> The United States replied that it maintained some planting information but it did not maintain information on individual farm production. Its answer to Question 67 *bis* had concerned production

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<sup>805</sup> Panel Question No. 125(5).

<sup>806</sup> Data which the United States provided to the Panel later upon request showed that the volume of acreage on those farms was approximately 26 per cent: see table A-1 in the Attachment at the end of Section VII:D.

<sup>807</sup> Brazil submitted evidence of discussions with a USDA Farm Services Agency official that the vast majority of farms filed acreage reports under the FAIR Act of 1996: see Exhibit BRA-318. See also data on comprehensiveness of acreage reports for another covered commodity (rice) in Exhibit BRA-368.

<sup>808</sup> Annexed to Exhibit BRA-368. See also Exhibit BRA-369.

<sup>809</sup> Panel Question No. 195.

<sup>810</sup> United States' response to Panel Question No. 195.

<sup>811</sup> United States' letter to the Panel dated 20 January 2004.

<sup>812</sup> Panel Question No. 260.

whilst its statement in January 2004 concerned planting. The United States emphasized the distinction that must be made between planting information and production information.<sup>813</sup>

7.628 The Panel notes that the first occasion on which the United States explained the particular definition of the word "producer" that it had been using in responding to the Panel's questions was in December 2003. It was important to know this definition in view of the following:

- (i) the relevant legislation does not define "producer" in this way, but rather defines it to include a person who plants but does not harvest (see the FAIR Act of 1996 and the FSRI Act of 2002 and regulations thereunder);<sup>814</sup>
- (ii) the Panel prefaced its oral questions by referring to production information in terms of planting information so that it was quite clear that, if the response was predicated on a difference between the two terms, this should have been explicitly drawn to the Panel's attention;
- (iii) the United States does not use its particular definition consistently in these proceedings, since it asserts that it provided information on total expenditures to "upland cotton producers" by providing information on total expenditures to "farms that plant upland cotton"<sup>815</sup>; and
- (iv) abandonment rate information is available which could be applied to farm-specific planting information to derive average harvesting information.<sup>816</sup>

7.629 The United States submits that "it was the United States itself at the second session of the first panel meeting that brought to the Panel's and Brazil's attention the planting reporting requirement that was introduced by Section 1105 of [the FSRI Act of 2002]"<sup>817</sup>

7.630 The Panel takes note that the United States first informed the Panel of the existence of Section 1105(c) of the FSRI Act of 2002 in response to an oral question from the Panel which specifically asked whether it gathered any production *or planted* acreage information. The Panel takes note that the United States' initial response at the meeting was negative, that its corrected response the following day related to only one year under review and that it only mentioned planting information in respect of the 1999, 2000 and 2001 marketing years later when asked specifically in writing about those marketing years.<sup>818</sup>

7.631 The Panel's requests for information under Article 13.1 of the *DSU* and the surrounding circumstances are set out in Section VII:A of this report. The Panel makes the following factual findings:

- (i) the United States provided much data in December 2003 (which it corrected in January 2004) in response to Brazil's request for information. Brazil sought this information to overcome the United States' objection that Brazil had provided no evidence to support its assumptions that every acre of upland cotton was planted by a holder of upland cotton base acreage, and

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<sup>813</sup> United States' 28 January 2004 comments on Brazil's response to Panel Question No. 195 and United States' response to Panel Question No. 260.

<sup>814</sup> Exhibits US-22, US-1, BRA-28, BRA-29, BRA-31 and BRA-35.

<sup>815</sup> See also the United States' letter dated 20 January 2004 in which it refers to the privacy interests in planting information as privacy interests of United States "producers".

<sup>816</sup> See the United States' response to Panel Question No. 209.

<sup>817</sup> United States' 28 January 2004 comments on Brazil's response to Question No. 196, paras. 15-18, and the United States' 11 February 2004 comments, para. 66.

<sup>818</sup> Panel Question No. 125(5) and the United States' response.

that no such base acreage holder planted more upland cotton than his or her base acres.<sup>819</sup> The United States did not supply the part of the data that was within its exclusive control in a format that permitted Brazil to attempt to rebut the United States' objection;

- (ii) the United States did not provide further data in January 2004 in response to the Panel's initial request pursuant to Article 13.1 of the *DSU* because it considered that this was not permitted under the Privacy Act of 1974. In its view, it was not possible to supply the data even with substitute farm identifiers because it could potentially be linked to the data it supplied in December 2003 with actual farm identifiers.<sup>820</sup> The Panel notes that the deletion of farm identifiers had been discussed at the second substantive meeting prior to supply of all data when the United States raised possible confidentiality concerns. At that time, Brazil indicated orally that it did not understand what the possible confidentiality issues would be because the FSA had used actual farm identifiers when it released planting information for rice.<sup>821</sup> Brazil also indicated that if the United States found that there was some kind of confidentiality problem that it would let Brazil know. The United States only asserted that confidentiality concerns prevented it releasing planting data with FSA farm numbers, and that the rice release had been an error, at the time it supplied the other data with actual farm identifiers<sup>822</sup> shortly after which, Brazil indicated that the United States could have used substitute farm numbers<sup>823</sup>; and
- (iii) the United States provided extensive and detailed data in response to the Panel's supplementary request for information pursuant to Article 13.1 of the *DSU*, which sought the same information in a format which would overcome aggregation problems and permit Brazil to attempt to rebut the United States' objection.

7.632 The Panel does not consider it necessary for the purposes of this dispute to rule on Brazil's request to draw adverse inferences, nor to express any view on the parties' respective interpretations of the Privacy Act of 1974, in light of the findings that the Panel has been able to make in this Section VII:D, including the Attachment.

7.633 The Panel wishes to point out that it has used its powers under Article 13 of the *DSU* to evaluate Brazil's arguments. The support delivered to upland cotton by these four types of payments is a central issue in this dispute. Brazil presented USDA data in its first written submission which measured support in accordance with payment formulae in the measures themselves. The Panel has relied on that data. Brazil later proposed a methodology using the then-available data which relied on a particular assumption. Data that could prove or disprove that assumption was in the control of the United States but not available to Brazil or to the Panel. Brazil had already explained the problems caused by the aggregation of data.<sup>824</sup> At the Panel's request, Brazil explained the methodology which it would apply to the unavailable data, which showed the Panel that it was both necessary and appropriate to use its powers under Article 13 of the *DSU* to access the data in a suitable format that would permit Brazil to run its methodology. At that stage, it was not clear to the Panel what the data

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<sup>819</sup> See *supra* at paragraph 7.576.

<sup>820</sup> It added in a footnote that, moreover, this data might be separately obtained - see United States' letter dated 20 January 2004, footnote 5.

<sup>821</sup> Exhibits BRA-368 and BRA-369.

<sup>822</sup> United States' letter dated 18 December 2003.

<sup>823</sup> Brazil's response to Panel Question No. 196, dated 22 December 2003.

<sup>824</sup> See the second statement of Christopher Campbell of EWG, paras. 3 and 4, reproduced in Exhibit BRA-368.

would show, nor what the results of Brazil's methodology would be. This was an information-gathering exercise on the Panel's part, in order for it to carry out its function. Any suggestion that a panel "makes the complainant's case", when it merely exercises its powers under the *DSU*, is entirely inaccurate. The *DSU* contains extensive provisions about the effective way for panels to gather facts and information, and how to assess those facts (including by way of commissioning advisory reports)<sup>825</sup>. It is a central feature of any system of redress, be that judicial, arbitral or otherwise, that evidence be obtained and analysed, and that the parties have equal opportunities to present their cases by using or contradicting that evidence, including by presenting their own evidence.

## 6. Attachment to Section VII:D

7.634 The Panel has found in paragraph 7.580 and following that it is appropriate to include in its measurement of support all payments calculated with respect to upland cotton base acreage for the purposes of Article 13(b)(ii) of the *Agreement on Agriculture*. Without prejudice to those findings, in accordance with the Panel's function under Article 11 of the *DSU* to make an objective assessment of the facts of the case, the Panel sets out in this Attachment certain additional findings of fact concerning the relationship between base acreage and upland cotton plantings and Brazil's allocation of an amount of payments calculated with respect to base acreage to upland cotton.<sup>826</sup> Certain of these factual findings provide support for findings in Section VII:G of this report.

### (a) Relationship between base acreage and upland cotton plantings

7.635 The PFC, MLA, DP and CCP programmes permit planting flexibility and do not require production.<sup>827</sup> Eligibility for these payments depends on production of specific covered commodities in a base period, not the year of the payment. Payments are calculated with respect to these "base acres", at a rate specific to each covered commodity, as described in Section VII:C of this report. Recipients who hold upland cotton base acres, in respect of which payments are calculated at the upland cotton rate, could have since ceased production of upland cotton. Recipients who hold other base acres, in respect of which payments are calculated at the rate for other specific covered commodities, could have since commenced production of upland cotton.

7.636 The evidence on the record shows where upland cotton production is taking place within the PFC, MLA, DP and CCP programmes. At the request of Brazil, and later at the request of the Panel under Article 13 of the *DSU*, the United States provided a large amount of data concerning the planting of upland cotton under these programmes. The data provided<sup>828</sup> shows that a very large proportion of farms with upland cotton base acres continue to plant<sup>829</sup> upland cotton in the year of payment. The data provided also shows that the overwhelming majority of farms enrolled in the programmes which plant upland cotton also hold upland cotton base. The total data, expressed in terms of acreage (which is the basis on which payments are calculated in respect of upland cotton) and percentages of total base acreage and total planted acreage, respectively, are as follows:

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<sup>825</sup> Article 13.1 and 13.2 and Appendix 4 to the *DSU*.

<sup>826</sup> See paragraph 7.580 of this Section.

<sup>827</sup> The present tense includes the past tense in respect of the PFC and MLA programmes and payments.

<sup>828</sup> Calculated based on USDA data submitted by the United States on 28 January and 3 March 2004. Note that the 1999-2001 data is based on crop reports that were not mandatory, which may lead to some undercounting.

<sup>829</sup> The data refers to planting which necessarily includes those farms which harvest. See USDA data on total of planted and harvested upland cotton acres in the United States' response to Panel Question No. 209. See also the definition of "producer" in the FAIR Act of 1996 and the FSRI Act of 2002 which includes a person who plants but does not harvest.

**Table A-1: Upland cotton base acres<sup>830</sup>**

	MY1999	MY2000	MY2001	MY2002
On farms with upland cotton planted acres	12,581,725	12,625,169	12,386,499	13,818,215
On farms without upland cotton planted acres	3,835,298	3,684,411	3,860,809	4,740,089
Total upland cotton base acres	16,417,023	16,309,580	16,247,309	18,558,304
% of upland cotton base acres on farms with upland cotton planted acres	76.6%	77.4%	76.2%	74.4%

**Table A-2: Upland cotton planted acres<sup>831</sup>**

	MY1999	MY2000	MY2001	MY2002
On farms with upland cotton base acres	13540383	14170478	14118952	13022669
On farms without upland cotton base acres	1032581	1217550	1344982	518837
Total upland cotton planted acres	14572964	15388028	15463935	13541506
% of upland cotton planted acres on farms with upland cotton base acres	92.9%	92.0%	91.3%	96.1%

7.637 These figures show a strongly positive relationship between those recipients who hold upland cotton base acres and those who continue to plant upland cotton, despite their entitlement to plant other crops, which is indicative of the relationship between payments calculated with respect to upland cotton base acreage and recipients who plant upland cotton. These figures also show that upland cotton production within these four programmes is almost exclusively taking place on farms which hold upland cotton base acres.

(b) Brazil's allocation of payments calculated with respect to base acreage to upland cotton

7.638 **Brazil** recognizes that recipients who hold upland cotton base acres and continue to plant upland cotton (that is, they have not recently ceased or commenced production of upland cotton) may have increased or decreased their acreage planted to upland cotton since they established their base acres. In other words, they may have "overplanted" or "underplanted" their upland cotton base.<sup>832</sup> This means that there is not a one-to-one relationship between upland cotton base acres and upland cotton planted acres on individual farms shown in the top line of tables A-1 and A-2.

7.639 The data supplied to the Panel shows the following:

<sup>830</sup> Calculated based on USDA data supplied by the United States on 28 January 2004 at the request of Brazil, described in Exhibit US-145.

<sup>831</sup> Calculated based on USDA data supplied by the United States on 28 January 2004 at the request of Brazil, described in Exhibit US-145. This data shows all upland cotton planted acres within these programmes. The table shown on page 10 of Brazil's 10 March 2004 comments show base acreage that could be included in a proportion of total planted acreage, or a "cotton to cotton" calculation.

<sup>832</sup> These aggregation problems are explained in the second statement of Christopher Campbell of EWG, paras. 3 and 4, reproduced in Exhibit BRA-368.

**Table A-3: Upland cotton acreage of recipients who underplanted their upland cotton base**<sup>833</sup>

<b>Marketing year</b>	<b>Upland cotton base acreage</b>	<b>Upland cotton planted acreage</b>	<b>Difference</b>
1999	10,346,685	4,548,886	5,797,799
2000	9,919,461	4,386,073	5,533,388
2001	9,869,516	4,146,352	5,723,164
2002	13,135,588	5,997,438	7,138,150

**Table A-4: Upland cotton acreage of recipients who overplanted their upland cotton base**<sup>834</sup>

<b>Marketing year</b>	<b>Upland cotton base acreage</b>	<b>Upland cotton planted acreage</b>	<b>Excess</b>
1999	6,070,338	8,991,496	2,921,158
2000	6,390,118	9,784,405	3,394,287
2001	6,377,793	9,972,600	3,594,807
2002	5,422,716	13,135,588	7,712,872

7.640 Brazil proposes an allocation of payments calculated with respect to base acreage made to recipients who plant upland cotton. It allocates payments according to the shifts from base acres (in respect of which payments are calculated) to planted acres (in respect of which recipients produce covered commodities). It applies the following steps:

- (i) it excludes payments calculated in respect of upland cotton base acreage on farms without upland cotton planted acres, which are shown on the second line of table A-1;
- (ii) it reduces payments for those who underplant their upland cotton base proportional to the drop in upland cotton planted acreage to upland cotton base acreage, as shown in the final column of table A-3;
- (iii) it increases payments for those who overplant their upland cotton base proportional to the increase in upland cotton planted acreage to upland cotton base acreage, as shown in the final column of table A-4, by allocating certain payments from other covered commodities for which they underplanted their base (not shown in the table);
- (iv) it includes payments calculated in respect of other covered commodity base acreage on farms without upland cotton base acres, which are shown on the second line of table A-2.

7.641 Brazil first applied a methodology which it labelled "cotton to cotton" to the data provided by the United States. This methodology allocates for each planted acre of upland cotton, those payments associated with one upland cotton base acre – if available on the same farm. This includes the *lower* of upland cotton base acres and upland cotton planted acres on each farm. Brazil calculated payments with respect to the "cotton to cotton" acres using the upland cotton payment rate specified in the legislation and regulations and average yields. The results were as follows:

<sup>833</sup> Calculated based on USDA data supplied by the United States on 3 March 2004 at the request of the Panel.

<sup>834</sup> Calculated based on USDA data supplied by the United States on 3 March 2004 at the request of the Panel.

**Table A-5: Cotton to cotton methodology**<sup>835</sup>

<b>\$ million</b>	<b>MY1999</b>	<b>MY2000</b>	<b>MY2001</b>	<b>MY2002</b>
PFC payments	434.9	411.7	329.5	
MLA payments	432.8	438.3	452.3	
DP payments				391.8
CCP payments				864.9

7.642 Brazil then made a calculation of "excess acres", which refers to the number of upland cotton planted acres in excess of upland cotton base acres on a farm. These acres are made up of the increase in paragraph (iii) over each farm's upland cotton base and all acres in paragraph (iv), where the farm had no upland cotton base. It pooled the payments for other contract commodities on each farm and allocated them according to their share of the total acres for each overplanted covered commodity. It added the results of its calculations of excess acres to the results of the cotton to cotton methodology. The results were as follows:

**Table A-6: Brazil's allocation of payments to upland cotton**<sup>836</sup>

<b>\$ million</b>	<b>MY1999</b>	<b>MY2000</b>	<b>MY2001</b>	<b>MY2002</b>
PFC payments	501.4	478.9	385.7	
MLA payments	499.0	509.8	529.4	
DP payments				421.3
CCP payments				869.4

7.643 The **United States** objects to the allocation of support, particularly from other commodity base to upland cotton where the recipient has increased or begun production of upland cotton. It argues that the allocation of payments for base acres to planted acres is arbitrary, leading to situations in which a particular crop could be subsidized at different rates; that a particular crop could receive a greater subsidy than another crop that accounts for more acreage on the farm; and that a recipient may grow crops without base acreage and engage in other types of production. It also argues that Brazil's methodology unfairly allocates excess payments to upland cotton, which biases its results upwards.<sup>837</sup>

7.644 The Panel agrees with the United States that base acres are not physical acres, and that money is fungible and that under these programmes it can subsidize whatever the recipient chooses to produce.<sup>838</sup> Differences in the "rate of subsidization" of a particular crop on different acres on the same farm, or on different farms, do not arise under the cotton to cotton methodology. They arise notionally under Brazil's allocation methodology but are irrelevant because the methodology calculates a total amount of support for a particular crop, not a rate of subsidization. The methodology of calculating payment amounts according to rates per acres, at different rates for different crops, is set out in the programmes' own conditions. A particular crop could receive a larger payment than another crop that accounts for more acreage on the farm due to the difference among the

<sup>835</sup> See Brazil's 10 March 2004 comments, paras 12-15. Details of the calculations are reproduced in Exhibit Bra-433.

<sup>836</sup> See Brazil's 10 March 2004 comments, para. 19. Details of the calculations are reproduced in Exhibit Bra-433, and the methodology is discussed in Brazil's response to Panel Question No. 258.

<sup>837</sup> United States' comments on Brazil's response to Panel Question No. 258, its 11 February 2004 comments, paras. 37-43 and 3 March 2004 comments, paras. 37-44. The United States also argues that the allocation of payments calculated according to base acreage across planted acreage does not account for producers who have switched into or out of upland cotton from/to other programmes.

<sup>838</sup> United States' comments on Brazil's response to Panel Question No. 258.

payment rates in the programmes' own conditions. This result could occur even if the recipient's planted and base acres for each covered commodity were identical.<sup>839</sup>

7.645 The Panel notes that the inclusion of excess acres in the calculation of support is the corollary of excluding payments made on upland cotton base where the recipient decreased production of upland cotton, to which the United States has not objected. Both imply that switches in planting decisions by recipients alter the allocation of support per commodity. Brazil's allocation of payment rates for so-called "excess acres" is a formula for the allocation of payments to account for the fact that payment recipients, to a greater or lesser degree, have shifted plantings of crops since the base period. The result is simply a proportion in monetary terms of the total payment for each commodity which the recipient actually chooses to produce.

7.646 Therefore, as a factual matter, the Panel finds the above allocation of support delivered under these programmes to one covered commodity appropriate, because it combines elements of the way in which the payments are calculated with the volume of upland cotton which recipients plant. Adjustments to payments for those who underplanted their upland cotton base could be appropriate, to account for the fact that upland cotton has one of the highest payment rates in the programme, but no specific adjustments were proposed in this dispute. Adjustments to payments for some planted acres that were later abandoned could also be appropriate.<sup>840</sup>

7.647 The factual findings in this Attachment do not imply any view as to whether evidence as to how domestic support measures which specify commodities in terms of eligibility criteria and payment rates actually deliver support to a particular commodity is a relevant consideration under Article 13(b)(ii) and (iii) of the *Agreement on Agriculture*.

## E. EXPORT SUBSIDIES

### 1. Measures at issue

7.648 This Section of our report deals with alleged export subsidies. These are the following measures, as described in Section VII:C:

- (i) Section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters;<sup>841</sup>
- (ii) export credit guarantees under the GSM 102, GSM 103 and SCGP programmes; and
- (iii) the ETI Act of 2000.

### 2. Overview of the parties' export subsidy claims and arguments under the *Agreement on Agriculture*, the *SCM Agreement* and the *GATT 1994*

7.649 Briefly, Brazil claims that the United States is in breach of its export subsidy obligations under the *Agreement on Agriculture* and the *SCM Agreement*, as follows:

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<sup>839</sup> For instance, the PFC payment rates per acre for upland cotton and wheat in the 2001 crop year were \$36.26 and \$16.35, respectively. As a result, a recipient who planted 200 acres of wheat on wheat base received a smaller payment than a recipient who planted 100 acres of upland cotton on upland cotton base. This is the case in every year under review: see data in Exhibits BRA-142 and BRA-394. Conversion for wheat into pounds at the standard moisture content of 60 lbs per bushel.

<sup>840</sup> Average cotton yields calculated in pounds per planted acres 1997-2002 are set out in Exhibit BRA-323.

<sup>841</sup> We address user marketing (Step 2) payments to domestic users under section 1207(a) of the FSRI Act of 2002 *infra*, Section VII:F.

- (i) user marketing (Step 2) payments to exporters under Section 1207(a) of the FSRI Act of 2002 are *per se* export subsidies listed in Article 9.1(a) of the *Agreement on Agriculture*, or, alternatively, under Article 10, and are inconsistent with Articles 3.3 and/or 8 of the *Agreement on Agriculture*, as well as with Articles 3.1 and 3.2 of the *SCM Agreement*;
- (ii) the GSM 102, GSM 103 and SCGP export credit guarantee programmes in respect of exports of eligible agricultural commodities are export subsidies inconsistent with Articles 8 and 10.1 of the *Agreement on Agriculture*, as well as with Articles 3.1 and 3.2 of the *SCM Agreement*; and
- (iii) the ETI Act of 2000 is inconsistent with Articles 8 and 10.1 of the *Agreement on Agriculture*, as well as with Articles 3.1 and 3.2 of the *SCM Agreement*.

7.650 Brazil contends that none of the United States' alleged export subsidies are exempt from actions based on Article 3 of the *SCM Agreement*, within the meaning of Article 13(c)(ii) of the *Agreement on Agriculture*, because they do not conform fully to the export subsidy provisions in Part V of the *Agreement on Agriculture*.

7.651 Again briefly, the United States maintains that the challenged measures are consistent with its export subsidy obligations under the *Agreement on Agriculture* and the *SCM Agreement* as follows:

- (i) user marketing (Step 2) payments under section 1207(a) of the FSRI Act of 2002 are not contingent upon export performance and thus do not constitute export subsidies for the purposes of the *Agreement on Agriculture* or Articles 3.1 and 3.2 of the *SCM Agreement* as they are available to exporters and domestic users;
- (ii) Article 10.2 of the *Agreement on Agriculture* indicates that export credit guarantee programmes are outside the scope of the export subsidy disciplines of the *Agreement on Agriculture* (and the *SCM Agreement*), and, in any event, the United States export credit guarantee programmes at issue do not constitute export subsidies for the purposes of the *Agreement on Agriculture* (or the *SCM Agreement*);
- (iii) Brazil has not established a prima facie case of inconsistency of the ETI Act of 2000 with Articles 8 and 10.1 of the *Agreement on Agriculture* (or Articles 3.1 and 3.2 of the *SCM Agreement*).

7.652 The United States submits that, as the measures described as (i) and (ii) in para. 7.648 conform fully to the provisions of Part V of the *Agreement on Agriculture*, they are exempt from actions based on Article 3 of the *SCM Agreement* within the meaning of Article 13(c)(ii) of the *Agreement on Agriculture*.

7.653 Brazil also makes claims with respect to certain of these measures under Articles XVI:1 and XVI:3 of the *GATT 1994*. The United States asks us to reject these claims.

### 3. Relationship between the export subsidy provisions in the *Agreement on Agriculture* and the *SCM Agreement* and the *GATT 1994*

7.654 We have set out, above, the order of analysis among the various agreements at issue that we will apply in our examination of Brazil's export subsidy claims in this dispute.<sup>842</sup> Now we briefly outline our understanding of the general relationship among the export subsidy provisions of the *Agreement on Agriculture*, the *SCM Agreement* and the *GATT 1994*.

7.655 We first look generally at the relevant obligations in the three agreements in question. The *Agreement on Agriculture* and the *SCM Agreement* are both multilateral agreements on trade in goods contained in Annex 1A of the *WTO Agreement*. The *Agreement on Agriculture* contains general rules and specific disciplines governing the provision by a Member of export subsidies in respect of agricultural products, including certain export subsidy reduction commitments specified in a limited number of Members' schedules.<sup>843</sup> Except as provided in the *Agreement on Agriculture*, the *SCM Agreement*<sup>844</sup> generally<sup>845</sup> prohibits granting or maintaining export subsidies in respect of any product. The respective texts of each of these agreements can, as necessary and appropriate, provide guidance in the interpretation of the provisions in that and the other agreements.

7.656 Article XVI of the *GATT 1994* also refers to certain types of subsidies which may affect exports of the subsidizing Member. Article XVI:1 of the *GATT 1994* appears in Section A of that Article, which is entitled "Subsidies in general". Article XVI:1 speaks to the situation where any Member "grants or maintains any subsidy ... which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory" and refers to "any case in which it is determined that serious prejudice to the interests of any other Member is caused or threatened by any such subsidization". Article XVI:3 of the *GATT 1994* appears in Section B of that Article, which is entitled "Additional provisions on export subsidies". It states that Members "should seek to avoid the use of subsidies on the export of primary products". If, however, a Member grants directly or indirectly "any form of subsidy which operates to increase the export of any primary product from its territory, such subsidy shall not be applied in a manner which results in that Member having more than an equitable share of world export trade in the product [...]".

7.657 With respect to the general relationship between these export subsidy disciplines and obligations *inter alia* in these three covered agreements, Article 21.1 of the *Agreement on Agriculture* stipulates: "The provisions of GATT 1994 and of other Multilateral Trade Agreements in Annex 1A of the *WTO Agreement* shall apply subject to the provisions of [the *Agreement on Agriculture*]." Accordingly, the provisions of the *SCM Agreement* and the *GATT 1994* apply subject to the provisions of the *Agreement on Agriculture*. In the event of a conflict between the provisions of the *Agreement on Agriculture* and a provision of the *GATT 1994* or another covered agreement pertaining to multilateral trade in goods in Annex 1A of the *WTO Agreement*, the rights and obligations in the *Agreement on Agriculture* would prevail to the extent of that conflict.

7.658 We therefore next turn, in more detail, to the export subsidy obligations contained in the *Agreement on Agriculture*. Article 8 of the *Agreement on Agriculture* provides:

"Each Member undertakes not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule."

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<sup>842</sup> *Supra*, Section VII:C.

<sup>843</sup> 25 Members, counting EC-15 as one (TN/AG/S/8).

<sup>844</sup> The product coverage of the *Agreement on Agriculture* is limited to agricultural products (in accordance with Article 2 and Annex I of that agreement). The product coverage of the *SCM Agreement* is broader, encompassing all industrial and agricultural goods.

<sup>845</sup> Article 27 of the *SCM Agreement* contains certain special and differential treatment provisions.

7.659 The qualified prohibition in Article 8 of the *Agreement on Agriculture* is supported by the more specific prohibitions in respect of "scheduled" and "non-scheduled" products in Article 3.3 of the *Agreement on Agriculture*. This provides, in part:<sup>846</sup>

"... a Member shall not provide export subsidies listed in paragraph 1 of Article 9 in respect of the agricultural products or groups of products specified in Section II of Part IV of its Schedule in excess of the budgetary outlay and quantity commitment levels specified therein and shall not provide such subsidies in respect of any agricultural product not specified in that Section of its Schedule."

7.660 Part V of the *Agreement on Agriculture*, together with Article 3.3 thereof, provide the principal specific export subsidy obligations pertaining to agricultural products. For the purposes of this dispute, its key provisions consist of Article 8 ("Export Competition Commitments"); Article 9 ("Export Subsidy Commitments"); and Article 10 ("Prevention of Circumvention of Export Subsidy Commitments").<sup>847</sup>

7.661 Article 1(e) of the *Agreement on Agriculture* contains a definition of "export subsidies" for the purposes of the *Agreement on Agriculture*. It states:

"export subsidies' refers to subsidies contingent upon export performance, including the export subsidies listed in Article 9 of [the *Agreement on Agriculture*]."

7.662 Article 9 of the *Agreement on Agriculture* is entitled "Export Subsidy Commitments". Article 9.1 lists specific types of export subsidies which are subject to reduction commitments under the *Agreement on Agriculture*. In most cases, such export subsidy reduction commitments include commitments in respect of both budgetary outlays and export quantities. These commitments are made an integral part of the *GATT 1994* under the provisions of Article 3.1 of the *Agreement on Agriculture* and are recorded in Section II of Part IV of a Member's schedule.

7.663 Article 10 of the *Agreement on Agriculture* is entitled "Prevention of circumvention of export subsidy commitments". Article 10.1 of the *Agreement on Agriculture* provides that "[e]xport subsidies not listed in paragraph 1 of Article 9 shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments."

7.664 In general terms, these export subsidy provisions of the *Agreement on Agriculture* permit a limited number of Members to use export subsidies, as defined in that Agreement, within the limits of the budgetary outlay and/or quantitative commitments specified in Section II of Part IV of its Schedule and only with respect to the agricultural products described therein.

7.665 However, the provision of any export subsidy listed in Article 9.1 of the *Agreement on Agriculture* in respect of unscheduled products or in excess of scheduled reduction commitment levels is formally prohibited under Articles 3.3 and 8 of the *Agreement on Agriculture*. The use of other export subsidies in excess of commitment levels, in respect of scheduled or non-scheduled products, is subject to the anti-circumvention provisions of Article 10.1.

7.666 Upland cotton falls within the product coverage of the *Agreement on Agriculture*.<sup>848</sup> The United States has no "scheduled" commitment with respect to upland cotton.<sup>849</sup> Any export subsidy

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<sup>846</sup> The provisions to which this prohibition is specifically subject comprised temporary exceptions that are no longer operative.

<sup>847</sup> Article 11 of the *Agreement on Agriculture* (entitled "Incorporated products" and relating to commitments on subsidies on agricultural products contingent upon their incorporation in exported products) was not directly invoked in this dispute.

<sup>848</sup> As provided in Article 2 of the *Agreement on Agriculture*, the product coverage of that Agreement appears in Annex I to that Agreement *supra*, Section VII:C.

listed in Article 9.1(a) of the *Agreement on Agriculture* in respect of upland cotton (or any other unscheduled product) is therefore prohibited.

7.667 If a particular product within the coverage of the Agreement is not the subject of a scheduled commitment, then, pursuant to Article 10.1 of the *Agreement on Agriculture*, export subsidies shall not be applied in respect of that product in a manner which results in, or which threatens to lead to, circumvention of a Member's commitment under Article 3.3 not to provide listed export subsidies in respect of such an unscheduled product.<sup>850</sup>

7.668 Of particular relevance in this dispute, Article 10.2 of the *Agreement on Agriculture* provides that:

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

7.669 A question arises as to whether or not the United States export credit guarantee programmes at issue in this dispute are subject to the export subsidy disciplines of the *Agreement on Agriculture* (and the *SCM Agreement*) at all.<sup>851</sup>

7.670 The *SCM Agreement* also contains export subsidy disciplines pertaining to trade in goods. Article 1 of that agreement defines a "subsidy" for the purposes of that agreement. Export subsidy disciplines can be found in Articles 3 and 4 of the *SCM Agreement*. Subject to the provisions on special and differential treatment in Article 27 of the *SCM Agreement* (and related Annex VII), and to other considerations set out in the text of Article 3.1 of the *SCM Agreement* (which defers to the *Agreement on Agriculture*), the latter contains a prohibition on export subsidies, except as provided in the *Agreement on Agriculture*. Article 3.1(a) of the *SCM Agreement* provides:

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<sup>849</sup> The United States has scheduled export subsidy reduction commitments in respect of the following thirteen commodities: wheat, coarse grains, rice, vegetable oils, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, pigmeat, poultry meat, live dairy cattle, eggs. See "Schedule XX of the United States of America, Part IV, Section II, entitled Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments", reproduced in Exhibit BRA-83 and Exhibit US-13, respectively.

<sup>850</sup> We note that, with regard to the circumvention of the Article 3.3 prohibition on the use of subsidies listed in Article 9.1 in respect of unscheduled products, the Appellate Body stated: "Members would certainly have 'found a way round', a way to 'evade', this prohibition if they could transfer, through tax exemptions, the very same economic resources that they are prohibited from providing in other forms under Articles 3.3 and 9.1. Thus, with respect to the *prohibition* against providing subsidies listed in Article 9.1 on *unscheduled* agricultural products, we believe that the FSC measure involves the application of export subsidies, *not* listed in Article 9.1, in a manner that, at the very least, *threatens* to lead to circumvention' of that 'export subsidy commitment' in Article 3.3." Appellate Body Report, *US – FSC*, para. 150.

<sup>851</sup> We address this issue *infra*, in particular, in paras. 7.897 *ff.* We recall that our examination of Brazil's export subsidy claims related to export credit guarantees granted under the GSM 102, GSM 103 and SCGP programmes is not limited to upland cotton. "Export credit guarantees ... to facilitate the export of US upland cotton, and other eligible agricultural commodities" as addressed in Brazil's panel request, are within the Panel's terms of reference. Such "eligible agricultural commodities" under the United States programmes include both scheduled and unscheduled agricultural products. See our description of the measure in *supra*, Section VII.C. We also refer to our ruling on this issue *supra*, Section VII.B. Exhibit BRA-73 contains an excerpt from the USDA website ([www.fas.usda.gov/excredits/...](http://www.fas.usda.gov/excredits/)) which offers a summary of activity under the challenged export credit guarantee programmes, indicating the allocations and applications received by country and commodity, 1999-2003. See also Exhibits US-12 and US-41 and Exhibit BRA-299. Exhibit BRA-298 contains a FASonline Press Release dated 24 September 2002: "USDA Amends Commodity Eligibility Under Credit Guarantee Programs", listing eligible standard products and high value agricultural products for GSM 102 and SCGP, available at [www.fas.usda.gov/](http://www.fas.usda.gov/).

"3.1 *Except as provided in the Agreement on Agriculture*, the following subsidies, within the meaning of Article 1, shall be prohibited:

(a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I," (emphasis added, footnotes omitted)

7.671 Pursuant to Article 3.2 of the *SCM Agreement*: "A Member shall neither grant nor maintain subsidies referred to in paragraph 1 [of Article 3]."

7.672 The text of Article 3.1(a) of the *SCM Agreement* indicates that the obligation it contains (and consequently the related obligation in Article 3.2 of that agreement) applies except as provided in the *Agreement on Agriculture*.

7.673 As we have already indicated, we therefore believe that it is appropriate to examine an alleged export subsidy in respect of an agricultural product first under the *Agreement on Agriculture* before, if and as appropriate, turning to any examination of the same measure under the *SCM Agreement*. Furthermore, for the reasons already stated, we believe it is also appropriate to examine an alleged export subsidy in respect of an agricultural product first under the *Agreement on Agriculture* before, if and as appropriate, turning to any examination of the same measure under Article XVI of the *GATT 1994*.<sup>852</sup>

7.674 This approach is borne out by the provisions of Article 13(c)(ii) of the *Agreement on Agriculture*. We recall (once again) that this provision reads:

"(c) export subsidies that conform fully to the provisions of Part V of this Agreement, as reflected in each Member's Schedule, shall be: ...

(ii) exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement."

7.675 The conditions set out in the chapeau of Article 13(c) of the *Agreement on Agriculture* refer to compliance with particular substantive provisions in Part V of the *Agreement on Agriculture* (which includes Articles 8 through 11, as well as, by reference, Article 3.3, of that Agreement) and export subsidy reduction commitments in each Member's Schedule.

7.676 As these two issues – i.e. substantive compliance with the provisions of Part V and fulfilment of Article 13(c) of the *Agreement on Agriculture* – are squarely before us with respect to at least certain of Brazil's claims<sup>853</sup>, we conduct a two-pronged enquiry in examining the merits of Brazil's export subsidy claims under the *Agreement on Agriculture*, before proceeding, as appropriate, to Brazil's claims under Articles 3.1(a) and 3.2 of the *SCM Agreement* and/or Article XVI of the *GATT 1994*.

7.677 Our examination of the export subsidy claims of Brazil under the *Agreement on Agriculture* will, in the first instance, determine the merits of Brazil's claims under the export subsidy provisions of the *Agreement on Agriculture*. Where substantive compliance with the provisions of Part V and fulfilment of Article 13(c) of the *Agreement on Agriculture* are both squarely before us, these findings will also be determinative for the purposes of the examination of consistency with Part V of the

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<sup>852</sup> This applies *a fortiori* during the implementation period for reasons set out in *supra*, Section VII:C, "Order of analysis".

<sup>853</sup> That is, Brazil's claims relating to user marketing (Step 2) export payments and export credit guarantees under the GSM 102, GSM 103 and SCGP programmes.

*Agreement on Agriculture* called for under Article 13(c)(ii) of the *Agreement on Agriculture*.<sup>854</sup> Should we find a violation of the export subsidy provisions in Part V of the *Agreement on Agriculture*, we may then conduct an examination, as necessary and appropriate for the resolution of this dispute, under Articles 3.1(a) and 3.2 of the *SCM Agreement* and/or Article XVI of the *GATT 1994*.

#### 4. Section 1207(a) of the FSRI Act of 2002: user marketing (Step 2) payments to exporters

##### (a) Main arguments of the parties

7.678 **Brazil** asserts that since the United States did not schedule any export subsidy commitments for upland cotton under the *Agreement on Agriculture*, it may not provide any export subsidies for upland cotton.

7.679 Brazil challenges section 1207(a) of the FSRI Act of 2002 mandating user marketing (Step 2) payments to exporters of upland cotton as a *per se* export subsidy listed in Article 9.1(a), and defined in Article 1(e), of the *Agreement on Agriculture*, which is in violation of Articles 3.3 and 8 of the *Agreement on Agriculture*.<sup>855</sup> In the alternative, Brazil claims that section 1207(a) of the FSRI Act of 2002 mandating payments to exporters is an export subsidy, not listed in Article 9.1, which is applied in such a manner as to circumvent (or threaten to circumvent) the United States' export subsidy commitments within the meaning of Article 10.1 of the *Agreement on Agriculture*.

7.680 According to Brazil, as section 1207(a) of the FSRI Act of 2002 mandating payments to exporters does not conform fully to the provisions of Part V of the *Agreement on Agriculture*, it is not exempt from actions based on Article 3 of the *SCM Agreement* within the meaning of Article 13(c)(ii) of the *Agreement on Agriculture*. For the same reasons as it constitutes an "export subsidy" "contingent upon export" within the meaning of the *Agreement on Agriculture*, the measure also constitutes a prohibited export subsidy in violation of Articles 3.1(a) and 3.2 of the *SCM Agreement*.

7.681 Brazil states that user marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 are export-contingent because, when certain market conditions prevail, the United States Secretary of Agriculture must make such payments to eligible exporters upon proof of the export of United States upland cotton. The existence of another factual situation in which user marketing (Step 2) payments are available, to domestic users, does not dissolve this export contingency.

7.682 Brazil asserts that the Appellate Body has indicated that context for interpretation of an "export subsidy" under the *Agreement on Agriculture* is found in the *SCM Agreement*. Step 2 export payments involve a subsidy within the meaning of Article 1 of the *SCM Agreement*. Step 2 export payments are also export contingent within the meaning of Article 3.1(a) of the *SCM Agreement* because exporters are only eligible to receive Step 2 export payments if they produce evidence that they have exported an amount of United States upland cotton.<sup>856</sup> The United States' position is flawed because Members could avoid the disciplines of Articles 3.1(a) and (b) of the *SCM Agreement* by structuring a subsidy in such a way as to have both a "*de jure* export contingency" element and a "*de jure* local content contingency" element.<sup>857</sup>

7.683 Brazil further asserts that the text of section 1207(a) clearly indicates that the user marketing (Step 2) programme is mandatory in that it does not provide the United States Secretary of

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<sup>854</sup> *Supra*, Section VII:C, "Exempt from actions" and Section VII:A and Panel communication of 20 June 2003.

<sup>855</sup> Brazil's first written submission, paras. 237-238.

<sup>856</sup> Executive summary of Brazil's first written submission, para. 32.

<sup>857</sup> Brazil's oral statement at the first session of the first substantive meeting, paras. 74-76.

Agriculture with the discretion to apply it in a WTO-consistent manner. The fact that payments are dependent upon market price conditions does not alter their mandatory nature.<sup>858</sup>

7.684 The **United States** does not contest that user marketing (Step 2) payments are "subsidies" in favour of United States agricultural producers.<sup>859</sup> However, the United States argues that section 1207(a) of the FSRI Act of 2002 – providing for payments to exporters *and* domestic users – is not an export subsidy listed in Article 9.1(a) of the *Agreement on Agriculture* and, in the alternative, not an export subsidy in circumvention of its obligation not to confer an export subsidy with respect to upland cotton contrary to Article 10.1. The United States submits that, in accordance with Article 1(e) of the *Agreement on Agriculture*, to constitute an "export subsidy" for the purposes of the Agreement, the subsidy must first be "contingent on export performance". The benefits of the user marketing (Step 2) programme under section 1207(a) of the FSRI Act of 2002 are not contingent on export performance as they are also available to domestic users. Looking at the programme as a whole, user marketing (Step 2) payments under section 1207(a) of the FSRI Act of 2002 may be obtained without exporting.

7.685 The United States asserts that user marketing (Step 2) payments are made to eligible users of upland cotton. The Secretary of Agriculture is authorized to issue marketing certificates or cash payments to domestic users and exporters of upland cotton for documented purchases by domestic users and sales for export by exporters. The programme is indifferent to whether recipients of the benefit of this programme are parties that open bales for the processing of manufacturing raw cotton into cotton products in the United States or exporters. The United States stresses that *all* upland cotton produced in the United States is eligible for the Step 2 payment without regard to how such cotton is used, and all actual users of such cotton are eligible for the payment. Moreover, the form and rate of payment are identical. The only contingency is use. Eligible domestic users and exporters comprise the universe of eligible users. Parties in the cotton market who do not use cotton are the only parties not eligible for the payment. The United States reports the benefits conferred under the user marketing (Step 2) programme as product-specific amber box domestic support.<sup>860</sup>

7.686 According to the United States, subject to the availability of funds (that is, the availability of CCC<sup>861</sup> borrowing authority), user marketing (Step 2) payments must be made to all those who meet the conditions for eligibility.<sup>862</sup> The United States generally invokes the adjustment authority "circuitbreaker" provision in section 1601(e) in the FSRI Act of 2002, which authorizes the Secretary to adjust support to the maximum extent practicable to comply with the United States' Uruguay Round domestic support commitments.

7.687 The United States submits that, as the measure conforms fully to the provisions of Part V of the *Agreement on Agriculture*, it is exempt from actions based on Article 3 of the *SCM Agreement* within the meaning of Article 13(c)(ii) of the *Agreement on Agriculture*. For the same reasons as it does not constitute an "export subsidy" "contingent upon export" within the meaning of the *Agreement on Agriculture*, the measure also does not constitute a prohibited export subsidy in violation of Articles 3.1(a) and 3.2 of the *SCM Agreement*.

(b) Main arguments of third parties

7.688 **Argentina** submits that user marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 are export subsidies in violation of the United States commitments under

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<sup>858</sup> Brazil's response to Panel Question No. 257(b).

<sup>859</sup> United States' response to Panel Question No. 108. The United States, however, argues that user marketing (Step 2) payments to exporters and domestic users constitute domestic support for the purposes of the United States obligations under the domestic support provisions of the *Agreement on Agriculture*.

<sup>860</sup> Executive summary of the United States' first written submission, para. 25.

<sup>861</sup> "CCC" is the Commodity Credit Corporation. See description of the measure, *supra*, Section VII:C.

<sup>862</sup> United States' response to Panel Question No. 109.

Articles 3.3 and 8 of the *Agreement on Agriculture*, not exempt from actions based on Article 3 of the *SCM Agreement* within the meaning of Article 13(b)(ii) of the *SCM Agreement* and in violation of Articles 3.1(a) and 3.2 of the *SCM Agreement*. User marketing (Step 2) payments establish the right of exporters to receive a subsidy for shipments made in connection with foreign sale operations, while establishing an obligation upon the CCC to grant that subsidy once the particular requirements are satisfied.<sup>863</sup>

7.689 **Australia** observes that the United States has not specified any reduction commitments in its Schedule for upland cotton. Australia argues that user marketing (Step 2) payments to exporters under both the FAIR Act of 1996 and the FSRI Act of 2002 are export subsidies listed in Article 9.1(a) of the *Agreement on Agriculture* in violation of the United States commitments under Articles 3.3 and 8 of the *Agreement on Agriculture*, not exempt from actions based on Article 3 of the *SCM Agreement* within the meaning of Article 13(c)(ii) of the *Agreement on Agriculture* and in violation of Articles 3.1(a) and 3.2 of the *SCM Agreement*. User marketing (Step 2) payments are available only to exporters (export payments) or to domestic users (domestic payments). Section 1207(a)(1) "identifies the two situations which must be different since the very same property cannot be" exported or used within a Member.<sup>864</sup> In each of the distinct factual situations of export or domestic use, such payments are contingent upon export performance or contingent upon the use of domestic over imported goods respectively.<sup>865</sup>

7.690 **New Zealand** agrees with Brazil that user marketing (Step 2) payments to exporters violate *per se* Articles 3.3 and 8 of the *Agreement on Agriculture*<sup>866</sup>, as they are either within the description set out in Article 9.1(a) of the *Agreement on Agriculture*, or "at the very least", threaten circumvention of subsidy reduction commitments within the meaning of Article 10.1. The fact that payments may also be made to domestic users of upland cotton does not "dissolve" the export contingency of the payments that are made to exporters. Payments to eligible exporters of upland cotton are dependent on proof of export being provided and are therefore contingent on export performance.<sup>867</sup>

7.691 New Zealand also supports Brazil's conclusion that the Step 2 export payments meet the requirements of a "subsidy" under Article 1.1(a)(1)(i) and Article 1.1(a)2(ii) of the *SCM Agreement* and are contingent upon export within the meaning of Article 3.1(a) of the *SCM Agreement*. Accordingly if the Panel finds, as New Zealand believes it should, that Step 2 export payments constitute *per se* prohibited subsidies under Articles 3.1(a) and 3.2 of the *SCM Agreement*, the Panel is required to recommend under Article 4.7 of the *SCM Agreement* that the United States withdraw the programme without delay. New Zealand therefore supports Brazil's request that the Panel make such an express recommendation.<sup>868</sup>

(c) Evaluation by the Panel

(i) *Claims under the Agreement on Agriculture*

7.692 Brazil claims that section 1207(a) of the FSRI Act of 2002 mandating user marketing (Step 2) payments to exporters is a *per se* export subsidy within the meaning of Article 9.1(a) of the *Agreement on Agriculture*. The United States disagrees, asserting that section 1207(a) of the FSRI Act of 2002, as a whole, provides for payments to both exporters and domestic users.

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<sup>863</sup> Argentina's response to Panel third party Question No. 38.

<sup>864</sup> Australia's written submission to the first session of the first substantive meeting, paras. 52-54.

<sup>865</sup> Australia's response to Panel third party Question Nos. 38 and 39.

<sup>866</sup> New Zealand's written submission to the first session of the first substantive meeting, paras. 3.03-3.04.

<sup>867</sup> New Zealand's written submission to the first session of the first substantive meeting, paras. 3.05-3.08.

<sup>868</sup> New Zealand's written submission to the first session of the first substantive meeting, paras. 3.10-3.11.

7.693 We recall that Article 3.2 of the *DSU* recognizes that interpretative issues arising in WTO dispute settlement are to be resolved through the application of customary rules of interpretation of public international law. It is well settled that the principles codified in Articles 31 and 32 of the *Vienna Convention on the Law of Treaties* (the "*Vienna Convention*") are such customary rules.<sup>869</sup> Thus, the task of interpreting a treaty provision must begin with its specific terms.

7.694 We naturally begin our examination of Brazil's claim with the text of the relevant treaty provision. Article 9 of the *Agreement on Agriculture* is entitled "Export Subsidy Commitments". Article 9.1(a) reads:

"1. The following export subsidies are subject to reduction commitments under this Agreement:

(a) the provision by governments or their agencies of direct subsidies, including payments-in-kind, to a firm, to an industry, to producers of an agricultural product, to a cooperative or other association of such producers, or to a marketing board, contingent on export performance; ..."

7.695 We do not understand the United States to disagree that section 1207(a) of the FSRI Act of 2002 -- the legislative provision governing the user marketing (Step 2) payments to exporters and domestic users -- provides for payments that constitute "the provision by governments ... of direct subsidies ... to a firm, to an industry, to producers of an agricultural product, to a cooperative or other association of such producers, or to a marketing board ...".<sup>870</sup>

7.696 Nor, in our view, could the United States properly do so. User marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 are granted by the CCC of the United States Department of Agriculture, which is a United States government agency. The payments take the form of cash grants (or commodity certificates)<sup>871</sup> for which no consideration is received by the government. The recipients of the export payments are expressly defined in the text of the implementing regulations of the measure as "eligible exporters", which includes "...a producer or a cooperative marketing association" (both terms which appear in the text of Article 9.1(a) of the *Agreement on Agriculture*).

7.697 Rather, the key issue before us is whether the measure provides for subsidies "contingent on export performance" within the meaning of Article 9.1(a) of the *Agreement on Agriculture*.

7.698 Article 1(e) of the *Agreement on Agriculture* states that the term "export subsidies" "refers to subsidies contingent upon export performance, including the export subsidies listed in Article 9 of this Agreement".

7.699 However, the *Agreement on Agriculture* does not contain any further textual or contextual elaboration of that term. The term "contingent upon export performance" also appears in Article 3.1(a) of the *SCM Agreement*. That provision reads:

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<sup>869</sup> Article 31(1) of the *Vienna Convention* provides in relevant part that: "A treaty shall be interpreted in good faith 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."

<sup>870</sup> The United States' submits that user marketing (Step 2) payments are support in favour of agricultural producers. See United States' response to Panel Question No. 108.

<sup>871</sup> The parties concur that there is no need to draw any distinction between cash payments and "commodity certificates" in terms of whether a "subsidy" exists. Brazil makes no material distinction in its allegations, while the United States' concurred with this proposition in its response to Panel Question No. 110. We therefore do not make any such distinction in our analysis.

"Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

(a) subsidies contingent, in law or in fact<sup>4</sup>, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I<sup>5</sup> ..."

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<sup>4</sup> This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.

<sup>5</sup> Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.

7.700 We see no reason to read the term "contingent upon export performance" in the *Agreement on Agriculture* differently from the same term in the *SCM Agreement* for the purposes of this dispute. The two Agreements use precisely the same words to define "export subsidies". We therefore believe that it is appropriate for us to seek contextual guidance in that provision of the *SCM Agreement* for our interpretation of the term "contingent upon export performance" in the *Agreement on Agriculture* in the particular circumstances of this dispute.<sup>872</sup>

7.701 The meaning of "contingent" is "conditional" or "dependent for its existence upon".<sup>873</sup> The grant of the subsidy must be conditional or dependent upon export performance. Article 3.1(a) further provides that such export contingency may be the sole condition governing the grant of a prohibited subsidy or it may be "one of several other conditions".<sup>874</sup>

7.702 Brazil is making a claim of "*per se*" contingency, challenging section 1207(a) of the FSRI Act of 2002 "as such".<sup>875</sup> We understand Brazil's *per se* claim to be conceptually analogous to a claim of "*de jure*" export contingency within the meaning of Article 3.1(a) of the *SCM Agreement*. Such *de jure* export contingency is demonstrated on the basis of the words of the relevant legislation, regulation or other legal instrument.<sup>876</sup> A subsidy is also properly held to be *de jure* export contingent where the condition to export can be derived by necessary implication from the words actually used in the measure.<sup>877</sup>

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<sup>872</sup> See, for example, Appellate Body Report, *US – FSC*, para. 141: "We see no reason, and none has been pointed out to us, to read the requirement of 'contingent upon export performance' in the *Agreement on Agriculture* differently from the same requirement imposed by the *SCM Agreement*. The two Agreements use precisely the same words to define 'export subsidies'. Although there are differences between the export subsidy disciplines established under the two Agreements, those differences do not, in our view, affect the common substantive requirement relating to export contingency. Therefore, we think it appropriate to apply the interpretation of export contingency that we have adopted under the *SCM Agreement* to the interpretation of export contingency under the *Agreement on Agriculture*." See also *US – FSC (Article 21.5 – EC)*, para. 192. See also *infra*, note 917.

<sup>873</sup> Appellate Body Report, *Canada – Aircraft*, para. 166.

<sup>874</sup> See Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 111.

<sup>875</sup> See e.g., Brazil's first written submission, para. 245.

<sup>876</sup> Appellate Body Report, *Canada – Aircraft*, para. 167.

<sup>877</sup> Appellate Body Report, *Canada – Autos*, cited with approval in Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 112. This approach stands in contrast to a "*de facto*" inquiry, in which a panel would examine the "total configuration of the facts constituting and surrounding the grant of the subsidy."

7.703 We will therefore examine whether export contingency is apparent from the words of section 1207(a) of the FSRI Act of 2002 (and related legal and regulatory instruments)<sup>878</sup>, or can be derived by necessary implication from the words actually used therein.

7.704 Section 1207(a) of the FSRI Act of 2002 governs user marketing (Step 2) payments. The text of section 1207(a) provides that during the period beginning on the date of the enactment of the FSRI Act of 2002 through 31 July 2008, "... the Secretary shall issue marketing certificates or cash payments, at the option of the recipient, to domestic users and exporters for documented purchases by domestic users and sales for export by exporters..." where certain market conditions prevail.<sup>879</sup>

7.705 Implementing regulations "set forth the terms and conditions under which CCC shall make payments ... to eligible domestic users and exporters of upland cotton who entered into an Upland Cotton Domestic User/Exporter Agreement with CCC to participate in the upland cotton user marketing certificate program under Section 1207."<sup>880</sup> Eligible upland cotton is domestically produced baled upland cotton which bale is opened by an eligible domestic user or exported by an eligible exporter, between certain time periods and under certain market conditions.<sup>881</sup> "Eligible domestic users and exporters" are defined as follows:

"(1) A person regularly engaged in the business of opening bales of eligible upland cotton for the purpose of manufacturing such cotton into cotton products in the United States (domestic user), who has entered into an agreement with CCC to participate in the upland cotton user marketing certificate program; or

(2) A person, including a producer or a cooperative marketing association ... regularly engaged in selling eligible upland cotton for exportation from the United States (exporter), who has entered into an agreement with CCC to participate in the upland cotton user marketing certificate programme."<sup>882</sup>

7.706 Eligible upland cotton will be considered:

"(1) Consumed by the domestic user on the date the bale is opened for consumption; and

(2) Exported by the exporter on the date CCC determines is the date on which the cotton is shipped through 31 July 2008."<sup>883</sup>

7.707 Applications for payment<sup>884</sup> must contain the documentation required by the provisions of the Upland Cotton Domestic User/Exporter Agreement and the instructions that the CCC issues.

7.708 The United States asserts that the user marketing (Step 2) payment programme must be assessed globally, as the relevant United States law and regulations do not separate the programme into domestic users and exporters. The United States asserts that there is but one Step 2 statute and one Step 2 rule set out in the regulations for all upland cotton users. The statute and rule identify

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<sup>878</sup> Exhibit BRA-37 contains 7 CFR 1427.100 *et seq.*, which are the regulations setting forth the terms and conditions under which the CCC shall make user marketing (Step 2) payments under section 1207 of the FSRI Act of 2002.

<sup>879</sup> Section 1207(a) of the FSRI Act of 2002, reproduced in Exhibits BRA-29 and US-1, and 7 CFR 1427.100-1427.108 (1 January 2003 edition), reproduced in Exhibit BRA-37.

<sup>880</sup> See 7 CFR 1427.100(a), reproduced in Exhibit BRA-37.

<sup>881</sup> See 7 CFR 1427.103(a), reproduced in Exhibit BRA-37.

<sup>882</sup> See 7 CFR 1427.104(a), reproduced in Exhibit BRA-37.

<sup>883</sup> See 7 CFR 1427.108(c), reproduced in Exhibit BRA-37.

<sup>884</sup> There are separate reporting forms for exporters and domestic users. Eligible domestic users must submit form CCC-1045UP-1. Eligible exporters must submit form CCC-1045UP-2.

"domestic users" and "exporters" as the universe of *bona fide* users of upland cotton and thus potential recipients for Step 2 payments. According to the United States, the only distinction drawn between these recipients is the proof of use: domestic users are paid when they open a bale, and exporters are paid when they export. For the United States, as it is not necessary to export in order to receive a Step 2 payment, the Step 2 payments to exporters are not contingent upon exportation.

7.709 We agree that user marketing (Step 2) payments are governed by a single legislative provision: Section 1207(a) of the FSRI Act of 2002. We also agree that there is a single set of regulations pertaining to the Step 2 programme: 7 CFR. 1427.100 *ff.* We further agree that, pursuant to the legislation and regulations, the form<sup>885</sup> and rate of payment<sup>886</sup> to domestic users and exporters are identical; and the fund from which payments are made is a unified fund available to both eligible domestic users and exporters. We acknowledge that, as the United States argues, upland cotton does not have to be exported in order to trigger eligibility for a user marketing (Step 2) payment under section 1207(a) as domestic users are also eligible (i.e. for a payment to a *domestic user*).<sup>887</sup>

7.710 However, we disagree with the United States that this measure involves only one factual situation, which is use of upland cotton during a particular period of time.<sup>888</sup>

7.711 We recall that at least two prior WTO disputes have addressed claims under Article 3.1(a) of the *SCM Agreement* pertaining to alleged export subsidies involving a distinct set of circumstances and discrete segments of recipients: *Canada - Aircraft* and *US - FSC (Article 21.5 - EC)*. Brazil cites the Appellate Body reports in these disputes in support of its arguments that the user marketing (Step 2) payments to exporters are export-contingent. The United States contends that neither report is relevant as they speak to different factual situations. For its part, the United States invokes the panel report in *Canada - Dairy*, which concluded that where a subsidy was available either exclusively for the domestic market or in connection with exportation but also with the domestic market, "access to milk under such other classes is not 'contingent on export performance.'"

7.712 We recall the essence of these three prior reports cited by the parties to discern any relevance they may have for the instant dispute.

7.713 First, in its report in *US - FSC (Article 21.5 - EC)*, the Appellate Body stated:

"We recall that the ETI measure grants a tax exemption in two different sets of circumstances: (a) where property is produced *within* the United States and held for use *outside* the United States; and (b) where property is produced *outside* the United States and held for use outside the United States. Our conclusion that the ETI measure grants subsidies that are export contingent in the first set of circumstances is not affected by the fact that the subsidy can also be obtained in the second set of circumstances. The fact that the subsidies granted in the second set of circumstances *might* not be export contingent does not dissolve the export contingency arising in the first set of circumstances. Conversely, the export contingency arising in these circumstances has no bearing on whether there is an export contingent subsidy in the

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<sup>885</sup> In this respect, we refer to 7 CFR 1427.106, which makes no distinction between exporters and domestic users in terms of the form of payment: "Payments under this subpart shall be made available in the form of commodity certificates [...] or in cash, at the option of the program participant."

<sup>886</sup> 7 CFR 1427.107 outlines the payment rate for purposes of calculating payments, and does not differentiate between the rate applicable to domestic users and exporters. The Upland Cotton Domestic User/Exporter Agreement in Exhibit US-21, Section A-4 prescribes that the general payment rate shall be in accordance with the regulations found in 7 CFR 1427. While there are slight differences between the provisions governing the reporting for the purposes of payment rate to domestic users, on the one hand, and exporters, on the other, we understand that these do not affect the amount actually paid.

<sup>887</sup> United States' oral statement at the first session of the first substantive meeting, paras. 25-26.

<sup>888</sup> United States' response to Panel Question No. 99.

second set of circumstances. Where a United States taxpayer is simultaneously producing property within and outside the United States, for direct use outside the United States, subsidies may be granted under the ETI measure in respect of both sets of property. The subsidy granted with respect to the property produced within the United States, and exported from there, is export contingent within the meaning of Article 3.1(a) of the *SCM Agreement*, irrespective of whether the subsidy given in respect of property produced outside the United States is also export contingent."<sup>889</sup> (footnote omitted)

7.714 The facts and conditions relating to the grant of the subsidy before us are, to some extent, distinguishable from those addressed by the panel and Appellate Body in *US – FSC (Article 21.5 – EC)*. In that dispute, the subsidy programme dealt with products produced within and outside the United States. There, the export-contingency of the subsidy *vis-à-vis* products produced within the United States was not vitiated by the fact that the subsidy could also be obtained in a second set of circumstances, irrespective of whether the subsidy in this second set of circumstances (in respect of property produced outside the United States) was also export contingent. By contrast, here, the two "situations" in the user marketing (Step 2) programme *both* involve production within the United States, whether for domestic use or for export. That is, the eligible product (upland cotton) is the same *and* its locus of production (i.e. within the United States) is identical for all user marketing (Step 2) user payments under section 1207(a) of the FSRI Act of 2002.<sup>890</sup>

7.715 Second, in *Canada – Aircraft*, the Appellate Body stated that,

"[T]he fact that some of TPC's contributions, in some industry sectors, are *not* contingent upon export performance, does not necessarily mean that the same is true for all of TPC's contributions. It is enough to show that one or some of TPC's contributions do constitute subsidies "contingent ... in fact ... upon export performance".<sup>891</sup>

7.716 The facts and conditions relating to the grant of the subsidy before us are, to some extent, distinguishable from those addressed by the panel and Appellate Body in *Canada - Aircraft*, in terms of the eligible product itself. In that dispute, the subsidy in question was available to multiple industry sectors. There, the export-contingency of the subsidy *vis-à-vis* regional aircraft was not vitiated by the fact that payments in some other industry sectors may not have been contingent upon export performance. By contrast, here, the subsidy programme under section 1207(a) deals with one eligible product – upland cotton – and not with any other product or industry sector. The eligible product is notionally *all* United States upland cotton, subject to its eligible "use".

7.717 Third, in *Canada – Dairy*, the panel stated:

"The United States also makes claims under milk classes other than Classes 5(d) and (e). In this regard, we note that milk under such other classes is also available (often exclusively) to processors which produce for the domestic market. Accordingly, access to milk under such other classes is not "contingent on export performance". We therefore find that such other milk classes do not involve an export subsidy under Article 9.1(a)."<sup>892</sup>

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<sup>889</sup> Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 119.

<sup>890</sup> We recall that 7 CFR 1427.103(a) and (c), reproduced in Exhibit BRA-37, provide that "[...] eligible upland cotton is *domestically produced* baled upland cotton" which "must *not* be" "imported cotton" (emphasis added).

<sup>891</sup> Appellate Body Report, *Canada – Aircraft*, para. 179.

<sup>892</sup> Panel Report, *Canada – Dairy*, para. 7.41. The Panel reached a similar view under Article 10.1 of the *Agreement on Agriculture*.

7.718 The facts and conditions relating to the grant of the subsidy before us are also distinguishable from those addressed by the panel in *Canada – Dairy*, in light of the express terms of the text of the measure. In that case, there was no explicit condition limiting a discrete segment of the payments of the subsidies concerned to exporters, nor was there a subsidy expressly combining the two contingency components before us: that is, use of domestic products and exportation.

7.719 We thus recognize that the facts and conditions surrounding the grant of the subsidy before us are, to some extent, distinguishable from those addressed in those previous disputes.

7.720 We nevertheless firmly believe that the legal principles in *US – FSC (Article 21.5 – EC)* and *Canada – Aircraft* are relevant and illuminating here. We understand these prior reports to stand for the proposition that export contingency in respect of a discrete segment of payments in one set of circumstances may not be vitiated by the existence of other discrete segments of payments which may not be conditioned upon exportation.

7.721 On this basis, even if we examine the legislative and regulatory framework governing user marketing (Step 2) payments globally, we cannot accept the United States' argument that we should treat all user marketing (Step 2) payments as a single situation and all recipients as a single class of eligible "users" who constitute the entire universe of potential purchasers of upland cotton from producers.<sup>893</sup>

7.722 Rather, we must discern the actual nature of the measure from its text. The text of the measure itself explicitly identifies, on its face, two distinct factual situations involving two distinct types of eligible recipients: one in which the payment is made to eligible exporters, and another in which the payment is made to eligible domestic users.

7.723 The universe of potential recipients of user marketing (Step 2) payments are "eligible domestic users" and "eligible exporters". Contrary to the United States' assertion, this is not a single class of eligible "users" who constitute the entire universe of potential purchasers of upland cotton from producers.

7.724 A bale of United States domestically produced upland cotton must *either* be exported to trigger receipt of a user marketing (Step 2) export payment, *or* purchased for domestic use to trigger receipt of a user marketing (Step 2) domestic payment. The two situations must be distinct as the same bale of cotton cannot be exported and also sold to a domestic user.<sup>894</sup>

7.725 We consider it determinative that the text of the single legal provision at issue explicitly identifies the two distinct situations in which user marketing (Step 2) payments are made. The text does not identify a single monolithic situation in which payments are made to a single class of recipients. On the contrary, the text of the measure itself compels us to examine separately the conditions pertaining to the grant of the subsidy in these two distinct factual situations addressed by the measure that involve two distinct sets, or discrete segments, of eligible recipients.<sup>895</sup> We do not

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<sup>893</sup> United States' oral statement at the first session of the first substantive meeting, para. 25.

<sup>894</sup> We find support for this approach in Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 115. See also the text of the measure itself, reproduced in Exhibit BRA-37, 7 CFR 1427.103(c)(1), where the definition of eligible upland cotton indicates that it must not be, *inter alia*, "[c]otton for which a payment, under the provisions of this subpart, has been made available".

<sup>895</sup> Segregated data is available indicating the amount of payments going to domestic users and exporters under the programme and its FAIR Act predecessor. Brazil initially submitted such data by fiscal year and use (Exhibit BRA-69). In response to Panel Question No. 104, the United States subsequently submitted USDA data. The USDA data, which we have no reason to believe is not factually accurate, shows that in 1991-1993 and 1997-2001, domestic user payments were greater than export payments. Export payments exceeded domestic user payments in 1994-1996 and 2002. In 1996, there were no domestic payments: only export payments were made. The amounts indicated for export payments, on a fiscal year basis, are as follows: 1991:

see this as any kind of artificial bifurcation in our analysis of the measure before us. We see this as being at the heart of the *de jure* export contingency at issue.<sup>896</sup>

7.726 This textual distinction is not the only distinction between the two distinct factual situations, involving two distinct sets, or discrete segments, of eligible recipients.

7.727 We note further that a distinction is drawn in the measure itself between domestic users and exporters in terms of the proof needed to be eligible for the subsidy: domestic users are eligible upon proof of opening a bale, and exporters are eligible upon proof of export. Documentation to be submitted is also different. There are separate regulatory sub-sections and separate conditions pertaining to fulfilment of either of the two situations in which a user marketing (Step 2) subsidy can be granted.<sup>897</sup>

7.728 Furthermore, the relative proximity of the recipient of the user marketing (Step 2) payment to the producer may also differ depending upon whether the transaction involves exportation or domestic use.<sup>898</sup> The recipients of domestic payments are necessarily *not* producers; they are domestic *users*. By contrast, the recipients of export payments may include producers.<sup>899</sup>

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\$17,259; 1992: \$30,852,107; 1993: \$89,095,640; 1994: \$178,266,742; 1995: \$75,200,203; 1996: \$34,798,579; 1997: \$2,875,936; 1998: \$158,924,004; 1999: \$113,521,476; 2000: \$185,273,956; 2001: \$90,903,021; 2002: \$105,415,152. See United States' response to Panel Question No. 104. We also refer to Section VII:D *supra* in relation to data pertaining to user marketing (Step 2) payments to domestic users, as well as to unsegregated data available, for crop years 1991-2001, in Exhibit BRA-4, as follows (\$ million): 1991: \$140.3; 1992: \$206.7; 1993: \$198.9; 1994: \$90.5; 1995: 34.1; 1996: 3.3; 1997: \$390.2; 1998: \$307.5; 1999: \$421.6; 2000: \$236.1; 2001: \$196.3. For fiscal year 2002, the record indicates, in United States response to Panel Question 196, an amount of \$415,379, 000; We note that we are conducting a *de jure* examination of the text of the measure, on its face, and that it is therefore not strictly necessary to consider actual conditions surrounding the operation of the measure. See, for example, *supra*, footnote 877. If, however, the Appellate Body were called upon to review this matter and disagreed with our export contingency analysis here under Article 9.1(a) and, in the alternative, Article 10.1 of the *Agreement on Agriculture*, then such data might be relevant for determination of the level of domestic support examined in Section VII:D, *supra*.

<sup>896</sup> Even if Brazil's claim was not solely one of *de jure* inconsistency, it seems to us that it would only be necessary for us to consider any *de facto* inconsistency where *de jure* inconsistency was not apparent on the face of the measure itself.

<sup>897</sup> Brazil's oral statement at the first session of the first substantive meeting, paras. 71-73.

<sup>898</sup> Export-contingent subsidies need not be made solely to producers of the product concerned. To the extent a subsidy made to a purchaser of the product enables that purchaser to obtain that product on more favourable terms than would otherwise be available in the marketplace, this will, at a minimum, represent a *prima facie* case that the payments confer a benefit on the *producers* of that product as well, as it lowers the cost of the product to their purchasers and thus makes their product more attractive relative to competing products. The Panel in *Canada – Aircraft Credits and Guarantees* examined whether or not a benefit was conferred on the producer by virtue of a benefit being conferred on the customer purchasing the product (para. 7.229 and note 187 of that Panel Report), and endorsed the following statement by the *Brazil – Aircraft (Article 21.5—Canada II)* Panel: "We note that PROEX III payments are made in support of export credits extended to the *purchaser*, and not to the *producer*, of Brazilian regional aircraft. In our view, however, to the extent Canada can establish that PROEX III payments allow the purchasers of a product to obtain export credits on terms more favourable than those available to them in the market, this will, at a minimum, represent a *prima facie* case that the payments confer a benefit on the *producers* of that product as well, as it lowers the cost of the product to their purchasers and thus makes their product more attractive relative to competing products." See Panel Report, *Brazil – Aircraft (Article 21.5 – Canada II)*, para. 5.28, footnote 42) (emphasis in original).

<sup>899</sup> In connection with Panel Question No. 249 observing that 7 CFR 1427.104(a)(2) includes "a producer" within the definition of "eligible exporter", the United States indicated that producers would only receive the payments in their capacity as manufacturers, that this would only occur with very large producers, if at all, and that such payments would be "highly isolated". See United States' 28 January 2004 comments on Brazil's response to Panel Question No. 249.

7.729 Moreover, an export sale transaction is sufficient for the purposes of section 1207(a). Thus, an eligible exporter having completed an export sale transaction (and having submitted proof of exportation) may receive a "user marketing (Step 2) payment". While the United States asserts that exportation is deemed to be a "use" for the purposes of the programme, an eligible exporter need not open a bale of upland cotton to trigger receipt of a payment. Thus, at the very least, an exporter is not a "user" in the same sense as a domestic "user".

7.730 By contrast, it is not true that *any* completed domestic transaction concerning the sale of upland cotton by a domestic cotton producer qualifies as a use.<sup>900</sup> The eligible domestic *user* criteria exclude all individuals or firms that do not purchase the bale to open it, such as domestic cotton brokers or resellers.<sup>901 902</sup> This is a fundamental distinction made in the text of the measure itself and confirmed to us by the United States in these proceedings.<sup>903</sup> This fundamental distinction also aligns with the text of the two prohibitions in Article 3.1 of the *SCM Agreement* itself. Article 3.1(b) of the *SCM Agreement* refers to contingency upon the "use" of domestic over imported goods. Article 3.1(a) refers to contingency upon "export performance", which is not expressly referred to in the text of the treaty as any kind of "use".

7.731 The United States insists that because it is not necessary to export in order to receive a user marketing (Step 2) payment (i.e. because user marketing (Step 2) payments are also available to domestic users), the user marketing (Step 2) payments to eligible exporters cannot be export contingent.

7.732 However, this argument does not properly characterize the measure before us. We are not dealing here, for example, with a subsidy that is paid to a producer irrespective of whether the producer sells domestically or for export. Rather, this measure involves payment to two distinct sets of recipients (exporters or domestic users) in two distinct factual situations (export or domestic use).

7.733 As we have seen, these factual situations are distinct in terms of the identified recipients, the proximity of such recipients to the producer, the documentation required to trigger eligibility and the distinction between eligibility on the basis of any export transaction as opposed to the requirement of domestic *use* (not simply *any* domestic sale). Each of these two factual situations, in our view, falls squarely into each of the two prohibitions set out in Articles 3.1(a) and (b) of the *SCM Agreement*.<sup>904</sup>

7.734 It is undeniable that a condition of the receipt of user marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 will always and inevitably be proof of exportation. The only way to receive such a payment is through exportation. Export performance is, therefore, a condition of receipt for this discrete segment of eligible recipients.

7.735 Every user marketing (Step 2) payment to an eligible exporter is contingent upon export.

7.736 Here, it is not the case that the subsidy is indiscriminately and generally available to all producers and/or processors of upland cotton, irrespective of whether a domestic or export transaction is involved. Nor does the measure generally target all upland cotton production or processing while

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<sup>900</sup> United States' response to Panel Question No. 96.

<sup>901</sup> United States' 28 January comments on Brazil's response to Panel Question No. 249. We also understand that a producer simply bundling a bale to break it, without involving a transaction with a domestic user, would not be eligible for the payment. We note that Exhibit US-21 (Upland Cotton Domestic User/Exporter Agreement, Section B1) indicates: in the event that the cotton is not used for the specified purpose (by a domestic user as a person regularly engaged in manufacturing eligible upland cotton into cotton products in the United States) "the payment received shall be returned immediately and with interest".

<sup>902</sup> Brazil's response to Panel Question No. 101.

<sup>903</sup> United States' response to Panel Question Nos. 96 and 105.

<sup>904</sup> We also refer to our finding in Section VII:F that the user marketing (Step 2) payment to domestic users is a prohibited Article 3.1(b) subsidy.

merely incidentally and randomly happening to benefit the occasional exporter.<sup>905</sup> Rather, the measure specifically and explicitly targets eligible exporters – persons who are "regularly engaged" in exporting upland cotton – as a defined class of recipient for a defined, discrete, segment of the payments for a single eligible product. No one else is eligible to receive such payments. The only way to receive such payments is to be an eligible exporter exporting eligible (i.e. domestically produced) upland cotton. This United States upland cotton must be exported outside the United States, traversing the United States border. The measure at issue is, therefore contingent, or conditional upon, exportation.

7.737 We recall again the United States' insistence that user marketing (Step 2) payments to eligible exporters cannot be export-contingent because user marketing (Step 2) payments to domestic users are also available.

7.738 We again observe that section 1207(a) grants user marketing (Step 2) payments, under certain market conditions, in two distinct factual situations: (a) where a bale of United States upland cotton is exported by an eligible exporter; and (b) where a bale of United States upland cotton is opened by an eligible domestic user. Our conclusion that the user marketing (Step 2) measure grants subsidies that are export-contingent in the first situation is not affected by the fact that the subsidy can also be obtained in the second situation, which we have also found to constitute a prohibited subsidy (albeit of a different kind, that is, contingent upon use of domestic over imported goods within the meaning of Article 3.1(b) of the *SCM Agreement*).<sup>906</sup>

7.739 The fact that the subsidies granted in the second situation may not be export contingent does not dissolve the export contingency arising in the first situation. The subsidy granted to eligible exporters upon proof of exportation is export contingent, irrespective of the fact that the subsidy given to domestic users is not (although it is a prohibited subsidy of another kind).<sup>907</sup>

7.740 We do not view it as necessary for an entire subsidy programme to be export-contingent in order to find export contingency: we have found that, under section 1207(a), a distinct and explicitly identified and targeted segment of the subsidies will inevitably be export-contingent. Where a programme makes some payments contingent upon export of products, the fact that other, also prohibited, payments under the programme are made to domestic users contingent upon the use of domestic over imported goods cannot eliminate the export contingency of the programme.

7.741 Most importantly, here, we do not believe that it is possible for a Member to design two prohibited subsidy components – an export subsidy and an import substitution subsidy<sup>908</sup> – and, merely through joining them in a single legal provision, somehow render one, or both, of them

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<sup>905</sup> Contrary to the United States' assertion (United States' 28 January 2004 comments on Brazil's response to Panel Question No. 249), this is not a situation analogous to the Ad Note to Article III of the *GATT 1994*, which basically describes when a measure imposed at a Member's border may be considered nevertheless an "internal" tax or charge. According to that provision: "Any internal tax or other internal charge, or any law, regulation or requirement of the kind referred to in [Article III:1] which applies to an imported product and to the like domestic product and is collected or enforced in the case of the imported product at the time or point of importation is nevertheless to be regarded as an internal tax or other internal charge, or a law, regulation or requirement of the kind referred to in [Article III:1], and is accordingly subject to the provisions of Article III."

<sup>906</sup> Section 1207(a) envisages certain conditions that would exclude potential recipients that are common to both domestic user and exporter payments. For example, in the case of both domestic users and exporters, an "eligible" user cannot include individuals or firms that are not "regularly engaged in" opening bales of upland cotton for manufacturing upland cotton products in the United States or exporting upland cotton from the United States. The United States characterizes this provision as an anti-fraud provision.

<sup>907</sup> We find support for our interpretation in Appellate Body Report, *US – FSC (Article 21.5 – EC)*, para. 119.

<sup>908</sup> We also refer to our finding *infra*, Section VII:F, that user marketing (Step 2) payments to domestic users are a prohibited import substitution subsidy within the meaning of Article 3.1(b) of the *SCM Agreement*.

"unprohibited". It is simply inconceivable to us that two prohibited subsidies could somehow become permitted because they are provided for in the same legal provision. Two wrongs cannot make a right.

7.742 Finally, we consider whether the measure is mandatory.<sup>909</sup>

7.743 Turning once more to the text of the relevant legal provision, pursuant to section 1207(a)(1) of the FSRI Act of 2002, "the Secretary *shall* issue marketing certificates or cash payments, at the option of the recipient, to domestic users and exporters" (emphasis added).<sup>910</sup>

7.744 The United States does not disagree that, subject to the availability of funds (that is, the availability of CCC borrowing authority), user marketing (Step 2) payments must be made to all those who meet the conditions for eligibility.<sup>911</sup>

7.745 We are of the view that section 1207(a)(1) of the FSRI Act of 2002 mandates the granting of subsidies in that the United States authorities have no discretion not to allow it if exporters fulfil certain conditions. This is not a situation in which the United States executive enjoys a discretion to somehow grant user marketing (Step 2) payments to exporters in a WTO-consistent manner. Every user marketing (Step 2) payment to an exporter constitutes a prohibited export subsidy.

7.746 The fact that the actual payment of subsidies is triggered only if certain market conditions prevail does not impact upon our analysis of the normative nature and operation of the measure within the United States legal system. The operation of the world upland cotton market, and the underlying determinative prices for the level of user marketing (Step 2) payments to upland cotton, are not exclusively within the control of the United States government. When certain market conditions exist, the Secretary of Agriculture has no discretion: the payments are automatically triggered.

7.747 We recall that, pursuant to section 1601(e) of the FSRI Act of 2002, the United States Secretary of Agriculture is authorized to adjust support to the maximum extent practicable to comply with total allowable *domestic support* levels under the Uruguay Round Agreements. This authority applies to certain aspects of the user marketing (Step 2) programme.<sup>912</sup> However, this authority pertains exclusively to the *level* of United States *domestic support* commitments under the *Agreement on Agriculture*<sup>913</sup>, an issue distinct from the constituent qualitative elements and conditionality of subsidies governed by the *SCM Agreement*, and from compliance with the agricultural export subsidy obligations in Part V of the *Agreement on Agriculture*. The level of domestic support is not legally relevant to whether or not the United States grants export-contingent subsidies. Therefore, this provision is not legally determinative for whether the measure is of binding normative nature and operation within the United States domestic legal system, and has no strict relevance to our finding that the user marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 are prohibited export subsidies within the meaning of Article 3.1(a) of the *SCM Agreement*, or export subsidies under Articles 9.1(a) and 1(e) of the *Agreement on Agriculture*.

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<sup>909</sup> See *supra*, para. 7.336 of Section VII:C.

<sup>910</sup> Section 1207(a)(1) of the FSRI Act of 2002, reproduced in Exhibit BRA-29.

<sup>911</sup> United States' response to Panel Question No. 109.

<sup>912</sup> Section 1601(e) pertains to expenditures under subtitles A through E of the FSRI Act of 2002. Section 1207(a) is in Subtitle B of that Act. Levels of domestic support expenditures under section 1207(a) are therefore covered by the provision.

<sup>913</sup> United States' response to Panel Question No. 253. In response to Panel Question No. 253(b), the United States confirmed that "section 1601(e) applies to the Aggregate Measure of Support commitments under the Uruguay Round Agreement on Agriculture."

7.748 We therefore find that section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters constitutes a subsidy "contingent on export performance" within the meaning of Article 9.1(a) of the *Agreement on Agriculture*.

7.749 As we have already stated, the United States has no scheduled export subsidy reduction commitments for upland cotton.<sup>914</sup> User marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 are an export subsidy listed in Article 9.1 of the *Agreement on Agriculture*. In providing such subsidies, the United States has acted inconsistently with its obligation under Article 3.3 of the *Agreement on Agriculture* to "not provide subsidies in respect of any agricultural product not specified in ... its Schedule". The United States has furthermore acted inconsistently with its obligation in Article 8 of the *Agreement on Agriculture* "not to provide export subsidies otherwise than in conformity with [the *Agreement on Agriculture*] and with the commitments as specified in [its] Schedule".

7.750 In light of this finding, we do not examine Brazil's alternative claim of violation of Article 10.1 of the *Agreement on Agriculture*.

7.751 Having examined the WTO-consistency of the export subsidies for agricultural products, in the first place, under the *Agreement on Agriculture*, we observe that, as articulated in Article 13(c)(ii) of the *Agreement on Agriculture*, to the extent that the export subsidy at issue does not conform fully to the provisions of Part V of the *Agreement on Agriculture*, it is not exempt from actions based on Articles 3.1(a) and 3.2 of the *SCM Agreement*. We, therefore, now examine Brazil's claims based on Articles 3.1(a) and 3.2 of the *SCM Agreement*.

(ii) *Claims under Article 3.1(a) (and 3.2) of the SCM Agreement*

7.752 Pursuant to Article 3.1(a) of the *SCM Agreement*:

"Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

- (a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I ..."  
(footnotes omitted)

7.753 The United States does not contest that user marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 are "subsidies" within the meaning of Article 1 of the *SCM Agreement*.<sup>915</sup> Nor, for the reasons we have already stated, could the United States properly do so.<sup>916</sup> The only question before the Panel is whether such payments are "contingent ... upon export performance" within the meaning of Article 3.1(a) of the *SCM Agreement*.

7.754 We recall our earlier finding that user marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 constitute a subsidy "contingent upon export performance" within the meaning of Article 9.1(a) of the *Agreement on Agriculture*. Although there are differences between the export subsidy disciplines established under the two Agreements, we do not believe that those differences affect our examination of the substantive requirement relating to export-contingency here.<sup>917</sup> We are not aware of any reason, and none has been brought to our attention in this dispute,

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<sup>914</sup> *Supra*, para. 7.666.

<sup>915</sup> United States' response to Panel Question No.108.

<sup>916</sup> We recall our examination *supra*, para. 7.696

<sup>917</sup> We find support for our approach in Appellate Body Report, *US – FSC*. We are aware that the Appellate Body conducted an examination of export subsidies there under Article 10.1 of the *Agreement on Agriculture*. As the definition of "export subsidies" contained in Article 1(e) includes export subsidies listed in Article 9, we see a parallel, in the particular circumstances in this dispute, relating to the requirement of export

why it would not be appropriate to apply directly the interpretation of export contingency that we have adopted under Article 9.1(a) of the *Agreement on Agriculture* – which, in any event, referred for contextual guidance to the export contingency condition in the *SCM Agreement* – to the interpretation of export contingency under the *SCM Agreement* in this factual situation.

7.755 In so doing, we must, once again, underline the unreasonableness of the view of the WTO-consistency of the user marketing (Step 2) payments advocated by the United States in this dispute.

7.756 Acceptance of the United States' argument would be to accept the proposition that a government could elect to bestow export-contingent subsidies simply by combining them with other, equally egregious, but different, prohibited subsidies. Members could thereby avoid the disciplines of both Articles 3.1(a) and (b) of the *SCM Agreement* by structuring a subsidy in such a way to have both a "de jure export contingency" element and a "de jure local content contingency" element. This would reduce the fundamental prohibitions in Articles 3.1(a) and (b) of the *SCM Agreement* to "redundancy and inutility".<sup>918</sup>

7.757 As we have already stated<sup>919</sup>, we do not believe that it is possible for a Member to design two prohibited subsidy components and, merely through joining them in a single legal provision, somehow render one, or both, of them "unprohibited". It is simply inconceivable to us that two prohibited subsidies could somehow become permitted because they are provided for in the same legal provision. Two wrongs cannot make a right.

7.758 Furthermore, the interpretation advanced by the United States would be irreconcilable with the object and purpose of the *SCM Agreement*, given that it would give a licence to Member governments to evade any effective disciplines on export subsidies by combining export-contingent subsidies with subsidies contingent on the use of domestic over imported goods in a single legislative provision and programme. This would subvert the most stringent subsidy disciplines in the *SCM Agreement*.<sup>920</sup>

7.759 We recall our earlier finding that the measure is mandatory in nature.<sup>921</sup> We see no reason why that finding, made in the context of our examination under Article 9.1(a) of the *Agreement on Agriculture*, cannot also be applicable to our analysis under Article 3.1(a) of the *SCM Agreement* in this factual situation.

7.760 For these reasons, we find that section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters is inconsistent with Article 3.1(a) of the *SCM Agreement*.

7.761 Article 3.2 of the *SCM Agreement* provides: "A Member shall neither grant nor maintain subsidies referred to in paragraph 1" of Article 3. To the extent that section 1207(a) of the FSRI Act

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contingency in Article 9.1(a) of the *Agreement on Agriculture*. See also Appellate Body Report, *Canada – Aircraft*, paras. 162-180.

<sup>918</sup> It is well established that an interpreter is not free to adopt a reading that would reduce whole clauses of a treaty to redundancy or inutility. See, for example, Appellate Body Report, *Brazil – Aircraft*, para. 179 and footnote 110, and Panel Report, *US – FSC (Article 21.5 – EC)*.

<sup>919</sup> *Supra*, para. 7.741.

<sup>920</sup> See Panel Report, *US – FSC (Article 21.5 – EC)*. As that panel also observed, the panel in *Canada – Aircraft* noted that "[...] the object and purpose of the SCM Agreement could more appropriately be summarised as the establishment of multilateral disciplines on the premise that some forms of government intervention distort international trade, [or] have the potential to distort [international] trade." See Panel Report, *Canada – Aircraft*, para. 9.119. We also find support for our view of the object and purpose of the *SCM Agreement* in Appellate Body Report, *Canada – Aircraft*, para. 157, where the Appellate Body referred to "the trade-distorting potential of a 'financial contribution'".

<sup>921</sup> *Supra*, para. 7.748.

of 2002 providing for user marketing (Step 2) payments to exporters is inconsistent with Article 3.1(a), it is, consequently, also inconsistent with Article 3.2 of the *SCM Agreement*.

## 5. Export credit guarantee programmes

### (a) Measures at issue

7.762 Brazil challenges export credit guarantees under three United States export credit guarantee programmes: GSM 102, GSM 103, and the Supplier Credit Guarantee Programme ("SCGP") under Articles 10.1 and 8 of the *Agreement on Agriculture*. These measures are described in Section VII:C, *supra*.

7.763 Brazil challenges these programmes both "as such" and "as applied". Because of the analytical approach we adopt below in our examination under the *Agreement on Agriculture*, for the reasons we indicate<sup>922</sup>, based on the contextual guidance available under item (j) of the Illustrative List of Export Subsidies in Annex I to the *SCM Agreement*, we do not view this distinction as a determinative one here. Item (j) refers to the provision by governments of export credit guarantee "programmes". We adopt a programme-wide analysis under item (j) and examine whether or not the premiums charged under the export credit guarantee programmes at issue are inadequate to cover long-term operating costs and losses.<sup>923</sup> We then transpose this contextual guidance to make a finding, with respect to the scheduled and unscheduled products at issue, under Articles 10.1 (and 8) of the *Agreement on Agriculture*.<sup>924</sup>

7.764 We recall that our examination here is not limited to upland cotton as our terms of reference include "export credit guarantees ... to facilitate the export of US upland cotton, and other eligible agricultural commodities" as addressed in Brazil's panel request.<sup>925</sup>

### (b) Main arguments of the parties

7.765 **Brazil** argues that three United States export credit guarantee programmes – GSM 102, GSM 103 and SCGP – violate Articles 10.1 and 8 of the *Agreement on Agriculture* and are therefore not exempt, under Article 13(c)(ii) of the *Agreement on Agriculture*, from actions based on Articles 3.1(a) and 3.2 of the *SCM Agreement*. Brazil alleges that the programmes also violate the latter provisions.

7.766 Brazil contends that GSM 102, GSM 103 and SCGP result in, or threaten to lead to, circumvention of the United States' export subsidy commitments within the meaning of Article 10.1 of the *Agreement on Agriculture*. According to Brazil, GSM 102, GSM 103 and SCGP, insofar as they are available for unscheduled products, violate Articles 10.1 and 8 of the *Agreement on*

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<sup>922</sup> *Infra*, paras. 7.802 *ff*.

<sup>923</sup> *Infra*, paras. 7.804 *ff*.

<sup>924</sup> *Infra*, paras. 7.870 *ff*.

<sup>925</sup> *Supra*, Section VII:C. We recall that, in our 5 September 2003 communication, we, "invited the parties to address further the issue whether the export credit guarantee programs at issue constitute export subsidies for the purposes of the *Agreement on Agriculture*." We also indicated our intention to rule that the programmes as they relate to upland cotton, and all other eligible agricultural commodities, are within our terms of reference and that the Brazil's statement of available evidence is adequate in this respect. See *supra*, Section VII:A and Annex L-1.11. Exhibit BRA-73 contains an excerpt from the USDA website ([www.fas.usda.gov/excreds/...](http://www.fas.usda.gov/excreds/)) which offers a summary of activity under the challenged export credit guarantee programmes, indicating the allocations and applications received by country and commodity, 1999-2003. Exhibit BRA-299 contains a summary of activity of GSM 102, GSM 103 and SCGP for FY 2003. Exhibit US-12 indicates eligible US commodities (and high-value commodities) under the GSM 102 and SCGP programmes. See also Exhibit US-41. Exhibit BRA-298 contains a FASonline Press Release dated 24 September 2002: "USDA Amends Commodity Eligibility Under Credit Guarantee Programs", listing eligible standard products and high value agricultural products for GSM 102 and SCGP, available at [www.fas.usda.gov/](http://www.fas.usda.gov/).

*Agriculture* because they make export subsidies available for unscheduled products. With respect to scheduled products, GSM 102, GSM 103 and SCGP also threaten to lead to circumvention of the United States export subsidy reduction commitments.

7.767 Brazil asserts that item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* and Articles 1 and 3 of the *SCM Agreement* provide contextual guidance for the interpretation of the terms "export subsidies" under Article 10.1 of the *Agreement on Agriculture*. The United States export credit guarantee programmes are export subsidies within the meaning of Article 10 *Agreement on Agriculture* as they are provided at premium rates which are inadequate to cover the long term operating costs and losses of the programmes as set out in item (j) and are therefore export subsidies within the meaning of Article 3.1 of the *SCM Agreement*. According to Brazil, they also constitute financial contributions conferring a benefit, within the meaning of Article 1 of the *SCM Agreement*, as there are no commercially comparable instruments in the marketplace. They are contingent on export under Article 3.1(a) of the *SCM Agreement*.

7.768 Brazil disagrees with an *a contrario* interpretation of item (j): even if an export credit guarantee programme is not an export subsidy within the meaning of item (j) (with adequate premiums for the purposes of item (j)), it could still constitute an export subsidy by virtue of the definitional elements contained in Articles 1 and 3 of the *SCM Agreement*.

7.769 Brazil argues that Article 10.2 of the *Agreement on Agriculture* does not serve to exempt export credit guarantees from the provisions on prevention of circumvention of export subsidy disciplines in Article 10.1 of the *Agreement on Agriculture*, nor from the prohibition on export subsidies in Article 3.1(a) of the *SCM Agreement*. Brazil argues that Article 10.2 indicates Members' commitment to undertake the development of further disciplines on export credit guarantees, but does not imply that no disciplines currently exist.

7.770 For the **United States**, analysis of export credit guarantees under the *Agreement on Agriculture* "begins and ends" with Article 10.2 of the *Agreement on Agriculture*. The United States asserts that Article 10.2 of the *Agreement on Agriculture* "reflects the deferral of disciplines on export credit guarantee programs contemplated by WTO Members"<sup>926</sup> and that export credit guarantee programmes are not export subsidies under the *Agreement on Agriculture* and are not subject to the export subsidy disciplines of that Agreement. Invoking Article 21.1 of the *Agreement on Agriculture* and the introductory language in Article 3 of the *SCM Agreement*, the United States also asserts that Article 10.2 of the *Agreement on Agriculture* is an "explicit exception" from the subsidy disciplines under the *SCM Agreement*.<sup>927</sup>

7.771 While it does not concede that any WTO disciplines exist on agricultural export credit guarantees, it submits that even if the *SCM Agreement* were relevant to United States export credit guarantees, "the only appropriate mode of analysis" is an examination under item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*.<sup>928</sup> The United States also states, however, that Article 1 of the *SCM Agreement* would provide relevant context in determining whether a subsidy exists in order to determine the applicability of Article 10.1 to a particular measure not described in Article 9.1.<sup>929</sup>

7.772 The United States argues that its export credit guarantee programmes "do not run afoul of the criteria of item (j)" of Annex I of the *SCM Agreement* and that, therefore, "...they are not a prohibited export subsidy under Article 3.1(a) of the Subsidies Agreement."<sup>930</sup> The United States thus asks the

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<sup>926</sup> United States' first written submission, para. 160.

<sup>927</sup> Executive summary of the United States' first written submission, paras. 35-37.

<sup>928</sup> United States' response to Panel Question No. 75.

<sup>929</sup> United States' response to Panel Question No. 74.

<sup>930</sup> United States' first written submission, para. 183.

Panel to interpret item (j) *a contrario*: to the extent premiums cover long-term operating costs and losses, then export credit guarantees are not export subsidies for purposes of item (j) and they must be automatically deemed not to confer export subsidies for the purposes of Article 10.1 of the *Agreement on Agriculture* or Article 3.1 of the *SCM Agreement*.

7.773 The United States argues that Articles 1 and 3 of the *SCM Agreement* are not relevant. Nevertheless, as an additional line of defence, the United States argues that, even if its export credit guarantee programmes are export contingent financial contributions within the meaning of Articles 1 and 3, they do not confer a "benefit" in the marketplace, as identical instruments are available in the form of "forfeiting" (and private "insurance").

7.774 The United States submits that it is not permitted to provide export subsidies in respect of unscheduled products, but that it is in compliance with its scheduled quantitative reduction commitments with respect to 12 out of the 13 scheduled commodities.<sup>931</sup> In the United States view, under a "mandatory/discretionary" analysis, the relevant question would be whether the provisions establishing the export credit guarantee programmes mandate a breach of any WTO obligation. In the United States view, they do not, in view of the various discretionary elements in the operation of the programmes that restrict the actual issuance of guarantees.

(c) Main arguments of the third parties

7.775 In **Argentina's** view, the United States' interpretation of Article 10.2 of the *Agreement on Agriculture* is entirely at odds with the context of that provision and the object and purpose of Article 10, since it would contribute to the circumvention of export subsidy commitments by excluding an entire category of export subsidies from the general disciplines in that area. Article 1(e) clearly defines export subsidies without excluding those that are not listed in Article 9.1 of the *Agreement on Agriculture*. At the same time, Article 13(c)(ii) stipulates that in order to be exempt from actions based on Article 3 of the *SCM Agreement*, export subsidies must conform fully to the provisions of Part V of the *Agreement on Agriculture*, and not to a particular article. Thus, the lack of disciplines specifically developed for export credit guarantees does not necessarily imply the absence or shortage of criteria that would make it possible to establish whether these instruments "conform fully to the provisions of Part V of this Agreement" as stipulated in the chapeau of Article 13(c).<sup>932</sup>

7.776 According to Argentina, the relevance of Articles 1 and 3 of the *SCM Agreement* is unquestionable when it comes to evaluating the consistency of the export credit guarantees with WTO rules.<sup>933</sup> Argentina does not agree with an *a contrario* interpretation, either with respect to the first paragraph of item (k) or item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*, because unlike the final sentence of the second paragraph of item (k), the text of item (j) does not explicitly recognize that the measure will not be an export subsidy. Argentina submits that an *a contrario* interpretation that circumvents the test of Article 3.1(a) of the *SCM Agreement* is not possible.<sup>934</sup>

7.777 **Canada** asserts that the United States argument that Article 10.2 of the *Agreement on Agriculture* exempts export credit practices from subsidy disciplines under the Agreement is untenable. Article 10.2 sets out an intention on the part of Members to undertake further work regarding these measures – the simple fact of agreeing to do so, however, does not amount to a

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<sup>931</sup> United States' rebuttal submission, para. 183 and data in footnote 220.

<sup>932</sup> Argentina's response to Panel third party Question No. 37 (b).

<sup>933</sup> Argentina's response to Panel third party Question No. 30. Argentina argues that the Appellate Body in *US – FSC* and *Canada – Dairy* has turned to the *SCM Agreement* for context since the *Agreement on Agriculture* does not contain its own definition of a subsidy. According to Argentina, the Appellate Body has also established (in *US – FSC*) that export subsidies under Article 3.1(a) of the *SCM Agreement* constitute export subsidies under the *Agreement on Agriculture*.

<sup>934</sup> Argentina's response to Panel third party Question No. 30.

permission to use those measures to confer export subsidies without consequence and without limit. The United States interpretation of Article 10.2 ignores the context provided by Article 10.1 and contradicts the stated object and purpose of Article 10 as a whole: "Prevention of Circumvention of Export Subsidy Commitments". For the United States to meet the requirements of Article 10.3, it must demonstrate the absence of subsidization as understood under Article 1(e) of the *Agreement on Agriculture*.<sup>935</sup>

7.778 Canada is of the view that United States export credit guarantee programmes may provide "subsidies contingent upon export performance" under Article 1(e) of the *Agreement on Agriculture* that are "not listed in paragraph 1 of Article 9", pursuant to Article 10.1. Because the United States has no export subsidy reduction commitments for upland cotton, it may have violated Article 10.1 by applying such subsidies in a manner that results in circumvention of its export subsidy commitments. The United States may have also therefore violated Article 8 of the *Agriculture Agreement* by providing export subsidies "otherwise than in conformity with this Agreement". Canada submits that the Panel should refer to both item (j) and Articles 1 and 3 of the *SCM Agreement* for contextual guidance in interpreting Article 10 of *Agreement on Agriculture*. Item (j) allows the Panel to determine whether the United States provides "export credit guarantee[...] programmes" such that "guaranteed export credit transactions guaranteed" under those programs are subsidized *per se* and Articles 1 and 3 of the *SCM Agreement* enables the Panel to determine whether given quantities of United States exports are subsidized on a transaction-by-transaction basis.<sup>936</sup>

7.779 Canada argues that the United States cannot deny that United States export credit guarantees involve a "financial contribution" in the form of a "potential direct transfer of funds" under Article 1.1(a)(1)(i) of the *SCM Agreement*. Nor can the United States deny that the "export guarantees" are contingent upon export performance under Article 3.1(a) of the Agreement. Canada therefore addresses only the "benefit" requirement of the subsidy definition under Article 1.1(b) of the *SCM Agreement*.<sup>937</sup>

7.780 According to Canada, item (j) of the Illustrative List may not be interpreted *a contrario* to deem United States export credit guarantee practices as not providing export subsidies under Article 10.1. Canada argues that whether an export subsidy exists under Articles 1 and 3 of the *SCM Agreement* is relevant in determining whether the United States programmes grant export subsidies within the meaning of Article 1(e) of the *Agreement on Agriculture*. Where United States programmes may not be deemed to provide export subsidies because they do not meet the requirements of item (j), Articles 10.1 and 10.3 of the *Agriculture Agreement* nevertheless require the United States to demonstrate that it has not granted export subsidies within the meaning of Articles 1 and 3 of the *SCM Agreement* in respect of the relevant quantity of exports.<sup>938</sup>

7.781 The **European Communities** submits that Article 10.2 of the *Agreement on Agriculture* cannot be seen as exempting export credit guarantees granted to agriculture products from WTO disciplines as this provision makes it clear that export credit guarantees are not one of the types of export subsidies listed in Article 9.1 which a Member is given a limited authorization to apply. Thus, export credit guarantees which qualify as export subsidies may be illegal under Article 10.1 when they might lead to circumvention of the export subsidy commitments. Article 10.2 is designed to develop disciplines of a broader nature than simply the regulation of export credits and export credit guarantees which operate as an export subsidy, since whether an export credit guarantee is an export subsidy depends on an analysis of the structure of that instrument.

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<sup>935</sup> Executive summary of Canada's written submission to the first session of the first substantive meeting, paras. 14-15.

<sup>936</sup> Canada's response to Panel third party Question No. 31.

<sup>937</sup> Executive summary of Canada's written submission to the first session of the first substantive meeting, paras. 8-11 and Canada's response to Panel third party Question No. 32.

<sup>938</sup> Canada's response to Panel third party Question No. 30.

7.782 The European Communities argues that in the similar way the agreement to negotiate disciplines on harmonized rules of origin does not imply that Members are exempted from other WTO obligations on rules of origin, export credits or export credit guarantees which operate as export subsidies are subject to the export subsidy disciplines of the *Agreement on Agriculture* and the *SCM Agreement*.<sup>939</sup>

7.783 The European Communities disagrees with the United States' argument that there are no disciplines on export credit guarantees. The discipline applying to export credit guarantees, where they operate as export subsidies, is that they should not be provided in a manner inconsistent with Article 10.1. If they are provided inconsistently with Article 10.1 then they are not protected by Article 13 and are subject to the prohibition in Article 3 of the *SCM Agreement*.<sup>940</sup>

7.784 According to the European Communities, the relationship between the Illustrative List and Article 3.1(a) is addressed specifically by footnote 5 of the *SCM Agreement*. Item (j) describes circumstances in which, *inter alia*, export credit guarantee programmes may constitute export subsidies. In certain circumstances (e.g., where the government is the only provider), it may be that the requirement set out in item (j) – export credit guarantees must not be provided at premium rates which are inadequate to cover the long-term operating costs and losses of the programme – represents the appropriate benchmark for determining that an export subsidy does not exist.<sup>941</sup>

7.785 **New Zealand** finds no basis for the assertion by the United States that export credit guarantee programmes are not subject to the export subsidy disciplines of the *Agreement on Agriculture*. Nothing in Article 10.2 suggests that it provides an exception for export credit guarantee programmes from the disciplines of Article 10.1. According to New Zealand, the inclusion of reference to such programmes in the context of Article 10 supports the opposite conclusion - that Members were in fact concerned at the potential for such programmes to circumvent Members' export subsidy reduction commitments. According to New Zealand, while Article 10.1 currently provides the only discipline on the use of export credits, it is expected that the work envisaged in Article 10.2 will elaborate further and more specific disciplines that will presumably make identification of the extent to which such export credit programmes constitute export subsidies more straightforward.<sup>942</sup>

7.786 According to New Zealand, the Panel should refer to both item (j) and Articles 1 and 3 of the *SCM Agreement* for contextual guidance in the interpretation of Article 10 of *Agreement on Agriculture*. The *SCM Agreement* provides both a general definition of an "export subsidy" (specifically the definition of a "subsidy" in the terms of Article 1 and the requirement of contingency upon export in the terms of Article 3) and an Illustrative List containing specific examples of export subsidies. Therefore Articles 1 and 3 and item (j) of the Illustrative List provide contextual guidance for the interpretation of the terms in Article 10.<sup>943</sup>

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<sup>939</sup> European Communities' oral statement at the first session of the first substantive meeting, paras. 42-43.

<sup>940</sup> European Communities' response to Panel third party Question No. 37 (b).

<sup>941</sup> European Communities' response to Panel third party Question No. 30.

<sup>942</sup> Executive summary of New Zealand's written submission to the first session of the first substantive meeting, para. 18.

<sup>943</sup> New Zealand's response to Panel third party Question No. 31.

- (d) Evaluation by the Panel
- (i) *Claims under the Agreement on Agriculture*
  - i. Overview of Panel's approach

7.787 The initial issue before us is whether the three United States export credit guarantee programmes at issue conform fully to the export subsidy provisions in Part V of the *Agreement on Agriculture*. Pursuant to the provisions governing the relationship between the *Agreement on Agriculture*, the *SCM Agreement* (and the *GATT 1994*), and as articulated in Article 13(c)(ii) of the *Agreement on Agriculture*, if they so conform, then our examination would end there. However, to the extent that they do not "conform fully to" the provisions of Part V of the *Agreement on Agriculture*, we may also conduct an examination under the prohibition on export subsidies in Articles 3.1(a) and 3.2 of the *SCM Agreement* (and Article XVI of the *GATT 1994*).<sup>944</sup>

7.788 The parties agree that export credit guarantees are not included in the non-exhaustive list of export subsidies in Article 9.1, and that Article 10 of the *Agreement on Agriculture* is the relevant provision. We adopt this shared view of the parties, without prejudice to any interpretation of Article 9 of the *Agreement on Agriculture*.

7.789 We structure our examination under Article 10 of the *Agreement on Agriculture* as follows. First, we consider whether United States agricultural export credit guarantee programmes constitute export subsidies for the purposes of Article 10.1 of the *Agreement on Agriculture*. This requires us to identify the definitional elements of an export subsidy under Article 10.1 of the *Agreement on Agriculture*, and to determine what, if any, are the relevant contextual elements provided in the *SCM Agreement* (i.e. item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* and/or Articles 1 and 3 of the *SCM Agreement*).

7.790 Second, we examine whether the agricultural export credit guarantee programmes constitute "export subsidies" which conform fully to the provisions of Articles 10.1 and 8 of the *Agreement on Agriculture*.

7.791 Third, we examine whether Article 10.2 of the *Agreement on Agriculture* provides an "exception" or "carve out" or "deferral of disciplines" for export credit guarantee programmes that constitute export subsidies within the meaning of Article 10.1 of the *Agreement on Agriculture*.

7.792 Our examination requires us to take account of the burden of proof set forth in Article 10.3. As we have already mentioned<sup>945</sup>, Article 10.3 provides a special rule for proof of export subsidies that applies in certain disputes under Articles 3, 8, 9, and 10 of the *Agreement on Agriculture*.<sup>946</sup> Article 10.3 provides:

"Any Member which claims that any quantity exported in excess of a reduction commitment level is not subsidized must establish that no export subsidy, whether listed in Article 9 or not, has been granted in respect of the quantity of exports in question."

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<sup>944</sup> We refer to our "exempt from actions" and "order of analysis" examinations in Section VII:C, as well as our overview of export subsidy obligations, *supra*, paras. 7.654 *ff.*

<sup>945</sup> We refer to our discussion of the burden of proof, *supra*, Section VII:C.

<sup>946</sup> Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US II)*, paras. 69-71, 73-75. Contrary to the United States' assertion, in its further rebuttal submission, para. 191, we do not believe that our observation (in our 20 June communication contained in Section VII:A) that no provisions of the *Agreement on Agriculture* are identified as special or additional rules and procedures in Appendix 2 to the *DSU* is at variance with our application of this burden of proof, which flows from the text of Article 10.3 itself and related provisions.

7.793 As outlined above, the United States in effect claims or asserts in response to the primary claims made by Brazil that no export subsidies within the scope of Article 10.1 have been granted by virtue of the export credit programmes in question in excess of the commitment levels applicable to either scheduled or unscheduled products. In these circumstances, as a result of the special rule on burden of proof in Article 10.3, it is for Brazil as the complaining party to prove that the quantity of United States exports of a "scheduled"<sup>947</sup> agricultural product exceed the relevant quantity commitment level referred to in the first clause of Article 3.3 of the Agreement. The United States will then be treated as if it has granted WTO-inconsistent export subsidies in respect of the excess quantity, unless the United States presents adequate evidence to "establish" that no export subsidy has been granted through the United States export credit programmes in question in respect of this excess quantity of exports. With respect to upland cotton and other unscheduled products, the Panel considers that the United States' reduction commitment level, for the purposes of Article 10.3, is zero for each unscheduled product. By virtue of the second clause of Article 3.3, that is the level to which a Member must reduce any Article 9.1 export subsidies that were not in fact specifically made subject to "scheduled" reduction commitments. Accordingly, in the case of upland cotton and other unscheduled products the same sequence is to be followed, with Brazil as the complaining party first having to prove that United States' exports of unscheduled products exceed that "zero" level.<sup>948</sup>

ii. Do the United States agricultural export credit guarantee programmes at issue constitute export subsidies for the purposes of Article 10.1 of the *Agreement on Agriculture*?

7.794 The issue before us here is whether the United States export credit guarantee programmes at issue constitute "export subsidies" within the meaning of Article 10.1 of the *Agreement on Agriculture*.

7.795 Article 10.1 of the *Agreement on Agriculture* is entitled "Prevention of circumvention of export subsidy commitments". It states:

"Export subsidies not listed in paragraph 1 of Article 9 shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments; nor shall non-commercial transactions be used to circumvent such commitments."

7.796 Article 1(e) of the *Agreement on Agriculture* states that the term "export subsidies" "refers to subsidies contingent upon export performance, including the export subsidies listed in Article 9 of this Agreement". According to its own terms, and read in conjunction with Article 1(e) of the *Agreement on Agriculture*, Article 10.1 covers any subsidy contingent on export performance that is not listed in Article 9.1.

7.797 The *Agreement on Agriculture* does not contain any further textual or contextual elaboration of the terms "subsidies" "contingent upon export performance", beyond the list of export subsidies defined in Article 9.1. Nor does the *Agreement on Agriculture* contain any specific guidance on the

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<sup>947</sup> The United States has scheduled export subsidy reduction commitments in respect of the following thirteen commodities: wheat, coarse grains, rice, vegetable oils, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, pigmeat, poultry meat, live dairy cattle, eggs. See Schedule XX of the United States of America, Part IV, Section II, entitled "Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments", reproduced in Exhibit BRA-83 and Exhibit US-13.

<sup>948</sup> In any event, even if there is *no* reduction commitment level in respect of unscheduled products, affecting the rules of burden of proof that apply to Brazil's claims pertaining to unscheduled products so as to remove the burden entirely from Brazil or to place the entire burden on Brazil to prove not only that exports have been made, but even that export subsidies have been provided in respect of such exported products, this would not materially affect our analysis, as we are of the view that Brazil has discharged this burden as well, and the United States has failed to discharge its burden in this respect.

criteria that may be applied to determine when export credit guarantee programmes, in particular, in respect of agricultural products may constitute "export subsidies".

7.798 However, as we have previously noted, Article 1 of the *SCM Agreement* defines a "subsidy" as a "financial contribution" that confers a "benefit". In addition, "subsidies", as defined in Article 1 of the *SCM Agreement*, that are "contingent upon export performance" are prohibited by Article 3.1(a) of the *SCM Agreement*. That provision reads:

"Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited:

(a) subsidies contingent, in law or in fact<sup>4</sup>, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I<sup>5</sup> ..."

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<sup>4</sup> This standard is met when the facts demonstrate that the granting of a subsidy, without having been made legally contingent upon export performance, is in fact tied to actual or anticipated exportation or export earnings. The mere fact that a subsidy is granted to enterprises which export shall not for that reason alone be considered to be an export subsidy within the meaning of this provision.

<sup>5</sup> Measures referred to in Annex I as not constituting export subsidies shall not be prohibited under this or any other provision of this Agreement.

7.799 We see no reason to consider that, in this factual situation, the concept of "export subsidy" in Article 10.1 of the *Agreement on Agriculture* differs from the same term in the *SCM Agreement*. The two Agreements use precisely the same words to define "export subsidies".<sup>949</sup> We therefore believe that it is appropriate to seek contextual guidance in the relevant provisions of the *SCM Agreement* for our interpretation of the term "export subsidies" in Article 10.1 of the *Agreement on Agriculture* in this factual situation.<sup>950</sup>

7.800 The text of Article 3.1(a) of the *SCM Agreement* prohibits subsidies contingent upon export performance "including those illustrated in Annex I". Annex I to the *SCM Agreement* comprises an "Illustrative List of Export Subsidies". One of the items of this Illustrative List – item (j) – contains a specific textual reference to "export credit guarantee ... programmes". Item (j) of the Illustrative List reads:

"The provision by governments (or special institutions controlled by governments) of export credit guarantee or insurance programmes, of insurance or guarantee programmes against increases in the cost of exported products or of exchange risk programmes, at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes."

7.801 Brazil asserts that both Articles 1 and 3 of the *SCM Agreement* and item (j) of the Illustrative List provide relevant contextual guidance for the determination of what might constitute an export

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<sup>949</sup> See, for example, Appellate Body Report, *US – FSC*.

<sup>950</sup> Our examination of the United States export credit guarantee programmes on this basis is therefore without prejudice to the interpretation of the term "export subsidies" in the *Agreement on Agriculture* based on the definition of "export subsidies" in Article 1(e) and the text of Article 10.1, and other provisions of the *Agreement on Agriculture*, in and of themselves, or on other available contextual guidance.

subsidy for the purposes of Article 10.1 of the *Agreement on Agriculture*. The United States asserts that an item (j) inquiry is, in the first instance, determinative.<sup>951</sup>

7.802 We look for guidance to the overall disciplines contained in the *SCM Agreement* governing export credit guarantees granted under a Member's export credit guarantee programmes. We see that the *SCM Agreement* contains, in item (j) of the Illustrative List of Export Subsidies in Annex I, an explicit indication as to when export credit guarantee programmes constitute *per se* export subsidies for the purposes of the *SCM Agreement*.

7.803 Subject to the United States' view of the role and effect of Article 10.2 of the *Agreement on Agriculture*, there is no disagreement between the parties to this dispute that, if an export credit guarantee programme meets the elements of item (j), it is a *per se* export subsidy. We therefore examine the United States export credit guarantee programmes in question under the context provided by item (j) in the Illustrative List of the *SCM Agreement*. Only if the result of our examination is that the item (j) test is not met will we proceed to a further contextual examination of the definitional elements contained in Articles 1 and 3 of the *SCM Agreement*.

iii. Are premium rates under the United States export credit guarantee programmes inadequate to cover long-term operating costs and losses pursuant to item (j)?

7.804 In general terms, the test for determining whether an export credit guarantee programme satisfies the terms of item (j) is the net cost to the government, as the service provider, of providing the service under the export credit guarantee programmes.<sup>952</sup> To discern this overall cost to government, item (j) calls for an examination of whether the premium rates of the export credit guarantee programme at issue are inadequate to cover the long-term operating costs and losses of the programmes. Beyond that, item (j) does not set forth, or require us to use, any one particular methodological approach nor accounting philosophy in conducting our examination. Nor are we required to quantify precisely the amount by which costs and losses exceeded premiums paid.

7.805 We understand that we are to look at premiums in relation to long-term operating costs and losses. In this dispute, in order objectively to assess premiums in relation to long-term operating costs and losses, we believe it is also appropriate for us to take into account aspects of the structure, design and operation of the measure before us. We are entitled to inquire whether the programme, including in terms of the premiums charged, was set up in such a way that the total of all premiums would be

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<sup>951</sup> To the extent that the United States might contest the "export contingent nature" of its export credit guarantee programmes, we disagree that the United States could properly do so. We note that such programmes are, by their very nature, contingent upon exportation. Pursuant to 7 USC section 5622(a) and (b), reproduced in Exhibit BRA-141, the CCC may guarantee the repayment of credit made available to finance "commercial export sales of agricultural commodities" (emphasis added). Only United States agricultural commodities are eligible (see 7 USC 5622(h)), and such commodities must be exported. The programmes are conditional upon exportation. Under 7 CFR 1493.40 and 1493.430, reproduced in Exhibit BRA-38, Exhibit US-6, a firm export sale must exist before an exporter may submit an application for a payment guarantee. Such a firm export sale is a condition for seeking a guarantee under the three United States programmes at issue. We therefore consider that these programmes are export-contingent, in the sense of being conditional or dependent upon exportation within the meaning of Article 3.1(a) of the *SCM Agreement* and Articles 10.1 and 1(e) of the *Agreement on Agriculture*. In addition, we note that the stated purpose of the programme is to increase exports of United States agricultural commodities and to compete against foreign agricultural exports - see 7 USC 5622(h).

<sup>952</sup> We find support for this proposition in Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, para. 93. We further note that item (l) in the Illustrative List refers to "any other charge on the public account constituting an export subsidy in the sense of Article XVI of GATT 1994". The reference to "other" in item (l) supports the view that the other items in the Illustrative List also involve an examination of "charges on the public account", or net cost to government. We are not, therefore, involved, in this part of our analysis, with trying to discern or calculate any benefit to the recipient. For this reason, we do not believe that the arguments of the United States relating to whether or not a benefit to the recipient exists, for example, in its first written submission, para. 177, are legally relevant to the issue before us.

likely to cover the total of all operating costs and losses under the programme. For example, where a programme does not provide for premium rates that are fully reflective of the risks of a particular transaction, this might be one indicator that the programme was set up in such a way that its long-term operating costs and losses have to be borne, in total or in part, by the government.<sup>953</sup>

7.806 We note that it was well-established in the WTO, and, prior to that, in the GATT, that export credit guarantees may generally constitute export subsidies. This possibility was identified in the Illustrative List of Export Subsidies incorporated in the *Tokyo Round Subsidies Code*<sup>954</sup>, and had already been acknowledged by the 1960 Working Party.<sup>955</sup>

7.807 We recall that item (j) focuses on "The provision by governments (or special institutions controlled by governments)" of export credit guarantee programmes meeting certain conditions. There is no disagreement between the parties that the CCC, a United States government agency, is the agency responsible for administering the three export credit guarantee programmes at issue.<sup>956</sup> Our examination therefore focuses upon CCC's long-term operating costs and losses in administering these programmes, while recognizing that the CCC operates within the larger context of the United States Treasury and the United States government as a whole.

7.808 We must examine the totality of the relevant evidence on the Panel record, on its merits, and on the basis of the text of item (j), to come to an overall view of whether the United States government charges premiums that are inadequate to cover the long-term operating costs and losses of the three United States export credit guarantee programmes at issue: GSM 102, GSM 103 and SCGP.

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<sup>953</sup> We note the view expressed in GATT Panel Report, *EEC – Airbus*. Regarding the condition, "at premium rates, which are manifestly inadequate to cover the long-term operating costs and losses of the programmes" in item (j) of the *Tokyo Round SCM Code*, the panel considered that in assessing an exchange risk programme, what counted was not the particular premium rate applied to a particular transaction, but whether the scheme was set up in such a way that the total of all premiums would be likely to cover the total of all costs and losses under the programme. That GATT panel thus considered that item (j) was applicable to any exchange risk programme which involved a net cost to the government. A programme that did not contain premium rates and which was set up in such a way that its long-term operating costs and losses have to be borne, in total or in part, by the government would therefore fall under the provision of item (j). As with any unadopted report, we may find useful guidance to the extent we consider this relevant. See Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 14: "a panel could nevertheless find useful guidance in the reasoning of an unadopted panel report that it considered to be relevant."

<sup>954</sup> The text of item (j) of the Illustrative List of Export Subsidies annexed to the *Tokyo Round Subsidies Code* was identical to the current item (j), except that it contained the term "manifestly" modifying "inadequate to cover long term costs and losses of the programmes".

<sup>955</sup> "Subsidies: Provisions of Article XVI:4", Report adopted on 19 November 1960 (L/381). Article XVI:4 deals with exports of any product other than a primary product. That Working Party referred to a list of practices which certain contracting parties agreed, for certain purposes, "generally are to be considered as subsidies in the sense of Article XVI:4 [of the *GATT 1994*] or are covered by the Articles of Agreement of the International Monetary Fund." That list included: "In respect export credit guarantees, the charging of premiums at rates which are manifestly inadequate to cover the long-term operating costs and losses of the credit insurance institutions". See BISD, 9S/185, paras. 5-6.

<sup>956</sup> See Exhibit US-129 and Exhibit BRA-158. Established in 1933, the CCC is a wholly owned government corporation within the United States Department of Agriculture. It is the United States government's primary financing arm for a range of domestic and international agricultural programs, including extending export credit guarantees for commodity sales to other countries. The CCC has no employees. It carries out the majority of its programs through the personnel and facilities of the Farm Service Agency (FSA). A Board of Directors manages CCC, subject to the general supervision and direction of the Secretary of Agriculture, who is an *ex officio* director and chairperson of the Board. The Board consists of seven members, in addition to the Secretary, appointed by the President of the United States with the advice and consent of the Senate. The CCC has its own disbursing authority rather than issuing payments through the Treasury Department. It has a variety of funding mechanisms (Appendix B of Exhibit US-129 lists CCC accounts with the Treasury Department).

We underline that our approach is based on the evidence, taken as a whole, and that no one avenue of inquiry has, in isolation, been determinative for us.

7.809 We begin by examining the terms of the text of item (j).

a. "Export credit guarantee ... programmes"

7.810 Item (j) calls for an examination of export credit guarantee "programmes".<sup>957</sup> Brazil's claims identify three such "programmes", that is, GSM 102, GSM 103 and SCGP. Brazil asserts that an item (j) analysis must examine the export credit guarantee "programmes".

7.811 The United States does not disagree that GSM 102, GSM 103 and SCGP are "programmes". The United States contends, however, that merely tracking the activity of GSM 102, GSM 103 and SCGP on a net present value or cash basis by fiscal year would distort (overestimate) the costs of the programme. The United States distinguishes between activity on a fiscal year basis as opposed to cohort-based subsidy estimates and re-estimates that calculate net present value over the life of the programme. According to the United States, United States budget figures referred to in these proceedings are on a fiscal year basis and do not reflect re-estimates on a cohort basis.<sup>958</sup>

7.812 The United States therefore directs us to adopt a "cohort"<sup>959</sup>-specific" approach in our item (j) evaluation.

7.813 The United States further argues that "[n]ot until the cohort is closed can one make an assessment as to whether or not that particular cohort represents a cost to the Federal government."<sup>960</sup> Because all cohorts disbursed since the inception of federal credit reform remain open, a logical extension of the United States argument would be that it is impossible for this Panel, at this point in time, to judge whether the CCC guarantee programmes satisfy the elements of item (j).

7.814 However, we have the mandate and duty, within the time period provided under the covered agreements, and respecting the terms of reference given to us by the DSB, to examine Brazil's claims concerning the United States export credit guarantee programmes. We are also not required to use the accounting or regulatory characterization of the Member concerned in our item (j) examination.<sup>961</sup> We are required to interpret a treaty provision in accordance with its specific terms, and in its context.

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<sup>957</sup> As much of the evidence and argumentation submitted relates to the CCC export credit guarantee activity collectively under the three programmes, we also consider that we may treat the programmes collectively to the extent that we have relevant evidence and argumentation before us. Keeping the applicable burden of proof in mind, and to the extent that the record permits, we also examine relevant aspects of the programmes individually.

<sup>958</sup> The United States insists that a fundamental tenet of credit reform accounting is the requirement that the performance of the credit be tracked over its lifetime, which is done by tracking each cohort of credit until the credit period has expired or lapsed. According to the United States, the only estimates and re-estimates that may be applied directly against each other are upward and downward re-estimates for the same "cohort". The United States nevertheless submitted a fiscal-year chart in Exhibit US-147 depicting performance of certain cohorts on a fiscal year/cash basis.

<sup>959</sup> Executive Office of the President, Office of Management and Budget, June 2002: Circular No. A-11, Part 5: Federal Credit Programs", reproduced in Exhibit BRA-116, defines a "cohort" as all loan guarantees of a programme for which a subsidy appropriation is provided for a given fiscal year (except for modified pre-1992 loan guarantees). All guarantees issued during fiscal year 2002 comprise a distinct cohort. The Panel understands that all cohorts for the CCC export credit guarantee programmes under credit reform are still open, although cohorts for 1994 and 1995 should close this year. Although the formal administrative steps had not been taken to close the 1994 and 1995 cohorts, all financial transactions necessary to do so are complete. See United States' responses to Panel Questions 81(c) and 221(e).

<sup>960</sup> United States' response to Panel Question No. 81(c).

<sup>961</sup> See our more detailed discussion of this *infra*, footnote 993.

7.815 We see no explicit reference to the term "cohort" in the text of item (j). Nor do we read any caveat or condition in the text of item (j) which would require us to await the closure of any or all United States export credit guarantee cohorts before being able to conduct an objective assessment of the matter before us. Our task is not to calculate with precision any difference between premiums and operating costs and losses of certain cohorts on the basis of any specific accounting methodology. Rather, our task is to evaluate whether the premiums charged under the United States export credit guarantee programmes are inadequate to cover long-term operating costs and losses.

7.816 We nevertheless deem that our duty to conduct a thorough and objective assessment of the matter before us permits us also to take into account, to the extent relevant, the cohort-specific evidence before us.

b. "Premiums"

7.817 The ordinary meaning of the word "premiums" is "an amount to be paid for a contract of insurance".<sup>962</sup> There is no disagreement between the parties about the meaning of "premiums" for the purposes of item (j) in this dispute.

7.818 Under the GSM 102, GSM 103 and SCGP export credit guarantee programmes, such "premiums" are the fees paid by the applicant exporter constituting the consideration for the payment guarantee provided by the CCC.

7.819 Under the GSM 102 and GSM 103 programmes, the exporter must remit, with a written application, the full amount of the guarantee fee, and applications will not be approved until the guarantee fee has been received by CCC.<sup>963</sup> In return for this fee, the CCC agrees to pay the exporter (or assignee) an amount not to exceed the guaranteed value, plus eligible interest, in the event that the foreign bank fails to pay under the foreign bank letter of credit or the related obligation<sup>964</sup> in connection with the export sale to which CCC's guarantee coverage pertains.<sup>965</sup> The "guaranteed value" is the maximum amount, exclusive of interest that CCC agrees to pay the exporter (or assignee) under the payment guarantee.<sup>966</sup> The fee is computed by multiplying the guaranteed value by the guarantee fee rate.<sup>967</sup> Typically, 98 per cent of principal and a portion of interest (e.g. 55 per cent)<sup>968</sup> at an adjustable rate is covered.<sup>969</sup>

7.820 Under the GSM 102 and GSM 103 export credit guarantee programmes, the guarantee fee rates are based upon the length of the payment terms provided for in the export sale contract, the degree of risk the CCC assumes, as determined by the CCC, and any other factors which the CCC determines appropriate for consideration.<sup>970</sup> Fees vary by the guaranteed dollar value of the transaction, the repayment period, and the principal repayment interval (annual or semi-annual).<sup>971</sup>

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<sup>962</sup> *Concise Oxford English Dictionary* (Oxford: Clarendon Press, 1995).

<sup>963</sup> 7 CFR 1493.70(c), reproduced in Exhibit BRA-38. Guarantee fee rates paid in connection with an approved application will ordinarily not be refundable.

<sup>964</sup> 7 CFR 1493.60, reproduced in Exhibit BRA-38.

<sup>965</sup> 7 CFR 1493.10(3), reproduced in Exhibit BRA-38.

<sup>966</sup> 7 CFR 1493.20(o), reproduced in Exhibit BRA-38.

<sup>967</sup> 7 CFR 1493.70 (b), reproduced in Exhibit BRA-38.

<sup>968</sup> See Exhibit BRA-84.

<sup>969</sup> See FAS Online: CCC Export Credit Guarantee Programs, reproduced in Exhibit BRA-71.

<sup>970</sup> 7 CFR 1493.70(a), reproduced in Exhibit BRA-38. We note, however, that the United States has acknowledged that the fees are not risk-based. See e.g. Exhibit US-150.

<sup>971</sup> United States' response to Panel Question No. 84. Exhibit BRA-98 contains a fee schedule for GSM 102 and GSM 103 announced by USDA on 4 September 2001, which replaced those in PR 1080-94 issued 26 September 1994 and PR 1085-94, issued 27 September 1994. This fee schedule was altered for GSM 102 to include fees for 30-day and 60-day coverage, effective 1 October 2002 (the fee rates and length of coverage for

7.821 Under the SCGP, the exporter must similarly remit, with a written application, the full amount of the guarantee fee.<sup>972</sup> In return for this fee, the CCC agrees to pay the exporter (or assignee) an amount not to exceed the guaranteed value, plus eligible interest, in the event that the importer fails to pay under the importer obligation<sup>973</sup> in connection with the export sale to which CCC's guarantee coverage pertains.<sup>974</sup> The fee is computed by multiplying the guaranteed value by the guarantee fee rate.<sup>975</sup> The guaranteed value is currently 65 per cent of the principal amount.<sup>976</sup>

7.822 According to uncontested information submitted to us, a total of roughly \$246 million in premiums was collected on CCC guarantees under the GSM 102, GSM 103 and SCGP programmes over the period 1992-2003.<sup>977</sup> Pursuant to item (j), we examine whether premiums are inadequate to cover the long-term operating costs and losses of the programmes.

c. "Are inadequate to cover"

7.823 Item (j) requires us to examine whether premiums charged are "inadequate" "to cover" long-term operating costs and losses. "Inadequate" means: "not adequate; insufficient".<sup>978</sup> "Cover", in the sense that it is used in item (j), means: "...to be enough to defray (expenses, a bill, etc.)"<sup>979</sup>; "to be sufficient for, to counterbalance; as receipts that do not cover expenses..."<sup>980</sup>

7.824 We therefore understand that, under item (j), we are to assess whether or not premiums are sufficient to meet the long-term operating costs and losses of the export credit guarantee programmes.

7.825 We are not called upon to make a precise quantification of the amount by which premiums may or may not be sufficient. Rather, we are called upon to compare premiums charged against long-term operating costs and losses in order to assess the sufficiency of such premiums. In our view, such sufficiency cannot be met without at least some indication that premiums are charged with a view to covering long-term operating costs and losses.

7.826 Moreover, as we are looking into whether the government is incurring a net cost in running the programmes, we understand that it is premiums, rather than any other source of revenue from whatever source derived<sup>981</sup>, that are to be the revenue that covers long-term operating costs and losses. Item (j) does not make any reference to any other source of revenue that must be examined in counterbalance with operating costs and losses. Rather, it explicitly identifies premiums. It then juxtaposes premiums against long-term operating costs and losses.

GSM 103 remained unchanged). The revised fee rates are indicated in Exhibits US-20 and BRA-155. The fees are expressed in cents per \$100 of coverage, based on guaranteed value, with annual and semi-annual principal repayment intervals, and with fees including a charge to provide adjustable per annum eligible interest.

<sup>972</sup> 7 CFR 1493.460(c), reproduced in Exhibit BRA-38. Guarantee fee rates paid in connection with an approved application will ordinarily not be refundable.

<sup>973</sup> 7 CFR 1493.440, reproduced in Exhibit BRA-38.

<sup>974</sup> 7 CFR 1493.400, reproduced in Exhibit BRA-38.

<sup>975</sup> 7 CFR 1493.460(b), reproduced in Exhibit BRA-38. See also Exhibits BRA-166-168, which indicate, *inter alia*, that the guarantee fees is \$0.45 per \$100 (up to 90 days) and \$0.90 per \$100 (90 to 180 days).

<sup>976</sup> This is according to record evidence. 7 CFR 1493.460, reproduced in Exhibit BRA-38, provides that current "guarantee fee rates" will be available by Programme Announcement. See *FAS Online: CCC Supplier Credit Guarantee Program*, reproduced in Exhibit BRA-72.

<sup>977</sup> Exhibit US-128.

<sup>978</sup> *Concise Oxford English Dictionary* (Oxford: Clarendon Press, 1995); *Webster's Revised Unabridged Dictionary* (1996).

<sup>979</sup> *Concise Oxford English Dictionary* (Oxford: Clarendon Press, 1995).

<sup>980</sup> *Webster's Revised Unabridged Dictionary* (1996).

<sup>981</sup> We refer to United States' response to Panel Question No. 77.

## d. "Long-term"

7.827 Item (j) does not define the words "long-term" nor does it identify any conceptual or temporal benchmark, let alone a precise temporal period, which would constitute "long-term". Nor does it stipulate that the examination called for must necessarily be an historical or retrospective one.

7.828 The ordinary meaning of "long-term" is "occurring in or relating to a long period of time."<sup>982</sup> In its ordinary meaning, "long-term" does not necessarily pertain to any particular temporal period. Nor does it require that the "long-term" under consideration must be either in the future or in the past, or have any particular temporal or conceptual benchmark.

7.829 According to the United States, the item (j) analysis requires "a certain degree of retrospection..." to make the requisite comparison between premiums and net operating results of the programme. Brazil does not entirely agree, but nevertheless submits a considerable amount of evidence pertaining to past performance.<sup>983</sup>

7.830 The United States concedes that the programmes historically "admittedly incurred" "significant losses" with respect to Poland and Iraq<sup>984</sup> which are no longer reflected in accounts relating to cohorts since 1992. However, the United States asserts that to subject the programme to the "analytical yoke" of the unique circumstances of the Polish and Iraqi defaults over 10 years ago would effectively require elimination of the programme altogether.<sup>985</sup> While Brazil does not consider that an examination beyond 10 years is "inappropriate", Brazil nevertheless believes that it is adequate in this case to assess the performance of the CCC export credit guarantee programmes.<sup>986</sup>

7.831 The parties have submitted argumentation and evidence relating to the fiscal years since 1992, largely concerning the fiscal years from 1992-2002, and including, where possible, more recent data. Both parties agree that the period since 1992 is an adequately "long-term" period for the Panel to assess in its examination of Brazil's claims in this dispute.

7.832 We understand the reference to "long-term" in item (j) to refer to a period of sufficient duration as to ensure an objective examination which allows a thorough appraisal of the programme and which avoids attributing overdue significance to any unique or atypical experiences on a given day, month, trimester, half-year, year or other specific time period. The reference to "long-term" guides us to undertake an overall appraisal of the programme over a sufficiently long period of time in order to gain a full appreciation of the functioning of the programme and any relationship between premiums charged and operating costs and losses.

7.833 On the basis of the evidence and argumentation submitted to us, in our examination under item (j), we believe that it is reasonable to take into account specific developments over the period since 1992. We note that this period coincides with the entry into effect of the United States Federal Credit Reform Act of 1990, which introduced a reformed accounting methodology for the United States government to measure and reflect the performance of, *inter alia*, its export credit guarantee programmes, effective from fiscal year 1992. We also note that one of the programmes in issue, the SCGP was not in operation at the beginning of this period. We further note that a part of the period since 1992 – the years prior to 1995 – pre-date the entry into force of the *WTO Agreement*, and thus the entry into force of the current set of agricultural export subsidy disciplines. We nevertheless include this period in our examination, on the basis of the evidence and argumentation submitted.

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<sup>982</sup> *Concise Oxford English Dictionary* (Oxford: Clarendon Press, 1995).

<sup>983</sup> Brazil's response to Panel Question No. 257(a)(1).

<sup>984</sup> United States' rebuttal submission, paras. 172-174.

<sup>985</sup> United States' response to Panel Question No. 221(i).

<sup>986</sup> e.g. Brazil's 28 January 2004 comments on United States' response to Panel Question No. 226.

7.834 We consider that we may, however, also consider, for contextual confirmation, developments prior to this period. Item (j) contains no textual limitation on how "long-term" our analysis may be.

7.835 Furthermore, as we have already indicated<sup>987</sup>, we also believe that the item (j) analysis need not be a purely retrospective one. It also appropriately takes into account elements of the structure, design and operation of the measure which may affect the long-term operating costs and losses of the programmes, in terms of whether the programmes involve a net cost to government.

e. "Operating costs and losses"

7.836 Item (j) refers to "operating costs and losses". It does not identify what constitutes such "operating costs and losses". It provides no further precision or description of "operating costs and losses". It does not provide an illustrative nor exhaustive list of such operating costs and losses, nor does it supply any particular accounting methodology that must be followed in discerning such long-term operating costs and losses.

7.837 We begin our examination of "operating costs and losses" by recalling the ordinary meaning of these words. "Operating" or "operate" means to "manage, work, control; put or keep in a functional state."<sup>988</sup> "Cost" may be defined as "the price paid or to be paid .. "a ... sacrifice".<sup>989</sup> "Losses" means "a person, thing or amount lost"; "the act or an instance of losing"; "the detriment or disadvantage resulting from losing".<sup>990</sup> We observe that dictionaries are important guides to, not dispositive statements of, definitions of words appearing in agreements and legal documents.<sup>991</sup>

7.838 The context of item (j) indicates that the "operating costs and losses" relate to export credit guarantee programmes. We recognize that the terms "operating costs and losses" refer generally to an economic, financial or accounting concept. Operating costs and losses in that sense generally connote costs and losses in administering programmes.<sup>992</sup> It is not at all clear to us that these terms in item (j) have obtained a rigid or universally agreed definition. Even if such a definition had arisen, we do not see any indication that it has been included in item (j), or more broadly in the *SCM Agreement*, or in any other covered agreement, as a common understanding among WTO Members. Therefore, in our examination of the United States export credit guarantee programmes at issue under item (j), we decline to adopt one particular rigid definition of the terms "operating costs and losses", as those terms are used in item (j). Nor do we believe that the meaning of operating costs and losses, as referred to in item (j), are necessarily to be determined purely by reference to the domestic laws of the Member whose measures are subject to our examination, here, the United States.<sup>993</sup>

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<sup>987</sup> *Supra*, para. 7.805,

<sup>988</sup> *Concise Oxford English Dictionary* (Oxford: Clarendon Press, 1995).

<sup>989</sup> *Concise Oxford English Dictionary* (Oxford: Clarendon Press, 1995).

<sup>990</sup> *Concise Oxford English Dictionary* (Oxford: Clarendon Press, 1995).

<sup>991</sup> We find support for this proposition in Appellate Body Report, *US – Offset Act (Byrd Amendment)*, para. 248.

<sup>992</sup> For example, the term "operating cost" may mean "a term for prime or variable costs" (see, for example, *Dictionary of Economics* (The Economist Books, 1999)). To the extent the term "operating" in item (j) also refers to the term "losses", the term "operating loss" can mean a loss, before tax and interest, usually on the principal trading activities of the business, excluding extraordinary items (see, for example, *Dictionary of International Finance* (The Economist Books, 1999) or the accounting loss made by a business from its business activities in a given period (see, for example, Moles and Terry, *The Handbook of International Financial Terms* (Oxford University Press, 1999)).

<sup>993</sup> We observe that item (j) in Annex I to the *SCM Agreement* does not contain any statements analogous to the statement in footnote 6 to Article XIV of the *General Agreement on Trade in Services*, which reads: "Tax terms or concepts in paragraph (d) of Article XIV and in this footnote are determined according to tax definitions and concepts, or equivalent or similar definitions and concepts, under the domestic law of the Member taking the measure." See also, for example, Panel and Appellate Body Reports, *US – FSC (Article 21.5 – EC)*, paras. 8.93 and 140-141, respectively, interpreting certain terms in footnote 59 of the *SCM Agreement*.

7.839 We weigh the evidence before us as we deem relevant and appropriate, without prejudice to the validity of any one approach, in isolation, as a conclusive measurement for long-term operating costs and losses under item (j).

7.840 The parties agree that administrative expenses are among the "operating costs" that should be taken into account under item (j).<sup>994</sup> Nor is there a difference between the parties in the total amount of such administrative expenses for the CCC export credit guarantee programmes at issue: approximately \$39 million (\$3 million per year for the years 1992-1996 and approximately \$4 million for the years 1997-2002).<sup>995</sup>

7.841 In our examination of "operating costs and losses" (in comparison with "premiums") under item (j), we will examine whether there is a net cost to the United States government in administering the three export credit guarantee programmes at issue. To discern any net cost to the United States government, we will first consider the past performance of the United States export credit guarantee programmes. Second, we will examine relevant elements pertaining to the structure, operation and design of the programmes.

f. Past performance of the United States export credit guarantee programmes

7.842 We first note that the United States government currently utilizes a "net present value" approach to budget accounting for its export credit guarantee programmes.<sup>996</sup> Net present value analysis basically calculates the value today of a future stream of income or cost. Under this approach, the United States government identifies an annual "cost"<sup>997</sup> in terms of the "net present

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According to the United States' response to Panel Question No. 229, CCC financial statements are prepared in accordance with generally accepted accounting principles (GAAP), based on accounting standards promulgated by the Federal Accounting Standards Advisory Board (FASAB).

<sup>994</sup>See e.g., United States' response to Panel Question No. 77; United States' response to Panel Question No. 221(c); Brazil's 28 January comments on the United States' response to Panel Question No. 221. US "Statement of Federal Financial Accounting Standards No. 2: Accounting for Direct Loans and Loan Guarantees", 23 August 1993, paragraph 38, reproduced in Exhibit US-127 reads: "Costs for administering credit activities, such as salaries, legal fees and office costs, that are incurred for credit policy evaluation, loan and loan guarantee origination, closing, servicing, monitoring, maintaining accounting and computer systems, and other credit administrative purposes, are recognized as administrative expense. Administrative expenses are not included in calculating the subsidy costs of direct loans and loan guarantees." See United States' response to Panel Question No. 221(d).

<sup>995</sup>See e.g. Exhibit BRA-133, setting out administrative expenses of the United States export credit guarantee programmes per fiscal year from line 00.09 of the United States budget. See also Exhibit US-128. Exhibit BRA-119, *Federal Credit Reform Act of 1990*, P.L. 101-508, 5 November 1990, Section 504(g); 2 USC 661(c) all funding for an agency's administration of a direct loan or loan guarantee programme shall be displayed as distinct and separately identified subaccounts within the same budget account as the program's cost. See Exhibit US-11, Exhibit BRA-117.

<sup>996</sup>Effective for fiscal year 1992, the *Federal Credit Reform Act of 1990* ("FCR Act of 1990") required the United States President's Budget to reflect the costs of direct loan and guarantee programs. Exhibit US-11, Exhibit BRA-119, *US Federal Credit Reform Act of 1990*, P.L. 101-508, 5 November 1990, Sec. 501 indicates that the purposes of that legislation include: "to measure more accurately the costs of federal credit programs".

<sup>997</sup>Section 502(5)(c) of the United States *Federal Credit Reform Act of 1990*, P.L. 101-508, 5 November 1990, reproduced in Exhibit BRA-119, indicates that the cost of a loan guarantee shall be the net present value, when a guaranteed loan is disbursed, of the cash flow from: (i) estimated payments by the Government to cover defaults and delinquencies, interest subsidies, or other payments; and (ii) payments to the Government including origination and other fees, penalties and recoveries. See also 2 USC 661(a)(5)(C), reproduced in Exhibit US-11 and Exhibit BRA-117, respectively; and Section 185.3(o) of *Executive Office of the President, Office of Management and Budget, June 2002: Circular No. A11, Part 5: Federal Credit Programs*, reproduced in Exhibit BRA-116, defining "loan guarantee subsidy cost" and Section 185-2. See also, e.g. Treasury Financial Manual, Part 2-Chapter 4600, reproduced in Exhibit US-149. See also, e.g., "United States General Accounting Office, Report to the Director, Office of Management and Budget, Credit Reform: Review of OMB's Credit Subsidy Model", August 1997, pp. 3-4, reproduced in Exhibit BRA-120. See also, e.g.

value<sup>998</sup> associated with its export credit guarantee programmes. According to the United States government, a positive net present value means that the United States government is extending a "subsidy" to borrowers; a negative present value means that the programme generates a "profit" (excluding administrative costs) to the United States government.<sup>999</sup> The annual entries in the "guaranteed loan subsidy" line in the United States budget, 1992-2002 (plus 2003 and 2004 estimates) show us that, according to this formula, there has been a positive "guaranteed loan subsidy" every year.<sup>1000</sup> If administrative expenses<sup>1001</sup> are added thereto, the annual amount of cost to the United States government increases under this formula by approximately \$39 million.

7.843 We realize that these amounts are *initial estimates* of the long-term costs to the United States government. They are not, however, mere random guesses as to the amount of possible, but highly unlikely, costs to the government. Nor, at the other extreme, are they historically verifiable real amounts that have been, or actually will be, disbursed by the United States government. Rather, this is a methodology used and relied upon by the United States government to assess the estimated long-term net cost to the United States government of export credit guarantees. Actual historical experience is a "primary factor" on which estimates are based.<sup>1002</sup> The consistently positive numbers in the United States budget guaranteed loan subsidy line indicate to us that the United States government believes, based upon its own assessment, that it may not, even over the long term, be able to operate the export credit guarantee programmes without some net cost to government. In accordance with the FCR Act of 1990, such "estimates" are subject to certain re-estimations over the lifetime of the guarantees involved.<sup>1003 1004</sup> Re-estimates "take into account all factors that may have

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Exhibit BRA-123, United States Congressional Budget Office, *Budgeting for Administrative Costs under Credit Reform*, January 1992. See Exhibit BRA-121, p. 6. See also, Exhibit US-42, OMB Circular No. A-11 (July 2003), sections 20.5(a); 20.5(f), pages 20-19, 20-22; Exhibit US-127, FASAB, *Original Pronouncements, Statement of Federal Financial Accounting Standards No. 2: Accounting for Direct Loans and Loan Guarantees*; Exhibit BRA-160, Office of the Chief Financial Officer, Credit, Travel and Accounting Policy Division, *Agriculture Financial Standards Manual*, Revised May 2003; Exhibit BRA-161, Federal Financial Accounting and Auditing, Technical Release 3, "Preparing and Auditing Direct Loan and Loan Guarantee Subsidies under the Federal Credit Reform Act", 31 July 1999; Exhibit BRA-162, Government-wide Audited Financial Statements Task Force, Credit Reform, Issues Paper, "Model Credit Program Methods and Documentation for Estimating Subsidy Rates and the Model Information Store", Reference No. 96-CR-7, 1 May 1996; Exhibit BRA-163, "Introduction to Federal Credit Budgeting, OMB Annual Training, 24 June 2002"; Exhibit BRA-185, Congressional Budget Office Staff Memorandum, "An Explanation of the Budgetary Changes under Credit Reform", April 1991.

<sup>998</sup>2 USC 661a(5)(E), reproduced in Exhibits BRA-117 and US-11, states that "in estimating net present values, the discount rate shall be the average interest rate on marketable Treasury securities of similar maturity to the cash flows of the loan guarantee for which the estimate is being made".

<sup>999</sup>See Section 185.2 and definition of "loan guarantee subsidy cost" in *Executive Office of the President, Office of Management and Budget, June 2002: Circular No. A11, Part 5: Federal Credit Programs*, reproduced in Exhibit BRA-116. See also definition of "cost" in 2 USC section 661a(5)(C), reproduced in Exhibits BRA-117 and US-11. We note that the term "subsidy" in this sentence is used in the sense of subsidy cost within the meaning of the United States FCR Act of 1990, rather than strictly in the sense of Article 1 of the *SCM Agreement*.

<sup>1000</sup> Exhibit BRA-133.

<sup>1001</sup> See e.g., Exhibit BRA-133 and Exhibit US-128.

<sup>1002</sup>"Federal Accounting Standards Advisory Board, 'Statement of Federal Financial Accounting Standards, No. 19, Technical Amendments to accounting Standards for Direct Loans and Loan Guarantees' in *Statement of Federal Financial Accounting Standards No. 2'* (March 2001), p. 16, para. 36, reproduced in Exhibit BRA-118 states: "Actual historical experience of the performance of a risk category is a primary factor upon which an estimation of default cost is based".

<sup>1003</sup>See Section 185.2 of *Executive Office of the President, Office of Management and Budget, June 2002: Circular No. A-11, Part 5: Federal Credit Programs*, reproduced in Exhibit BRA-116, indicating that United States agencies concerned (including the CCC) are required to re-estimate the subsidy cost throughout the life of each cohort to account for differences between the original assumptions of cash flow and actual cash flow or revised assumptions about future cash flow. These re-estimates represent additional costs or savings to the Government and are recorded in the budget. An upward re-estimate indicates that insufficient funds had

affected the estimate of each component of the cash flows, including prepayments, defaults, delinquencies, and recoveries," to the extent that those factors have changed since the initial estimate was made for purposes of the budget year column of the budget.<sup>1005</sup>

7.844 Brazil has also placed on the record the following constructed "cost" formula, again based on United States budget data:

(Premiums collected + Recovered principal and interest (Line 88.40) + Interest revenue (Line 88.25)) – (Administrative expenses (Line 00.09) + Default claims (Line 00.01) + Interest expense (Line 00.02)).

7.845 This formula indicates the following (including references to the specific United States budget lines involved):

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been paid to the financing account, so the increase (plus interest) is paid from the programme account to the financing account. Permanent indefinite budget authority exists for this. A downward re-estimate indicates that too much subsidy has been paid into the financing account. See e.g. FASAB "Amendments to Accounting Standards for Direct Loans and Loan Guarantees, Statement of Federal Financial Accounting Standards No.18", May 2000, reproduced in Exhibit BRA-122, and FASAB "Original Pronouncements, Statement of Federal Financial Accounting Standards No. 18: Amendments to Accounting Standards for Direct Loans and Loan Guarantees in Statement of Federal Financial Accounting Standards No. 2", reproduced in Exhibit US-125.

<sup>1004</sup> There are two types of re-estimates: interest rate re-estimates and technical re-estimates. The latter adjust for revised assumptions about loan performance, such as differences between assumed and actual default rates or new projections of repayments. Exhibit US-31 shows US budget summary of GSM 102, GSM 103 and SCGP subsidy estimates and re-estimates by fiscal year, programme and financing accounts FY 1992-2004. Exhibit US-32 shows apportionments for the CCC export credit guarantee programs. It indicates that in FY 2001, in respect of cohorts 1992-1999, there was a total downward re-estimate of \$1,969,422. In FY 2002, in respect of cohorts 1992 through 1999, there was a total upward re-estimate of \$148,364,475. In FY 2003, in respect of cohorts 1999-2002, there was a net re-estimate of -\$3,039,202. Exhibit BRA-192 shows upward and downward (technical and interest) re-estimates 1992-2003. Exhibits BRA-364 and BRA-365 show subsidy rates and re-estimates for the programmes from the FY 2002 and 2003 *Federal Credit Supplement*.

<sup>1005</sup> Section 185.3(x), of *Executive Office of the President, Office of Management and Budget, June 2002: Circular No. A-11, Part 5: Federal Credit Programs*, p. 185-12, reproduced in Exhibit BRA-116, states: "Re-estimates mean revisions of the subsidy cost estimate of a cohort (or risk category) based on information about the actual performance and or estimated changes in future cash flows of the cohort." See also United States' response to Panel Question No. 221(f).

**Table 3: Results of Brazil's constructed "cost" formula**

Fiscal year	Premiums collected (88.40) + Recovered principal and interest (88.40) + Interest revenue (88.25)	Admin. expenses (00.09) + Default claims (00.01) + Interest expense (00.02)
1993	\$27,608,000 + \$12,793,000 + \$15,672,000 = \$56,073,000	\$3,320,000 + \$570,000,000 + \$0 = \$573,320,000
1994	\$20,893,000 + \$458,954,000 + \$0 = \$479,847,000	\$3,381,000 + \$422,363,000 + \$0 = \$425,744,000
1995	\$18,000,000 + \$62,000,000 + \$0 = \$80,000,000	\$3,000,000 + \$551,000,000 + \$10,000,000 = \$564,000,000
1996	\$20,000,000 + \$68,000,000 + \$26,000,000 = \$114,000,000	\$3,000,000 + \$202,000,000 + \$61,000,000 = \$266,000,000
1997	\$14,000,000 + \$104,000,000 + \$26,000,000 = \$144,000,000	\$4,000,000 + \$11,000,000 + \$62,000,000 = \$77,000,000
1998	\$17,000,000 + \$81,000,000 + \$54,000,000 = \$152,000,000	\$4,000,000 + \$72,000,000 + \$62,000,000 = \$138,000,000
1999	\$14,000,000 + \$58,000,000 + \$0 = \$72,000,000	\$4,000,000 + \$244,000,000 + \$62,000,000 = \$310,000,000
2000	\$16,000,000 + \$100,000,000 + \$99,000,000 = \$215,000,000	\$4,000,000 + \$208,000,000 + \$62,000,000 = \$274,000,000
2001	\$18,000,000 + \$149,000,000 + \$125,000,000 = \$292,000,000	\$4,000,000 + \$52,000,000 + \$104,000,000 = \$160,000,000
2002	\$21,000,000 + \$155,000,000 + \$61,000,000 = \$237,000,000	\$4,000,000 + \$40,000,000 + \$93,000,000 = \$137,000,000
Total	\$1,841,920,000	\$2,925,064,000
<b>Total difference</b>	<b>1,083,144,000</b>	

7.846 This data is taken from the "prior year" column of the United States government budget. It represents an additional informed appraisal, based on information generated by the United States government itself, of the performance of export credit guarantee programmes. Moreover, it takes into account the actual level of guarantees issued by the CCC in a given year, as opposed to an estimate of this level. We compare the result of this formula with<sup>1006</sup> fiscal year/cash basis evidence submitted by the United States<sup>1007</sup>, which, the United States asserts, portrays "actual performance" of the programmes. This reflects that, according to the United States, total revenues exceed total expenses of the programmes by approximately \$630 million. By this United States approach, rescheduled claims -- amounting to approximately \$1.6 billion -- are not treated as "outstanding" claims.<sup>1008</sup> This

<sup>1006</sup> See Brazil's 28 January comments on United States' response to Panel Question No. 221, para. 129. We acknowledge that data relating to particular cohorts and fiscal year data may not directly correlate, and we are aware that United States budget data may not always reflect "actual performance" of the export credit guarantee programmes. We are further sensitive to the fact that attention must be paid to the particular time periods covered by the data in question. In our view, none of these considerations undermine the comparison made.

<sup>1007</sup> United States' response to Panel Question No. 264 (a).

<sup>1008</sup> Column F of the cohort-based chart in Exhibit US-128; column F in fiscal year/cash basis chart in Exhibit US-147. See e.g. Exhibit BRA-431. Exhibit US-147 shows certain additional revenue and expense figures for an additional amount of approximately \$103.6 million. The additional information does not materially change the picture before us.

amount is of the same order of magnitude as the difference between the figures submitted by Brazil (\$1.083 billion) and the United States (\$630 million).

7.847 Thus, a major difference between the parties' approaches relates to the treatment of re-scheduled debt.

7.848 By way of brief background, when the CCC pays out a claim, it is subrogated and pursues repayment of the claim. Sometimes it is successful, in which case, the claim is deemed "recovered". Although there are disagreements on certain factual aspects of the record, there is no disagreement between the parties that, in principle, claims actually recovered may be treated as net revenue to (or at least not as a long-term loss by) the CCC. Sometimes, however, the CCC is not successful in recovering a paid-out claim. Then, as we understand it, one of two things may occur. First, the CCC may "write off" that debt.<sup>1009</sup> According to the record, no amounts have actually been determined uncollectible, written off or forgiven with respect to any post-1992 cohort.<sup>1010</sup>

7.849 Alternatively, the CCC will reschedule that debt, in which case it will conclude a rescheduling agreement providing for the capitalization of the principal and interest. This does not mean that the United States government *collects* an outstanding claim.<sup>1011</sup> In addition, reschedulings provide for repayment of principal (on a sliding scale or on equal payments) over terms such as 8, 10, 12, 14, 15 and 17 years, at various interest rates.<sup>1012</sup> It strikes us that given that the original terms of the export credit guarantees extended under the programmes are less than 3 years (GSM 102); 180 days (SCGP) and 3-10 years (GSM 103), these reschedulings are for terms generally far in excess of the original term of the guarantee.

7.850 Recalling our discussion of the "long-term" period relevant to our item (j) examination<sup>1013</sup>, we observe that the only amounts written off during the period since 1992 concern 1992 and pre-1992 cohorts. The write-offs occurred in fiscal years 1995<sup>1014</sup> and 1999.<sup>1015</sup> These amounts have therefore not been recovered. Amounts of debt forgiveness have also not been recovered.<sup>1016</sup> The record also

<sup>1009</sup> Exhibit BRA-116, Section 185, p. 185-15. See also United States' response to Panel Question No. 221(f).

<sup>1010</sup> United States' response to Panel Questions Nos. 225, 265 and 273. See also Exhibit BRA-158.

<sup>1011</sup> Column F in Exhibit US-147 indicates that approximately \$1.6 billion of defaulted guarantees have been re-scheduled, 1992-2003. In Column F of Exhibit US-148, the United States indicates \$205 million in "principal collected on re-schedulings". The United States indicated to us that "a significant portion" of principal collected on reschedulings "has not been reflected" in United States budget line 88.40 which is a basis for the table in para. 7.845. This is apparently so despite the United States' acknowledgement to us that, "[a]s a theoretical matter, such recovered principal should be reflected in the budget line 88.40". The United States asserted before us: "Accounting research within the US Government suggests, however, that a significant portion of [the amount of \$205 million of principal which the US states it has collected on reschedulings] has not in fact been reflected in that budget line." (See United States response to Panel Question No. 264 (b)). In any event, even if we accepted this assertion by the United States, it would not materially change our view.

<sup>1012</sup> See Exhibit US-153. According to the record, the principal outstanding (as of 30 November 2003) on re-scheduled amounts is \$1,579,950,350.

<sup>1013</sup> *Supra*, paras. 7.827 *ff.*

<sup>1014</sup> United States' response to Panel Question Nos. 225 (Nigeria, \$129,000) and 273.

<sup>1015</sup> United States' response to Panel Question Nos. 225 and 273 (Argentina, \$48,000; Russia and Former Soviet Union, \$13,000).

<sup>1016</sup> The United States submits the following uncontested data concerning debt forgiveness:

**Table 4: CCC Debt forgiveness**

Cohort	Fiscal Year of forgiveness	Country	Amount (US dollars)
Pre-1992	1991, 1994	Poland	1,406,000,000 (approximate)
Pre-1992	1997	Yemen	1,686,000

indicates sizeable defaults and reschedulings concerning Iraq (approximately \$2 billion)<sup>1017</sup> and Russia and the other former Soviet Union republics.<sup>1018</sup> We note that post-1991 defaults on pre-1992 CCC export credit guarantees are treated separately<sup>1019</sup> under the net present value methodology imposed by the FCR Act of 1990. At the very least, the existence of defaults on pre-1992 cohorts of a large order of magnitude<sup>1020</sup> indicates to us that the CCC did not enjoy a premium-based or market-generated equilibrium or surplus which it could carry forward from 1991, corresponding to the period forming the focus of our long-term analysis under item (j) and, coincidentally, the advent of the FCR Act of 1990, effective FY 1992.

7.851 The United States indicates that the standard accounting treatment of reschedulings by the CCC is to no longer treat them as an outstanding claim, but rather as a new direct loan.<sup>1021</sup> This is an instant reduction from the amount of claims outstanding in the year the terms of the rescheduling are

Pre-1992	1999	Honduras	5,951,000
Pre-1992	2002	Former Yugoslavia	3,343,000
Pre-1992	2002	Tanzania	8,806,000

See United States' response to Panel Question No. 225. The United States clarifies that all of the debt in the table is associated with Paris Club (Poland, Former Yugoslavia) or Heavily Indebted Poor Country (HIPC) (Honduras Tanzania and Yemen).

Exhibit BRA-114 contains a United States Treasury, February 2000 "Public Report to Congress: US Debt Reduction Activity FY 1990 through FY 1999" outlining the Multilateral Paris Club and Heavily Indebted Poor Country (HIPC) Initiative (1996, enhanced in 2000).

See also USDA "Undersecretary A Schumacher, Statement before the United States Sub-Committee on General Farm Commodities, Hearing on the Asian Financial Crisis", 4 February 1998, pp. 10-11, reproduced in Exhibit BRA-87.

<sup>1017</sup> Exhibit BRA-87, pp. 10-11. See also, "United States General Accounting Office, Report to the Chairman, Task Force on Urgent Fiscal Issues, Committee on Budget, House of Representatives, International Trade: Iraq's participation in US Agricultural Export Programs", November 1990, p. 2, reproduced in Exhibit BRA-157. See also, "United States General Accounting Office, Status Report on GAO's Reviews of the Targeted Export Assistance Program, and the GSM-102/103 Export Credit Guarantee program, Statement of Allan I Mendelowitz, Trade Energy and Finance Issues, National Security and International Affairs Division before the Task Force on Urgent Fiscal Issues Committee on Budget, House of Representatives", 28 June 1990, p. 9, reproduced in Exhibit BRA-152.

<sup>1018</sup> See "United States General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition, and Forestry, US Senate, *Former Soviet Union: Creditworthiness of Successor States and US Export Credit Guarantees*", GAO/GGD-95-60 (February 1995), pp. 50-52 and 56-67 and Table 2.6, reproduced in Exhibit BRA-181. The record indicates that, in 2002, Iraq no longer participated in the programme, and that FSU republics are no longer major beneficiaries. Congressional Research Service, "Agricultural Export and Food Aid Programs" (updated 14 June 2002), p. CRS-7, reproduced in Exhibit BRA-97,

<sup>1019</sup> Exhibit BRA-116. See also, e.g. Exhibit US-127 relating to the distinct treatment of pre-1992 loan guarantees.

<sup>1020</sup> We note the 1991 estimation by the United States GAO that "As of May 31, 1990, the Corporation had approximately \$8.6 billion outstanding in credit guarantees and \$2.6 billion in accounts receivable resulting from guarantee payments on delinquent loans. We estimate that the GSM 102 programs will cost the Corporation about \$6.7 billion in the long run, or about 60 per cent of the \$11.2 billion face value of the outstanding credits and receivables." See, United States GAO, Report to the Chairman, Subcommittee on Criminal Justice, Committee on the Judiciary, House of Representatives. "Loan Guarantees: Export Credit Guarantee Programs' Long-Run Costs are High", April 1991, reproduced in Exhibit BRA-115; See United States GAO, Report to Congressional Requesters, "Loan Guarantees: Export Credit Guarantee Program's Costs are High", December 1992, p. 3, reproduced in Exhibit BRA-159.

<sup>1021</sup> See United States' response to Panel Question No. 264(b). A "direct loan" is a disbursement of funds by the government to a non-federal borrower under a contract that requires the repayment of such funds within a certain time with or without interest. (Adapted from OMB Circular A-11), accessible on the FASAB website ([www.fasab.gov](http://www.fasab.gov)) Original Pronouncements, Version 3 (01/2004). See Exhibit BRA-116, section 185.3, pp. 185-6.

finalized.<sup>1022</sup> Particularly given the magnitude in the amounts involved, we share Brazil's concerns that the United States' treatment of rescheduled debt before us understates the net cost to the United States government associated with the export credit guarantee programmes at issue.<sup>1023 1024</sup>

7.852 Our view does not change in light of the evidence introduced by the United States ("Subsidy Estimates and Re-estimates by Cohort") reflecting cumulative re-estimates on a cohort-specific basis.<sup>1025</sup> These figures show a positive subsidy of approximately \$230 million, which approximates a figure of \$211 million submitted by Brazil.<sup>1026</sup> Neither figure includes administrative expenses of approximately \$39 million.

7.853 We note that, over the lifetime of the cohorts issued in 1992 and since, the record indicates an overall lifetime downward re-estimate of \$1.9 billion.<sup>1027</sup> With the exception of 2002, for which only very recent data is necessarily available, the United States directs the Panel to note that the trend for all cohorts is uniformly favourable as compared to the original subsidy amount. The United States submits that data for the 1992-1996 and 1999 "cohorts" indicate profitability. According to the United States, when data for the -- as yet uncompleted -- 2001 and 2002 cohorts are removed, the \$230 million is almost entirely eliminated. While taking note that the process of estimates and re-estimates by cohort is necessarily a fluid one that cannot be definitively finalized or forensically analyzed until a cohort is "closed", we disagree with the United States that we should "eliminate" the

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<sup>1022</sup> In charts provided to us in Exhibits US-128 and -147, the US defines "claims outstanding" as "claim payments" minus "claims recovered" minus "claims rescheduled". According to this treatment, a rescheduled claim no longer constitutes an outstanding claim.

<sup>1023</sup> We note that a 1991 report by the United States' General Accounting Office referred to "long-run costs" in terms of "the expenses the Corporation incurs over the long run, e.g. the next 18 years, because its guaranteed credits and accounts receivable will not be fully repaid." We consider it relevant that a United States government agency itself deems non-repaid accounts receivable to constitute "long-run costs". See "United States GAO, Report to the Chairman, Subcommittee on Criminal Justice, U.S. House of Representatives Committee on the Judiciary, 'Loan Guarantees: Export Credit Guarantee Programs' Long-Run Costs are High", April 1991. p.1, footnote 1, reproduced in Exhibit BRA-115.

<sup>1024</sup> The record indicates different levels of reschedulings and outstanding claims for each of the three programmes separately. However, we do not consider this legally determinative given the other elements we have taken into account in our examination. In particular, we are not persuaded that any particular characteristic of the GSM 103 programme or the SCGP programme or their long-term operating costs and losses would serve to distinguish it for the purposes of item (j).

<sup>1025</sup> We recall our discussion of "programmes" for the purposes of our item (j) analysis *supra*, paras. 7.810 *ff*. The United States submitted a revised and corrected version of the table in response to Panel Question 221(a). The original version of the table appeared in paragraph 161 of the United States' rebuttal submission. However, as acknowledged by the United States' agreement (in footnotes 82 and 96 of its further written submission and footnote 160 of its further rebuttal submission) to Brazil's assertion (footnote 67 in Brazil's 27 August comments on the United States' rebuttal submission), the total figure net of re-estimates is \$230,127,023, rather than the figure that originally appeared (\$381,345,059). The United States acknowledged, however, that data discrepancies occur with respect to cohorts 1992-1996 when compared to evidence submitted by Brazil on "Net lifetime re-estimate" in Exhibit BRA-182. In the absence of internal documentation to corroborate the figures originally submitted to the Panel and unable to explain the relatively minor disparity in figures, the United States "necessarily accepts" the figures submitted by Brazil on "Net lifetime re-estimate" by cohort.

<sup>1026</sup> Exhibit BRA-193.

<sup>1027</sup> See United States revised and corrected version of the table in response to Panel Question 221(a), Exhibit BRA-193. The United States submits evidence, in Exhibit US-32, comprising internal United States government budgetary documents, concerning the reapportionment constituting a decrease of subsidy in the permanent indefinite authority for the GSM programme as provided under the FCRA Act of 1990. According to these documents, "[The] downward estimate of \$1.9 billion is based on actual activity since the last reestimate was approved and apportioned [...]" OMB Circular No. A-11, Part 4, Instructions on Budget Execution (July 2003), reproduced in Exhibit US-43, describes the apportionment/reapportionment process.

data for certain, more recent, cohorts in our analysis. We have not been persuaded that cohort re-estimates over time, will necessarily not give rise to a net cost to the United States government.<sup>1028</sup>

7.854 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 programmes.

7.855 Furthermore, we note that the CCC financial statements for the years 2002 and 2003 indicate a "credit guarantee liability" of \$411 million and \$22 million, respectively. The CCC defines the term "credit guarantee liability" as the estimated cash outflows of the guarantees on a net present value basis.<sup>1029</sup> "Liability" is defined as "...a probable future outflow or other sacrifice of resources as a result of past transactions or events."<sup>1030</sup> We observe that these amounts are not actual losses. They are but another indicator, used and relied upon by the United States government, to assess the estimated long-term cost to the United States government of export credit guarantees. They are consistently positive, indicating to us that the CCC believes, based upon its own assessment, that it may not, even over the long term, be able to operate the export credit guarantee programmes without some net cost to government.<sup>1031</sup>

7.856 The above considerations relating to the past performance of the programmes support a view that the programmes are run at a net cost to the United States government. We next consider the structure, operation and design of the programmes.

g. Structure, design and operation of the programmes

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<sup>1028</sup> See United States' response to Panel Question No. 221(a). For example, for a cohort that is on the verge of closing, the original subsidy cost estimate for 1994 was \$123 million; thus, applying the downward re-estimate, the net cost of the programme to the United States Government is currently projected at \$7 million. For that cohort, there is currently a net cost indicated in the United States figures. Furthermore, the 1997, 1998, 2000, 2001 and 2002 data do not indicate a current appraisal of that the CCC export credit programmes will be operated at no net cost to government. The \$122 million positive figure for 1997 is a particularly large figure. We note the United States assertion that "it is reasonable to expect that, in the fullness of time, the data will ... reflect further negative re-estimates for cohorts 2001 and 2002". While there may be a possibility (based on the experience of certain of other cohorts) that this figure may diminish over the lifetime of the cohort concerned, there is no assurance that this figure will necessarily evolve towards, and conclude as, zero or a negative figure.

<sup>1029</sup> Exhibit US-129. Notes, p. 4.

<sup>1030</sup> Exhibit US-130. Appendix E of the FASAB Statements of Federal Financial Accounting Concepts and Standards. This differs from the definition of "loss" ("Any expense or irrecoverable cost, often referred to as a nonrecurring charge, an expenditure from which no present or future benefit may be expected").

<sup>1031</sup> See Exhibits BRA-194 and BRA-196. In CCC Financial Statements for 1999-2001, on the basis of testing GSM 102 data, USDA indicates that by not using the current risk rating, they may have understated the losses associated with these guarantees by about \$430 million. The CCC Financial Statements, Fiscal Year 2001 indicates that the CCC credit reform subsidy amount for direct credits and guarantees and noted substantially different credit reform accounting and reporting standards for the budget and financial statements for the CCC. It stated that they continued to find lack of quality assurance over CCC foreign loan accounting operations and preparations of its financial statements, and material weaknesses in the processes and procedures used by USDA's lending agencies to estimate and reestimate loan subsidy costs since 1994. The USDA Consolidated Financial Statement for Fiscal Year 1999 states: "We are unable for the sixth consecutive year to assess the reasonableness of USDA's credit program receivables and estimated losses on loan guarantees, stated at about \$70.7 billion and \$1.7 billion, respectively, as they relate to the subsidy costs. These same problems also materially impact the Department's budget submissions. Because we can provide no assurance on USDA's credit reform financial data, the Congress and other decision-makers do not know whether the costs of USDA's loan programs, estimated in excess of \$27.3 billion as of 30 September 1999, can be relied upon."

7.857 In terms of the structure, design and operation of the export credit guarantee programmes before us, there are several elements which lead us to believe that the programmes are not designed to avoid a net cost to government.

7.858 We deem it relevant to our examination that the CCC borrows from the United States Treasury.<sup>1032</sup> When it does borrow, it incurs interest, which is recognized as an interest expense in the "Interest on debt to Treasury" row of the United States budget<sup>1033</sup> and in material submitted to us.<sup>1034</sup> If the CCC did not pay or record interest expense, it would not be permitted to borrow from Treasury. Access to Treasury borrowings facilitates the functioning of the CCC's export credit guarantee programmes. Moreover, for a creditor, it provides the backing of the full faith and credit of the United States government concerning its ability to pay a claim in the case of default by a borrower.

7.859 Moreover, the premiums are not geared toward ensuring adequacy to cover long-term operating costs and losses for the purposes of item (j). We are of this view for several reasons.

7.860 First, there is a statutory fee cap in connection with transactions under the GSM 102 and SCGP programmes, of no more than 1 per cent of the amount of credit to be guaranteed. This 1 per cent fee cap does not, however, apply to the GSM 103 programme.<sup>1035</sup>

7.861 Second, the premiums are not risk-based<sup>1036</sup>, either with respect to country risk or the creditworthiness of the borrower in an individual transaction.<sup>1037</sup> All countries eligible for any of the CCC export credit guarantee programmes are categorized according to risk. CCC categorization of countries is based on a United States government internal risk classification system, which, according to the United States, "is administratively controlled and may not be released outside of the US Government".<sup>1038</sup> However, the United States has confirmed that "a country's risk classification has no impact on the premiums payable under the United States export credit guarantee programmes".<sup>1039</sup>

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<sup>1032</sup> FCRA Section 505, 2 USC Section 661d (c), reproduced in Exhibit US-11 and Exhibit BRA-117: "The Secretary of the Treasury shall borrow from, receive from, lend to, or pay to the financing accounts such amounts as may be appropriate."

<sup>1033</sup> The Panel notes Exhibit US-129. In its response to Panel Question No. 270(i), the United States assures us that references to the CCC "non-interest bearing" debt or repayments are unrelated to the export credit guarantee programmes at issue. In addition, in its response to Panel Question No. 270(ii), the United States asserts that "permanent indefinite borrowing authority from Treasury" is not available in respect of the programmes. We note that 2 USC 661c(c)(2), providing an "exemption for mandatory programs", exempts all CCC credit programs existing on 5 November 1990, from the "appropriations" requirement in 2 USC 661c(b) and from the "modifications" requirement in 2 USC 661c(e). In its response to Panel Question No. 271, the United States asserts that full reimbursement of the CCC for prior year net realized losses – as set out in Exhibit US-152– do *not* include any portion attributable or allocable to the export credit guarantee programs. In its response to Panel Question No. 271, the United States submits that Treasury reimbursements of CCC net realized losses "do not include any portion attributable or allocable to the export credit guarantee programs."

<sup>1034</sup> e.g. Exhibit US-128; Exhibit US-148.

<sup>1035</sup> See Exhibit BRA-300.

<sup>1036</sup> The United States government acknowledges this. See Exhibit US-150 and United States' response to Panel Question No. 86.

<sup>1037</sup> e.g. United States' response to Panel Question No. 85. The United States has confirmed to us that under the SCGP "CCC does not determine the creditworthiness of participating importers[...]" . Rather, according to the United States, the risk sharing between the CCC and the exporter is intended to ensure that due diligence is performed.

<sup>1038</sup> United States' response to Panel Question No. 86. According to 7 USC 5622, the CCC shall not make credit guarantees available in connection with sales of agricultural commodities to any country that the Secretary determines cannot adequately service the debt associated with such sale.

<sup>1039</sup> See e.g. Exhibit US-150 and United States' response to Panel Question No. 86. See also, "US General Accounting Office, Report to the Ranking Minority Member, Committee on Agriculture, Nutrition and Forestry, US Senate, *Former Soviet Union, Creditworthiness of Successor States and US Export Credit Guarantees*, GAO/GGD-95-60", February 1995, pp. 135-136, reproduced in Exhibit BRA-181: "Although

Rather than the premiums, it is the United States government subsidy estimates and re-estimates for the export credit guarantee programmes that are determined in large part by the obligor's sovereign or non-sovereign country risk grade.<sup>1040</sup>

7.862 In this respect, the statute governing the CCC export credit guarantee programmes currently sets out certain restrictions on the United States use of export credit guarantees. In general, "the CCC shall not make credit guarantees available in connection with sales of agricultural commodities to any country that the Secretary determines cannot adequately service the debt associated with such sale."<sup>1041</sup> The statute and the implementing regulations indicate that, in respect of GSM 102 and GSM 103, "Export credit guarantees ... shall not be used for foreign aid, foreign policy, or debt rescheduling purposes".<sup>1042</sup> Moreover, pursuant to the regulations, "criteria considered by CCC in reviewing proposals for country allocations under the GSM 102 or GSM 103 programs, will include, but not be limited to, the following: (a) Potential benefits that the extension of export credit guarantees would provide for the development of, expansion or maintenance of the market for particular United States agricultural commodities in the importing country; (b) Financial and economic ability of the importing country to adequately service CCC guaranteed debt; (c) Financial status of participating banks in the importing country as it would affect their ability to adequately service CCC guaranteed debt; (d) Political stability of the importing country as it would affect its ability to adequately service CCC guaranteed debt; and (e) Current status of debt either owed by the importing country to CCC or to lenders protected by CCC's guarantees."<sup>1043</sup> Additional considerations apply for GSM 103.<sup>1044</sup>

7.863 These criteria do not stipulate what might constitute an acceptable level of risk in evaluating whether countries can adequately service their debt. Nor does the statute impose any limitation on the amount of guarantees that can be provided annually to a high-risk country (in the aggregate or individually) or to high risks transactions. The CCC is, therefore, able to provide large amounts of guarantees to high-risk countries with a resulting high rate of default.

7.864 Finally, there are additional indications on the record that premiums are not the source of revenue that cover the long-term operating costs and losses of the programmes. In this connection, Brazil raises the issue of the adequacy of any review of premiums by the United States government to ensure that they are adequate to cover long-term operating costs and losses.<sup>1045</sup> The United States provides evidence of annual review of premiums pertaining to FY 2003 and FY 2004.<sup>1046</sup> However,

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GSM 102 recipient countries vary significantly from one another in terms of their risk of defaulting on GSM 102 loans, CCC does not adjust the fee that it charges for credit guarantees to take account of country risk. [...] CCC fees that included a risk-based component might not cover all of the country risk, but they could help to offset the cost of loan defaults." In Exhibit BRA-153, *Audit Report of CCC for FY 2000*, June 2001, USDA's Office of the Inspector General stated that fees for the GSM 102 and GSM 103 programs had not been changed in 7 years, and as a result "may not be reflecting current costs." Without accounting for country risk in the fees charged, the CCC foregoes an opportunity to cover the cost of loan defaults.

<sup>1040</sup> e.g. Exhibit US-150.

<sup>1041</sup> 7 USC 5622(f), reproduced in Exhibits BRA-141, BRA -366.

<sup>1042</sup> 7 USC 5622(e), reproduced in Exhibits BRA-141, BRA-366; 7 CFR 1493.3, reproduced in Exhibit BRA-38,

<sup>1043</sup> 7 CFR 1493.4, entitled "Criteria for country allocations", reproduced in Exhibit BRA-38. By virtue of 7 CFR 1493.400, these restrictions and criteria also apply to the SCGP. Furthermore, the SCGP operates in cases where credit is necessary to increase or maintain United States exports to a foreign market and where private United States exporters would be unwilling to provide financing without CCC's guarantee. The programme is targeted toward those countries where the guarantees are necessary to secure financing of the exports but which have sufficient financial strength so that foreign exchange will be available for scheduled payments. Also see 7 CFR 1493.400(a)(3).

<sup>1044</sup> 7 USC 5622(f)(2), reproduced in Exhibits BRA-141, and BRA-366; 7 CFR 1493.6, reproduced in Exhibit BRA-38.

<sup>1045</sup> Brazil's first written submission, para. 277.

<sup>1046</sup> Exhibit US-150.

there is also evidence that even the United States government itself has recognized, in the audit report relating to FY 2001:

"As reported, in [the] FY 1999 and 2000 financial statement audits, CCC has not yet conducted required annual reviews of fees associated with the General Sales Manager (GSM) guarantee program. As a result, the fees CCC charged for its GSM-102 and GSM-103 export credit guarantee programs have not been changed for many years and may not be reflecting current costs."<sup>1047</sup>

Since then, fees have been changed, but not substantially.<sup>1048</sup>

7.865 More importantly, evidence submitted by the United States to substantiate its assertion that there is an annual review of fees for USDA credit programmes also indicates that fees that are collected *offset* subsidy costs<sup>1049</sup> and result in a reduced "ending subsidy".<sup>1050</sup> However, *they do not come close to covering* the "subsidy cost" of the programme. The United States government itself acknowledges that the fees do not cover the subsidy cost. Indeed, the United States government also provides a "Justification for not covering the subsidy cost of the program". In respect of FY 2004, this is as follows:

"... cost information is an important basis in setting fees and re-imbursments. Pricing and costing, however, are two different concepts. Setting prices is a policy matter, sometimes governed by statutory provisions and regulations, and other times by managerial or public policies.

The current fees for GSM 102, GSM 103 and SCGP are not risk-based. There are several reasons for this. First of all, Section 211(b)(2) of the Agricultural Trade Act of 1978, as amended, caps the current fees at 1 per cent for Short-Term Credit Guarantees, as described in Section 202(a), which includes GSM 102 and SCGP. If the fees were changed to a risk-based system, this would most likely exceed 1 per cent, which would require legislative amendment. There is no statutory fee cap for GSM 103.

The US exporter currently pays a fee calculated on the dollar amount guaranteed, based on a schedule of rates applicable to different lengths of credit periods. The exporter therefore pays more for a longer term of coverage than for a shorter term. If all fees were increased to the 1 per cent maximum to offset a greater portion of the subsidy cost, all exporters would be paying the same for different coverage terms, which would favour exporters seeking longer guarantees.

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<sup>1047</sup> See USDA, Office of Inspector General, Great Plains Region, Audit Report, Commodity Credit Corporation's Financial Statements for Fiscal Year 2001, Audit Report No. 06401-4-KC, February 2002, reproduced in Exhibit BRA-154; and "USDA, Office of Inspector General Financial and IT Operations Audit Report of the CCC Financial Statements for FY 2000, Audit Report No. 06401-14-FM", June 2001, p. 31, reproduced in Exhibit BRA-153. These audit reports indicate that the CCC had not conducted the review of fees associated with the GSM guarantee programme (under OMB Circular A-129). In addition, in a similar vein to the audit report in respect of FY 2001 (Exhibit BRA-154), the audit report in respect of FY 2000 (Exhibit BRA-153) states: "We recommended in our prior audit that CCC conduct the required review of fees to assure the charges are set at levels that minimize the corporation's cost without unduly impairing these loan program's policy objectives, and ensure that these loan guarantee fees are reviewed annually in the future. In response to our recommendations, CCC stated that the Foreign Agricultural Service would work with the OCFO staff to develop a standard template for an annual review of fees."

<sup>1048</sup> Exhibit BRA-155 and Exhibit US-20.

<sup>1049</sup> We also refer to our general discussion of the *Federal Credit Reform Act* of 1990 and treatment of export credit guarantees thereunder.

<sup>1050</sup> See Exhibit US-150. CCC Export Credit Guarantee Programmes (FY 2004).

Finally, the current fee schedules for GSM 102, GSM 103 and SCGP are subject to negotiations taking place under the World Trade Organization (WTO). Once an agreement is reached under these negotiations, it is likely that the FAS will need to revise the fee structure. Changing the fee structure at this time without knowing the final outcome of these negotiations would be premature. We have however begun a study of the historical default and claims rates that will be the basis for developing options."<sup>1051</sup>

7.866 These elements indicate to us that the premiums may serve to *offset* long-term operating costs and losses to a certain degree. However, the premiums are by no means proportionate to, reflective of, nor geared towards, *covering* long-term operating costs and losses. It is the United States' government's subsidy estimates and re-estimates, and ultimately, the availability of United States government funds to cover any cost to government – rather than the premiums charged – which effectively ensure coverage of the long-term operating costs and losses of the export credit guarantee programmes.<sup>1052</sup>

7.867 We have conducted a detailed examination of the relevant evidence and argumentation submitted by the parties. On the basis of the totality of the record evidence, including approaches regularly relied upon by the United States government itself, we find that Brazil has established that the United States CCC provides the GSM 102, GSM 103 and SCGP export credit guarantee programmes "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 of Export Subsidies in Annex I of the *SCM Agreement*. Our view is based on a careful consideration of the evidence, taken as a whole, and no one element, in isolation, is determinative.

7.868 Moreover, recalling the burden of proof articulated in Article 10.3 of the *Agreement on Agriculture*, the United States has not established that it does not provide these export credit guarantee programmes at premium rates which are inadequate to cover the long-term operating costs and losses of the programmes.

7.869 We therefore find that the United States export credit guarantee programmes at issue – GSM 102, GSM 103 and SCGP – constitute a *per se* export subsidy within the meaning of item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*.

iv. Are the United States export credit guarantee programmes applied in a manner which results in, or threatens to lead to, circumvention of export subsidy commitments?

7.870 Having made this finding on the basis of the contextual guidance provided by the *SCM Agreement* relating to export credit guarantees, we consider its relevance for our examination under Article 10.1 of the *Agreement on Agriculture*. That provision refers to "export subsidies" not listed in paragraph 1 of Article 9. Such export subsidies "shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments."

7.871 We recall our earlier observations concerning the burden of proof under Article 10.3 of the *Agreement on Agriculture*<sup>1053</sup> and briefly summarize the parties arguments in this respect.

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<sup>1051</sup> The corresponding justification for not covering the subsidy cost in FY 2003 is substantially similar. See Exhibit US-150.

<sup>1052</sup> Our examination of the past performance of the programme sustains this finding. As we stated *supra*, para. 7.866, the consistently positive numbers in the United States budget guaranteed loan subsidy line indicate to us "... that the United States government believes, based upon its own assessment, that it may not, even over the long-term, be able to operate the export credit guarantee programmes without some net cost to government."

<sup>1053</sup> *Supra*, paras. 7.271-7.273 of Section VII:C.

7.872 **Brazil** asserts that, in respect of upland cotton and other unscheduled products, it is sufficient for Brazil to establish that export credit guarantees constituting export subsidies were provided. In respect of scheduled products, once Brazil establishes that export credit guarantees constituting export subsidies were provided in excess of United States quantitative reduction commitments, the United States bears the burden of proof, by virtue of Article 10.3 to prove that those excess quantities of scheduled products did not receive "export subsidies" within the meaning of Article 10.1. Brazil alleges that the United States has provided export subsidies for scheduled agricultural commodities that exceeded its quantitative reduction commitments for most scheduled commodities and that it has shown actual circumvention for at least one scheduled product, rice.<sup>1054</sup> The relevant test is not whether the measure is mandatory or discretionary, but whether there is a mechanism in the measure for CCC to stem or otherwise control the flow of CCC export credit guarantees. According to Brazil, there is not.

7.873 The **United States** submits that it is not permitted to provide any export subsidies in respect of unscheduled products, but that it is in compliance with its scheduled quantitative reduction commitments with respect to 12 out of the 13 scheduled commodities.<sup>1055</sup> In the United States view, under a "mandatory/discretionary" analysis, the relevant question would be whether the provisions establishing the export credit guarantee programmes mandate a breach of any WTO obligation. In the United States view, they do not, in view of the various discretionary elements in the operation of the programme that restrict the actual issuance of guarantees.

7.874 The **Panel** first examines the implications of its finding with respect to upland cotton and other unscheduled commodities in respect of which the record evidence sustains that export credit guarantees are granted. We then examine the implications with respect to certain scheduled commodities. Finally, we examine the implications with respect to other scheduled and unscheduled commodities.

a. Exports of upland cotton and other unscheduled agricultural products supported under the export credit guarantee programmes

7.875 Recalling our discussion of the applicable burden of proof, we find that Brazil has shown that export credit guarantees – constituting export subsidies within the meaning of Article 10.1 (and therefore, necessarily, not listed in Article 9.1) – have been provided under the programmes in question during the period we have examined in respect of exports of upland cotton and certain other unscheduled agricultural products.<sup>1056</sup> The United States has not shown that no export subsidy has been granted in respect of such products. We therefore conclude that, in respect of upland cotton and other such *unscheduled* agricultural products on record, the United States applies export credit guarantees constituting export subsidies in a manner which results in circumvention of its export subsidy commitments inconsistently with Article 10.1 of the *Agreement on Agriculture*.

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<sup>1054</sup> In Exhibit BRA-300, Brazil calculates the quantity of US rice exports benefiting from the 3 US export credit guarantees programmes at issue: FY 2003: 1,162, 700 metric tonnes; FY 2002: 1,236,700 metric tonnes; FY 2001: 1,180,500 metric tonnes.

<sup>1055</sup> United States' rebuttal submission, para. 183 and data in footnote 220

<sup>1056</sup> In its first written submission, para. 266, Brazil identifies upland cotton, soybeans, corn, and oilseed and oil products as unscheduled commodities in respect of which the United States has made export credit guarantees available under the challenged programmes. Brazil also refers to "all other non-scheduled commodities" and directs us to USDA "Summary of Export Credit Program Guarantee Activity", 1999-2003, reproduced in Exhibit BRA-73. See also Exhibits US-12, US-41 and BRA-299. To the extent that it identifies products within the product coverage of the *Agreement on Agriculture* that are within our terms of reference, we consider Exhibit BRA-73 to be the relevant record evidence of such products for the purposes of this dispute.

b. Exports of scheduled products supported under the programmes

7.876 Turning to United States *scheduled* agricultural products, we recall that the United States scheduled export subsidy reduction commitments are contained in Schedule XX of the United States of America, Part IV, Section II entitled "Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments".<sup>1057</sup>

7.877 In respect of *scheduled* products, Members are not subject to a general prohibition against providing export subsidies listed in Article 9.1; rather, there is a limited authorization for a limited group of Members<sup>1058</sup> to provide such subsidies up to the level of the reduction commitments specified in their Schedule. As regards scheduled products, when the specific reduction commitment levels have been reached, the limited authorization to provide export subsidies as listed in Article 9.1 is transformed, effectively, into a prohibition against the provision of the subsidies. Thus, where the United States exports an agricultural product in quantities that exceed its quantity commitment level, it will be treated for the purposes of Article 10.1 as if it has granted WTO-inconsistent export subsidies, for the excess quantities, unless it presents adequate evidence to "establish" the contrary.

7.878 Brazil initially alleged that the United States provided export subsidies for scheduled agricultural commodities that exceeded its quantitative reduction commitments for most scheduled commodities over a certain time period (July 2001-June 2002): wheat, coarse grains, rice, vegetable oils, butter, skim milk powder, cheese, other milk products, bovine meat, pig meat, poultry meat, live dairy cattle and eggs.

7.879 The United States submits that it is in compliance with its scheduled quantitative reduction commitments with respect to wheat, coarse grains, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, live dairy cattle and eggs<sup>1059</sup>; that this may also be true for vegetable oil and that, in fiscal year 2002 it would also be true for poultry meat. The United States asserts that it did not use the GSM 102 or GSM 103 programmes during 2001-2002 with respect to butter and butter oil, skim milk powder, cheese, other milk products, or eggs.

7.880 Brazil subsequently maintained that it has shown actual circumvention for at least one scheduled product: rice.<sup>1060</sup> It also asserts that it has established threat of circumvention for scheduled products stemming from the mandatory nature of the programmes and CCC's inability to stem or otherwise control the flow of CCC export credit guarantees.

7.881 We note that the United States has not specifically discharged its burden of establishing that it did not grant WTO-inconsistent export subsidies, for the excess quantities of rice exported.

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<sup>1057</sup> The United States has scheduled export subsidy reduction commitments in respect of the following thirteen commodities: wheat, coarse grains, rice, vegetable oils, butter and butter oil, skim milk powder, cheese, other milk products, bovine meat, pigmeat, poultry meat, live dairy cattle, eggs. See Schedule XX of the United States of America, Part IV, Section II, entitled "Export Subsidies: Budgetary Outlays and Quantitative Reduction Commitments", reproduced in Exhibit BRA-83 and Exhibit US-13.

<sup>1058</sup> See *supra*, footnote 843.

<sup>1059</sup> United States' rebuttal submission, para. 183 and, data in footnote 220.

<sup>1060</sup> This is the case for at least one year (July 2001-June 2002). The United States did not rebut Brazil's initial allegation in respect of this period. See, for example, footnote 150 of the United States further rebuttal submission, where the United States asserts that "[t]he only commodity with respect to which the United States did not provide ['uncontroverted' evidence that the respective quantities of exports under the export credit guarantee programmes did not exceed the applicable quantitative reduction commitment] is rice". Subsequently, in Exhibit BRA-300, Brazil calculated the quantity of United States rice exports benefiting from the three United States export credit guarantees programmes at issue: FY 2003: 1,162, 700 metric tonnes; FY 2002: 1,236,700 metric tonnes; FY 2001: 1,180,500 metric tonnes. The quantitative United States export subsidy reduction commitment (2000) for rice is 38,544 metric tonnes. See Exhibit BRA-83 and Exhibit US-13.

Therefore, we find that the United States has applied export credit guarantees constituting export subsidies within the meaning of Article 10.1 – and therefore, necessarily, not listed in Article 9.1 – in a manner which results in circumvention of export subsidy commitments in respect of this particular scheduled commodity. It has not been established, however, that such actual circumvention has resulted in respect of the twelve other United States scheduled commodities.

c. Scheduled products other than rice and unscheduled products not supported under the programmes

7.882 We next consider whether the United States export credit guarantee programmes require the provision of an "unlimited amount" of subsidies, so that scheduled commodities other than rice and unscheduled agricultural products not supported under the programmes, therefore, benefit from those subsidies when the reduction commitment levels specified in the United States' Schedule for those agricultural products have been reached.<sup>1061</sup>

7.883 If so, we would conclude that the export credit guarantee programmes constituting export subsidies within the meaning of Article 10.1 are applied in a manner that, at the very least, *threatens* to lead to circumvention of the export subsidy commitments made by the United States, under the first clause of Article 3.3 and/or Article 8, with respect to scheduled agricultural products other than rice and other unscheduled products (not supported under the programmes). However, if these programmes are not such as to necessarily create an unconditional legal entitlement to receive them, then there would not necessarily be such a threat. We therefore examine whether an unconditional statutory legal entitlement to an export credit guarantee exists in respect of such products.

7.884 The United States export credit guarantee programmes are classified as "mandatory" under the United States Budget Enforcement Act of 1990.<sup>1062</sup>

7.885 The designation of "mandatory" under United States law means basically that the spending is authorized by so-called "permanent law"<sup>1063</sup> rather than requiring annual appropriations.<sup>1064</sup> Brazil cites evidence that under mandatory credit programmes loans must be available to all eligible

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<sup>1061</sup> We recall that Article 10.1 of the *Agreement on Agriculture* provides that export subsidies not listed in Article 9.1 "shall not be applied in a manner which results in, *or* which threatens to lead to, circumvention of export subsidy commitments ..." (emphasis added). With respect to rice and to unscheduled agricultural products supported under programmes, we have found, in paragraphs 7.875 and 7.881, that the United States applies export credit guarantee programmes constituting export subsidies in a manner which *results in* circumvention of its export subsidy commitments inconsistently with Article 10.1. We consider that the "or" in Article 10.1 indicates that either one (resulting in circumvention) or the other (threatening to lead to circumvention) or both in combination would be adequate to trigger the remedies associated with this provision. We also see "resulting in circumvention" as including and exceeding the concept of "threatening to lead to circumvention". In this respect, we refer to and incorporate, *mutatis mutandis*, our findings in paragraphs 7.1494-7.1497 concerning the concept of "threat" and its relationship to the actual existence of a substantive requirement. We therefore do not believe that it is necessary to conduct any additional examination here.

<sup>1062</sup> See Exhibit BRA-295 "2004 US Budget, Federal Credit Supplement, Introduction and Table 2", stating "[...] the program's BEA classification under the Budget Enforcement Act (BEA) of 1990 as discretionary or mandatory"; and Table 2 (in which the classification "mandatory" is indicated).

<sup>1063</sup> *Supra*, Section VII:C.

<sup>1064</sup> 2 USC 661c.(c)(2), reproduced respectively in Exhibit US-11 and Exhibit BRA-117, indicates that all existing credit programmes of the CCC on 5 November 1990 are mandatory programs exempted from otherwise applicable statutory requirements of appropriations and/or modifications. Pursuant to 2 USC 661c.(e), "An outstanding direct loan guarantee (or commitment) shall not be modified in a manner that increases its costs unless budget authority for the additional cost has been provided in advance in an appropriations Act." Pursuant to 2 USC 661c.(f), "when the estimated cost for a group of direct loan guarantees for a given credit programme made in a single fiscal year is reestimated in a subsequent year, the difference between the reestimated cost and the previous cost estimate shall be displayed" separately in the budget. There is "hereby provided" permanent indefinite authority for these estimates.

borrowers.<sup>1065</sup> This evidence states that appropriations actions do not effectively control mandatory credit programmes.

7.886 This designation of "mandatory" under United States law is not, however, determinative for our examination of the nature of the measure in the context of the WTO covered agreements. Moreover, we do not believe that the "mandatory/discretionary" distinction is the sole legally determinative one for our examination of whether or not "threat" of circumvention of export subsidy commitments within the meaning of Article 10.1 of the *Agreement on Agriculture* has been proven to the required standard. This view is based, *inter alia*, on the reference in that provision to the manner in which a measure is applied, rather than the actual measure itself. We view this reference as supporting an examination as to whether the measure is actually applied in such a manner as to threaten to lead to circumvention.

7.887 The statutory requirement that the CCC "shall make available ... not less than \$5,500,000,000 in credit guarantees ..." <sup>1066</sup> does not mandate that the CCC actually *issue* any particular level of credit guarantees. <sup>1067</sup> This law requires that CCC "make available" certain guarantees. However, the actual issuance of guarantees is within the discretion of the CCC, which "may guarantee the repayment of credit made available to finance commercial export sales of [United States] agricultural commodities..." over certain time frames. <sup>1068</sup> The statute makes clear that "[e]xport credit guarantees *issued* pursuant to this section shall contain such terms and conditions as the Commodity Credit Corporation determines to be necessary." <sup>1069</sup> The statute sets out certain required determinations that the CCC must make in order to guarantee repayment, including that it must "develop, expand, or maintain the importing country as a foreign market, on a long-term basis, for the commercial sale and export of United States agricultural commodities, without displacing normal commercial sales...." <sup>1070</sup> It also sets out the purpose of the programme, to which end the CCC may use export credit guarantees authorized under the statute. <sup>1071</sup>

7.888 The statute also provides certain restrictions on the use of export credit guarantees, including that the CCC "...shall not make credit guarantees available in connection with sales of agricultural commodities to any country that the Secretary determines cannot adequately service the debt associated with such sale." <sup>1072</sup> Brazil argues that the entitlement that qualified applicants have to CCC guarantees is not curtailed by this latter requirement and that it is not relevant to stemming or otherwise controlling the flow of CCC guarantees. <sup>1073</sup> While this does not curtail the amount of guarantees that may ultimately be made available, it does indicate to us that there exists a discretion (on the part of the Secretary) to determine situations in which guarantees cannot be made available.

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<sup>1065</sup> Congressional Budget Office Staff Memorandum, *An Explanation of the Budgetary Changes under Credit Reform*, April 1991, p. 7, reproduced in Exhibit BRA-185,

<sup>1066</sup> 7 USC 5641(b)(1), reproduced in Exhibit BRA-297.

<sup>1067</sup> The Panel notes that except for programme year 1992, CCC has not since issued \$5.5 billion in guarantees in any year. Sales registrations have ranged from a low of \$2.876 billion for programme year 1997 and have generally been approximately \$3.0 billion-\$3.2 billion. See United States' further rebuttal submission, para. 201; United States' further written submission, para. 148 and accompanying table entitled CCC Export Credit Guarantee Program Levels, Annual President's Budgets and Actual Sales Registrations, Fiscal Years 1992-2004. 7 USC 5622 note, reproduced in Exhibits BRA-141 and BRA-366, indicate that the CCC shall make available for fiscal years 1996 through 2002 not less than \$1,000,000,000 of direct credits or export credit guarantees for exports to emerging markets.

<sup>1068</sup> 7 USC 5622(a)(1)(b), reproduced in Exhibit BRA-141; see also *id.* 5622(k) (imposing requirement that certain percentages "of the total amount of credit guarantees *issued* for a fiscal year [be] *issued*," not merely made available, with respect to certain products) (emphasis added).

<sup>1069</sup> 7 USC 5622(g), reproduced in Exhibits BRA-141, BRA-366.

<sup>1070</sup> 7 USC 5622(c), reproduced in Exhibits BRA-141, BRA-366.

<sup>1071</sup> 7 USC 5622(d), reproduced in Exhibits BRA-141, BRA-366.

<sup>1072</sup> 7 USC 5622(f)(1), reproduced in Exhibits BRA-141, BRA-366.

<sup>1073</sup> Brazil's comments (27 October) on Panel Question No. 142 posed to the United States, para. 91.

7.889 The statute sets out a limit on the total amount of guarantees issued in certain fiscal years with respect to "processed or high value" agricultural products, with the balance to be issued to promote the export of bulk or raw agricultural commodities (provided that this limit does not require a reduction in the total amount of credit guarantees issued for the fiscal year).<sup>1074</sup>

7.890 The regulations expand upon certain statutory provisions<sup>1075</sup>, but nothing in the regulations indicates that the CCC is *required* to issue a particular guarantee. They set forth restrictions and criteria which the CCC will apply in the exercise of its discretion to determine whether credit guarantees will be issued, and guiding country allocations and commodity allocations. There are no quantitative requirements obligating the CCC to extend any particular type or amount of guarantees in respect of any particular commodity.<sup>1076</sup>

7.891 Brazil also asserts that the fact that the CCC can deny guarantees to individuals who do not meet eligibility criteria does not affect the conclusion that the CCC cannot stem or otherwise control the flow of export credit guarantees.<sup>1077</sup>

7.892 However, we are of the view that the actual issuance of a particular export credit guarantee remains within the discretion of, and is susceptible to limitation by, the CCC. Availability of export credit guarantees is governed by allocations in effect at any one time for specific commodities and specific destinations.<sup>1078</sup> The CCC may increase allocations, and has done so<sup>1079</sup>, but there is no absolute legal *requirement* that it need necessarily do so. It has the ability to make commodity-specific allocations (although many allocations are specific as to country of destination).<sup>1080</sup> An exporter will not necessarily be entitled to an export credit guarantee in respect of exports of any product at a given time. It is the CCC which decides upon country and product allocations, which dictate the availability of guarantees to exporters. Allocations are made on a monetary basis, and do not dictate whether or not the United States may surpass its quantitative export reduction commitments in a given period (in respect of scheduled products), nor extend guarantees to other unscheduled products. The fact that they operate in conjunction with other export subsidies listed in Article 9.1 also does not necessarily lead to circumvention, at least in the case of scheduled products.

7.893 In order to pose a "threat" within the meaning of Article 10.1 of the *Agreement on Agriculture*, we do not believe that it is sufficient that an export credit guarantee programme might

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<sup>1074</sup> 7 USC 5622(k), reproduced in Exhibits BRA-141, BRA-366.

<sup>1075</sup> Exhibit US-6; Exhibit BRA-38.

<sup>1076</sup> Pursuant to 7 CFR 1493.5: "The criteria considered by CCC in reviewing proposals for specific U.S. commodity allocations within a specific country allocation will include, but not be limited to, the following: (a) Potential benefits that the extension of export credit guarantees would provide for the development, expansion or maintenance of the market in the importing country for the particular U.S. agricultural commodity under consideration; (b) The best use to be made of the export credit guarantees in assisting the importing country in meeting its particular needs for food and fiber...; (c) Evaluation, in terms of program purposes, of the relative benefits of providing payment guarantee coverage for sales of the U.S. agricultural commodity under consideration compared to providing coverage for sales of other U.S. agricultural commodities; and (d) Evaluation of the near and long-term potential for sales on a cash basis of the U.S. commodity under consideration." With respect to the SCGP, the United States agricultural commodity must be, *inter alia*, determined to be a high-value agricultural product. See Exhibit BRA-38.

<sup>1077</sup> Brazil 's comments (27 October) on Panel Question No. 142 posed to the United States, para. 90.

<sup>1078</sup> e.g., Exhibit US-12 shows examples of programme announcements issued in accordance with 7 CFR 1493.10(d). These programme announcements indicate that USDA authorizes a certain amount of credit guarantees for sales of particular commodities to particular estimations in a certain fiscal year. USDA also amends commodity eligibility.

<sup>1079</sup> See e.g. "USDA Announces \$2.8 billion in Export Credit Guarantees", FAS Press Release, 30 September 2003, reproduced in Exhibit BRA-296

<sup>1080</sup> See e.g. USDA, "Summary of FY 2003 Export Credit Guarantee Programme Activity", reproduced in Exhibit BRA-299. See also Exhibit US-41.

possibly, or theoretically, be used in a manner which threatens to lead to circumvention of export subsidy commitments.

7.894 We note that we would be entitled to take into account historical practice under the measure in order to discern its nature in terms of whether or not a "threat" arises. However, we cannot accept that, just because an export subsidy has, historically, actually circumvented within the meaning of Article 10.1 with respect to certain unscheduled and scheduled products<sup>1081</sup>, a "threat" of circumvention under Article 10.1 of the *Agreement on Agriculture* necessarily exists in respect of all other products absent a provision in the statutory and regulatory framework of a Member governing a certain measure that would *guarantee* that the measure would *always and inevitably* be used in a WTO-consistent manner (or *absolutely preclude the possibility* that the measure might *ever* be used to provide export subsidies that would contravene a Member's obligations under Article 10.1 of the *Agreement on Agriculture*).<sup>1082</sup>

7.895 We are of the view that the statutory and regulatory framework of the United States export credit guarantee programmes is such that the CCC would not necessarily be required to issue guarantees in respect of any other unscheduled agricultural product (not supported under the programmes), or in respect of scheduled agricultural products other than rice, in a manner which "threatens to lead to" circumvention of export subsidy commitments.

7.896 Keeping the applicable burden of proof in mind, we therefore decline to find that the export credit guarantee programmes at issue are generally applied to scheduled agricultural products other than rice and other unscheduled agricultural products (not supported under the programmes) in a manner which threatens to lead to circumvention of United States export subsidy commitments within the meaning of Article 10.1 of the *Agreement on Agriculture*.

v. Does Article 10.2 of the *Agreement on Agriculture* exempt export credit guarantees that are export subsidies from the anti-circumvention provision in Article 10.1 of the *Agreement on Agriculture*?

a. Text

7.897 We recall (again) that Article 3.2 of the *DSU* recognizes that interpretative issues arising in WTO dispute settlement are to be resolved through the application of customary rules of interpretation of public international law. It is well settled in WTO case law that the principles codified in Articles 31 and 32 of the *Vienna Convention on the Law of Treaties* (the "*Vienna Convention*") are such customary rules.<sup>1083</sup>

7.898 Thus, the task of interpreting a treaty provision must begin with its specific terms.

7.899 As always, we thus begin our examination with the specific terms of the text of the relevant treaty provision. Article 10.2 of the *Agreement on Agriculture* provides:

"2. Members undertake to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees

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<sup>1081</sup> See our findings *supra*, paras. 7.875 and 7.881.

<sup>1082</sup> We thus believe that the export credit guarantee programmes we are examining are of a fundamentally different nature than the mandatory and essentially unlimited subsidy (in the form of revenue forgone that is otherwise due) examined in *US – FSC*. Our examination also shows that they are of a different nature than the mandatory user marketing (Step 2) measure that we examine in paras. 7.742-7.748 and 7.1089-7.1097..

<sup>1083</sup> Article 31(1) provides in relevant part that: "A treaty shall be interpreted in good faith 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."

or insurance programmes and, after agreement on such disciplines, to provide export credits, export credit guarantees or insurance programmes only in conformity therewith."

7.900 The United States argues that the text of Article 10.2 of the *Agreement on Agriculture* reflects the deferral of disciplines on export credit guarantee programmes contemplated by Members. According to the United States, the structure and text of the *Agreement on Agriculture* reflect that Members came to no agreement with respect to substantive disciplines on export credit guarantee programmes.

7.901 We disagree with the United States view that "... the plain words of Article 10.2 ... indicate that the export credit guarantee programmes are not subject in any way to the export subsidy disciplines of that Agreement."<sup>1084</sup> Indeed, our reading of the text of Article 10.2 of the *Agreement on Agriculture*, in light of its context and the object and purpose of the Agreement, leads us to the opposite conclusion. For the reasons that follow, we view the text as clearly indicating that export credit guarantee programmes constituting export subsidies for the purposes of Article 10.1 must not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments.

7.902 The text of Article 10.2 indicates that Members have undertaken to work toward the "development of internationally agreed disciplines to govern the provision of .... export credit guarantees". It further indicates that, after agreement has been reached on such disciplines, WTO Members will be obliged to provide export credit guarantees only in conformity with such disciplines.

7.903 We recall that, in order to carve out or exempt particular categories of measures from general obligations such as the prevention of circumvention of export subsidy commitments in Article 10.1 of the *Agreement on Agriculture*, it would be reasonable to expect an explicit indication revealing such an intention in the text of the Agreement.<sup>1085</sup> Therefore, we examine the text of Article 10.2 of the *Agreement on Agriculture* in order to see whether there is a clear indication that the drafters intended to carve-out export credit guarantees in respect of agricultural products from the export subsidy disciplines in Article 10.1, or whether there is any provision that would do so.

7.904 However, we see no language in Article 10.2 which would modify the scope of application of the general export subsidy disciplines in Article 10.1 in the *Agreement on Agriculture* so as to carve out or exempt export credit guarantees from the export subsidy disciplines imposed by that Agreement. We find no textual support for the United States assertion that Article 10.2 serves to "defer disciplines" or to "except" export credit guarantee programmes from export subsidy disciplines.

7.905 The text tells us that WTO Members may not have been able to agree on new specific disciplines governing agricultural export subsidies. However, the text does *not* tell us that, in light of that, any other potentially relevant existing disciplines do not apply.

7.906 This contrasts starkly with the text of other provisions in the covered agreements, which clearly carve out or exempt certain products or measures from certain obligations that would otherwise apply pending the development of further multilateral disciplines.

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<sup>1084</sup>United States' first written submission, para. 164.

<sup>1085</sup>We find support for our reasoning in Appellate Body Reports, *US – Carbon Steel* and *US-Corrosion-Resistant Steel Sunset Review*, underlining the importance of the text and the role of cross-references and clear textual indications about the relationship between treaty provisions. Also, for example, Appellate Body Report, *EC-Sardines*, paras. 201-208; Appellate Body Report, *EC – Hormones*, para. 128, relating to the treatment of a large/significant group of measures and a fundamental treaty obligation.

7.907 For example, the text of Article 6.1(a) of the *SCM Agreement*<sup>1086</sup> specified that the presumption of serious prejudice flowing from the threshold total *ad valorem* subsidization of a product "[did] not apply to civil aircraft" since it "was anticipated that civil aircraft will be subject to specific multilateral rules. Similarly, the footnote to Article 8.2(a) of the *SCM Agreement*<sup>1087</sup> stipulates that: "Since it is anticipated that civil aircraft will be subject to specific multilateral rules, the provisions of this subparagraph *do not apply* to that product." (emphasis added) Likewise, Article XIII of the *General Agreement on Trade in Services*, entitled "Government Procurement" provides another example of a clear textual indication that certain existing disciplines *do not apply*, and that future negotiations are contemplated. That provision stipulates:

1. Articles II, XVI and XVII *shall not apply* to laws, regulations or requirements governing the procurement by governmental agencies of services purchased for governmental purposes and not with a view to commercial resale or with a view to use in the supply of services for commercial sale.
2. There shall be multilateral negotiations on government procurement in services under this Agreement within two years from the date of entry into force of the WTO Agreement. (emphasis added)"

7.908 These provisions in the covered agreements show us that the Uruguay Round drafters were well aware of how to take into account the prospect of development of international disciplines in certain areas following the completion of the Uruguay Round, and of how to specify in the text of the covered agreements that existing disciplines *did not apply* in a certain situation pending the negotiation of future disciplines that would then govern. Where the negotiators intended to carve out certain measures from the existing disciplines imposed by an agreement, including pending the development of further multilateral or internationally agreed disciplines, they demonstrated that they knew how to do so. They inserted clear textual guidance to this effect.<sup>1088</sup>

7.909 However, Article 10.2 contains no such explicit textual indication that the existing disciplines do not apply pending the negotiation of the internationally agreed disciplines to which Article 10.2

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<sup>1086</sup>We realize that this provision has now lapsed, by virtue of the operation of Article 31 of the *SCM Agreement*. Members took no action to extend the application of the provisions of this provision, nor of Articles 8 and 9 concerning non-actionable subsidies beyond the period of five years from the date of entry into force of the *WTO Agreement*. However, these provisions can nevertheless be instructive in understanding the overall architecture of the Agreement with respect to the different types of subsidies it sought and seeks to address. We recall that the Decision by the Arbitrator in *US – FSC (Article 22.6 – US)*, footnote 66, expressed a similar view.

<sup>1087</sup>*Ibid.*

<sup>1088</sup>We find other examples in the covered agreements of explicit guidance as to the temporal application of obligations pending the development of additional rules in other covered agreements.

For example, Article 9 of the *Agreement on Rules of Origin*, in Part IV of that Agreement, provides: "With the objectives of harmonizing rules of origin and, *inter alia*, providing more certainty in the conduct of world trade, the Ministerial Conference shall undertake the work programme set out below in conjunction with the CCC, on the basis of the following principles:..". Part II of that Agreement is entitled "Disciplines to Govern the Application of Rules of Origin". It contains two provisions. Article 2 is entitled "Disciplines During the Transition Period". Article 3 is entitled "Disciplines after the Transition Period". This provides a clear textual indication of the disciplines that apply pending the development of further disciplines.

Similarly, in the *General Agreement on Trade in Services*, Article XI provides for "multilateral negotiations on the question of emergency safeguard measures based on the principle of non-discrimination. The results of such negotiations shall enter into effect on a date not later than three years from the date of entry into force of the WTO Agreement." Article X:2 provides guidance for the situation "in the period before the entry into effect of the results of the negotiations [...]". Article XV of the *General Agreement on Trade in Services* obliges Members to "enter into negotiations with a view to developing the necessary multilateral disciplines to avoid such trade distortive effects [...]". It does not, however, contain any explicit carve-out from any other potentially relevant and applicable subsidy disciplines.

refers. There is no footnote stating that the obligations in Article 10.1 "do not apply" pending development of future internationally agreed disciplines. Nor is there any type of introductory caveat to Article 10.2, such as "except as provided in Article 10.1..."; "notwithstanding the provisions of Article 10.1..."; or "Nothing in any other provision of the Article 10 shall mean that the existing disciplines governing agricultural export credit guarantees do not apply to export credit guarantees on agricultural products..."<sup>1089</sup>

7.910 There is not even any indication along the lines of the caveat in Articles 5 and 6.9 of the *SCM Agreement*, which both stipulate that they do "not apply to subsidies maintained on agricultural products as provided in Article 13 of the *Agreement on Agriculture*". In turn, Article 13(c)(ii) of the *Agreement on Agriculture* explicitly indicates that certain measures are "exempt from actions" based on certain provisions of the *SCM Agreement* and Article XVI of the *GATT 1994* upon fulfilment of certain conditions.<sup>1090</sup>

7.911 The absence in Article 10.2 of such an explicit stipulation supports our view that the general export subsidy anti-circumvention disciplines apply pending development of the "internationally agreed disciplines" referred to in Article 10.2 of the *Agreement on Agriculture*. While those internationally agreed disciplines are under negotiation, the general disciplines on export subsidies included in the *Agreement on Agriculture* (and, subject to the provisions of Article 13(c) and the terms of the *SCM Agreement*, the export subsidy prohibition in Article 3 of the *SCM Agreement*) apply. Members have agreed to undertake to work toward the development of internationally agreed disciplines. If Members *do* conclude an agreement on these specific disciplines, the second part of Article 10.2 would be triggered (or, more likely, would be taken into account and modified by the specific disciplines) following any appropriate action by WTO Members.

b. Context, object and purpose

7.912 Our interpretation of the text finds support in the immediate context of Article 10.2, as well as in the object and purpose. Article 10.2 is a sub-paragraph of Article 10, which is entitled "Prevention of Circumvention of Export Subsidy Commitments". Article 10.1 refers to export subsidies "applied in a manner which *results in*, or which *threatens to lead to*, *circumvention* of export subsidy commitments". (emphasis added) The verb "circumvent" means, *inter alia*, "find a way round, evade...".<sup>1091</sup> The title of Article 10, and the text of Article 10.1, indicates an intention to prevent Members from circumventing or "evading" their "export subsidy commitments".<sup>1092</sup> Under Article 10.1, it is not necessary to demonstrate *actual* "circumvention" of "export subsidy commitments". It suffices that "export subsidies" are "applied in a manner which ... *threatens to lead to circumvention* of export subsidy commitments".

7.913 In response to questioning, the United States asserts that "export credit guarantees are not subsidies" within the meaning of Articles 9.1 or 10.1 of the *Agreement on Agriculture*, and that Article 13(c) therefore does not apply to them.<sup>1093</sup>

7.914 Again, we recall that, it is well-established in the WTO, and, prior to that, in the GATT, that export credit guarantees may generally constitute export subsidies. This possibility was already

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<sup>1089</sup> Nor do other provisions of Article 10 contain such a carve out or exemption, such as "Nothing in this provision shall mean that export credit guarantees may constitute export subsidies ...".

<sup>1090</sup> See *supra*, para. 7.5 of Section VII:A, which reproduces an excerpt from the 20 June 2003 communication from the Panel.

<sup>1091</sup> *The New Shorter Oxford English Dictionary*, (1993).

<sup>1092</sup> Appellate Body Report, *US – FSC*, para. 148.

<sup>1093</sup> United States' response to Panel Question No. 88(c).

identified in the Illustrative List of Export Subsidies incorporated in the *Tokyo Round Subsidies Code*, and had already been acknowledged by the 1960 Working Party.<sup>1094</sup>

7.915 Moreover, the entirely unreasonable implications of the approach advocated by the United States before us can be demonstrated by the following proposition, which takes the United States argument to its logical extreme. If, by virtue of Article 10.2, there are currently no disciplines on agricultural export credit guarantees, a WTO Member may therefore extend agricultural export credit guarantee without charging *any* premium whatsoever, for an indefinite period, for an infinite amount, and with or without any other conditions that a Member may wish. In our view, Members would have found "a way round", a way to "evade", their commitments under Articles 3.3 and 9.1, if they could make available, in the form of export credit guarantees, export incentives that they are prohibited from providing through other methods under the first clause of Article 3.3 and under Article 9.1.<sup>1095</sup>

7.916 The Panel put this proposition to the United States, and asked how the United States view of Article 10.2 would reconcile with the title of Article 10 ("Prevention of Circumvention of Export Subsidy Commitments").<sup>1096</sup>

7.917 The United States submitted that Article 10.2 applies only to export credit guarantees "properly characterized as such", and then lists a number of characteristics which, in the United States view, compel characterization of the programmes as export credit guarantees benefiting from a deferral of any disciplines by virtue of Article 10.2: "export credit guarantees are offered pursuant to programs which charge premiums; impose limits on tenor; impose limits on exposure to individual bank obligations; impose limits on exposure to risk of default from different countries; define shipping periods; and issue allocations (value limitations) of potential guarantee availability for specific commodities to be exported to specific destinations" and guaranteeing only a relatively small portion of the interest. Consequently, the United States asserts, "participants remain exposed to a significant component of the overall risk of default". According to the United States, "[i]llegitimate attempts to characterize export subsidy programmes as export credit guarantee programmes would be subject to the anti-circumvention provisions of Article 10.1...".<sup>1097</sup>

7.918 However, we see no indication in the text of the provision that only certain types of export credit guarantees – those meeting certain criteria relating to premiums or tenor or limitation of risk exposure – may benefit from a deferral of disciplines, while certain other types – those not meeting such criteria – would not. The text of Article 10.1 refers to "export subsidies". The text of Article 10.2 refers to "export credit guarantees". No further details or specific definitional elements exist that would serve as a textual basis for the United States view. The only question to be asked is whether or not export credit guarantees constitute export subsidies for the purposes of Article 10.1, and not whether a Member's agricultural export credit guarantees may or may not be of a type that would benefit from a deferral of disciplines.

7.919 Further context for Article 10 is found in Article 9.1 of the *Agreement on Agriculture*. Article 9.1 of the *Agreement on Agriculture* lists a number of specifically identified export subsidies.

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<sup>1094</sup> See *supra*, para. 7.806.

<sup>1095</sup> We note that the text of Article 10.2 is not limited to export credit guarantees, but also refers to "export credits" and "export credit insurance programmes". Logically, the implications of any analysis of the meaning of Article 10.2 for export credit guarantees would also have to be tenable in the context of export credits. Under the United States' approach, a Member could provide an agricultural export credit at zero per cent interest for a term of, for example, 50 years. We do not view this as a reasonable interpretation of Article 10.2, particularly in light of the provisions of Article 10.1.

<sup>1096</sup> United States' response to Panel Question No. 88(b).

<sup>1097</sup> United States' response to Panel Question No. 88(b).

The terms "export credit guarantees" do not explicitly appear in the text listing such practices.<sup>1098</sup> The United States asserts: "Conspicuously absent in Article 9.1 is any provision addressing such practices, even though US export credit guarantee programmes had been in existence for nearly fifteen years preceding the inception of obligations under the WTO."<sup>1099</sup>

7.920 We acknowledge that Article 9.1 of the *Agreement on Agriculture* sets forth a list of six specific practices known to the drafters and deemed to constitute export subsidies under the *Agreement on Agriculture*. However, the existence of such a list does not negate the possibility that other forms of export subsidies might exist, apart from those that appear in the list. If this were not the case, there would have been no need for the drafters to have included Article 10, which deals with export subsidies "not listed in paragraph 1 of Article 9". Article 10 exists precisely to prevent circumvention of export subsidy commitments through the use of export subsidies not listed in Article 9.1. Furthermore, if Members had intended to defer export subsidy disciplines on export credit guarantees, they would have done so. In contrast to the United States argument that some sort of implicit permission was maintained with respect to export credit guarantees in the drafting history of Article 9.1, we find an express obligation in the final text of Article 10.1 of the *Agreement on Agriculture*.

7.921 Article 3.3 of the *Agreement on Agriculture* prohibits the use of export subsidies listed in Article 9.1: (i) in excess of reduction commitment levels in the case of scheduled products; and (ii) in respect of non-scheduled products. It does not cover other types of export subsidies. The parties to this dispute agree that Article 8 of the *Agreement on Agriculture*, pursuant to which Members undertake "not to provide export subsidies otherwise than in conformity with this Agreement and with the commitments as specified in that Member's Schedule" serves to prohibit the use of *listed and non-listed* export subsidies in excess of reduction commitment levels in the case of scheduled products and to prohibit the use of export subsidies otherwise than in conformity with reduction commitments and the provisions of the Agreement.<sup>1100</sup>

7.922 The final clause of Article 10.1 reads: "nor shall non-commercial transactions be used to circumvent such commitments." The United States argues that instead of making any connection between "non-commercial transactions" and export credit guarantees (by, for example, providing guidance as to when export credit guarantees might be considered to be on "commercial" or "non-commercial terms"), the Members agreed in Article 10.2 to provide wholly distinct treatment to export credits, export credit guarantees and insurance.<sup>1101</sup> However, we understand the reference in this final clause of Article 10.1 to refer, *inter alia*, to international food aid. In this respect, Article 10.4<sup>1102</sup> provides additional guidance with respect to international food aid, setting out criteria,

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<sup>1098</sup> As we have noted, the parties to this dispute agree that Article 9.1 does not apply to export credit guarantees and that Article 10 is the relevant provision for our analysis. Our examination is therefore without prejudice to the interpretation of Article 9.

<sup>1099</sup> United States' response to Panel Question No. 74.

<sup>1100</sup> See Brazil's and the United States' respective responses to Panel Question No. 219.

<sup>1101</sup> United States' response to Panel Question No. 219.

<sup>1102</sup> Article 10.4 of the *Agreement on Agriculture* reads:

"Members donors of international food aid shall ensure:

- (a) that the provision of international food aid is not tied directly or indirectly to commercial exports of agricultural products to recipient countries;
  - (b) that international food aid transactions, including bilateral food aid which is monetized, shall be carried out in accordance with the FAO 'Principles of Surplus Disposal and Consultative Obligations', including, where appropriate, the system of Usual Marketing Requirements (UMRs);
- and

including references to certain internationally agreed disciplines, which might help to identify when international food aid might be considered to constitute an export subsidy for the purposes of the anti-circumvention disciplines of Article 10.1. We see no contradiction between this and an interpretation of Articles 10.1 and 10.2 whereby, in contrast to Article 10.4, Article 10.2 contains no additional substantive criteria, but nevertheless identifies the possibility that export credit guarantees may constitute export subsidies within the meaning of Article 10.1.

7.923 Still further context is found in item (j) of the Illustrative List of Export Subsidies, included in Annex I of the *SCM Agreement*. This item explicitly refers to export credit guarantee programmes, and offers criteria to assess whether such programmes constitute *per se* export subsidies. The United States asserts that this Illustrative List, including item (j), had previously formed part of the *Tokyo Round Subsidies Code*. For the United States, the fact that Members had agreed on item (j) and yet, in Article 10.2, agreed to "undertake to work toward *the development* of internationally agreed disciplines to govern the provision of export credits, export credit guarantees" and, once agreed, only to provide export credit guarantee programmes "in conformity with" such developed and agreed disciplines, suggests that item (j) does not impose disciplines on export credit guarantees for agricultural goods.

7.924 We do not agree. The existence of item (j) and its direct reference to, and disciplines upon, export credit guarantees does not support the United States view. In item (j), there is a recognition that export credit guarantee programmes may constitute export subsidies *per se*, and a test is provided to identify when they do so: when premiums are inadequate to cover long-term operating costs and losses. The inclusion of a reference to agricultural export credit guarantee programmes in the context of Article 10 supports the conclusion that Members were very well aware of the possibility that such export credit guarantees may constitute export subsidies *per se* and that Members were, in fact, concerned about the potential for such programmes to circumvent Members' export subsidy reduction commitments. Members therefore undertook to develop disciplines specific to agricultural export credit guarantees. They did not, however, carve out such export credit guarantees from otherwise applicable disciplines.

7.925 The existence of disciplines on export credit guarantee programmes would not render the internationally agreed disciplines envisioned by Article 10.2 unnecessary nor irrelevant. Rather, the purpose of any eventual disciplines could be further to facilitate the determination of when export credit guarantee programmes in respect of agricultural products constitute export subsidies *per se* by developing and refining existing disciplines. Pending the development of such disciplines, certain guidance already exists as to when export credit guarantees constitute export subsidies *per se*.<sup>1103</sup> Such a reading of Article 10.2, in the context of Article 10.1, allows both provisions to have full meaning and does not reduce either to inutility.

7.926 Article 10.2 sets out an intention on the part of Members to undertake to work toward the development of internationally agreed disciplines regarding agricultural export credit guarantees. The expression of this undertaking, however, does not amount to a fiat to use those measures to confer export subsidies without consequence and without limit. Admittedly, as the United States has argued, the provision does not explicitly indicate that the disciplines which Members have committed themselves to developing would apply *in addition to* disciplines which already exist.<sup>1104</sup> However, such an explicit indication is not necessary in light of the unqualified wording of the provision, and its

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(c) that such aid shall be provided to the extent possible in fully grant form or on terms no less concessional than those provided for in Article IV of the Food Aid Convention 1986."

<sup>1103</sup> We refer to our examination above concerning the contextual guidance available in the *SCM Agreement* (i.e. item (j) of the Illustrative List of the *SCM Agreement*), leading to the finding in para. 7.869.

<sup>1104</sup> See the United States' first written submission, para. 164.

context. While Article 10.1 currently provides the discipline in the *Agreement on Agriculture* on the use of export credit guarantee programmes, the work envisaged in Article 10.2 would presumably elaborate further and more specific disciplines that could facilitate identification of the extent to which such export credit guarantee programmes constitute export subsidies, or to what extent export credit guarantee programmes are not permitted. Such rules might, for example, provide more precise rules applicable to all export credit guarantees, irrespective of a Member's reduction commitments under the *Agreement on Agriculture*.

7.927 Our interpretation is not tantamount to saying that agricultural export credit guarantees will *always* constitute export subsidies. It simply means that when an agricultural export credit guarantee meets the definition of "export subsidy" for the purposes of Article 10.1, it will be subject to the anti-circumvention disciplines imposed by that provision.

c. Subsequent practice

7.928 The United States also invokes Article 31(3)(b) of the *Vienna Convention*<sup>1105</sup>, arguing that "subsequent practice" supports the view that disciplines on agricultural export credit guarantees were deferred. According to the United States, such "subsequent practice" is evident in the years of negotiations to develop internationally agreed disciplines immediately following the conclusion of the WTO Agreement<sup>1106</sup> under the auspices of the Organization for Economic Co-operation and Development (OECD)<sup>1107</sup> and subsequently within the WTO itself under the mandate of the Doha Ministerial Declaration.<sup>1108</sup>

7.929 The record in these Panel proceedings does not suggest that there is a discernible pattern of acts or pronouncements implying an agreement among WTO Members on the United States' interpretation of Article 10.2.<sup>1109 1110</sup>

7.930 However, even assuming that the United States has identified a "concordant, common and consistent" sequence of acts or pronouncements which is sufficient to establish a discernible pattern implying the agreement of the parties to a treaty regarding its interpretation<sup>1111</sup>, we understand that such practice would consist precisely of an implementation by Members of their undertaking in

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<sup>1105</sup> Article 31.3(b) of the *Vienna Convention* provides: "There shall be taken into account, together with the context: [...] any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation".

<sup>1106</sup> United States' rebuttal submission, para. 135.

<sup>1107</sup> Exhibit US-7 contains document TD/CONSENSUS(2000)25/REV4, Arrangement on Officially Supported Export Credits: *The Chairman's Revised Proposal for a Sector Understanding on Export Credits for Agricultural Products*, dated 9 July 2002.

<sup>1108</sup> WT/MIN(01)/DEC/1. Exhibit US-8 contains a Cairns Group "Negotiating Proposal on Export Competition" submitted to the Informal Meeting of the Special Session of the Committee on Agriculture, 18-20 November 2002, containing proposals relating to, *inter alia*, export credit guarantees. Exhibit US-9 contains document TN/AG/W/1/Rev.1, "Negotiations on Agriculture, First Draft of Modalities for the Further Commitments", addressing, *inter alia*, export credit guarantees in the context of export competition and export subsidies. Exhibit US-10 contains document G/AG/NG/W/139-G/AG/W/50, "Export Credits for Agricultural Products", Proposal by MERCOSUR (Argentina, Brazil, Paraguay and Uruguay), Bolivia, Chile, Costa Rica, Guatemala, India and Malaysia).

<sup>1109</sup> We note that neither Brazil nor any of the third parties that expressed a view on this matter agree with the United States' arguments in these Panel proceedings.

<sup>1110</sup> We note that no revisions to, nor universally agreed interpretations of, the relevant provisions of the *Agreement on Agriculture* (including within the meaning of Article 10 of the *WTO Agreement*) have, as yet, resulted from the WTO negotiations launched on the basis of the Doha Ministerial Declaration. It is certainly not our task to prejudge, or to try to predict the scope and content of, any future results of those negotiations.

<sup>1111</sup> See Appellate Body Report, *Japan – Alcoholic Beverages II*, para. 107. See Appellate Body Report, *Chile – Price Band System*, para. 213.

Article 10.2 "to work toward the development of internationally agreed disciplines to govern the provision of export credits, export credit guarantees or insurance programmes ...".

7.931 Subsequent practice, if any, clearly and indisputably demonstrates that Members are attempting to develop internationally agreed disciplines. It does not reflect any concession or agreement that there are no current rules in this area. We therefore disagree with the United States' argument that "subsequent practice" supports the proposition that there are presently no disciplines in place.

7.932 In brief, our examination of the text of Article 10.2 in light of its context and the object and purpose indicates that there is no justification for the United States' approach. Nowhere does the *Agreement on Agriculture* define "export credit guarantees", exempt export credit guarantees from the definition of export subsidies, nor enumerate characteristics which might serve to exempt certain export credit guarantees constituting export subsidies from the disciplines of Article 10.1. If the drafters had intended to ensure that agricultural export credit guarantees were *never* to be considered export subsidies, they would have clearly so indicated. However, they have not done so.

#### d. Drafting history

7.933 We believe that our examination of the text of Article 10.2 of the *Agreement on Agriculture*, in its context and in light of the object and purpose of that agreement leads to a clear interpretation of the text.<sup>1112</sup> However, as the United States has relied upon the drafting history of Article 10.2, and of related provisions, to support its argument that Article 10.2 defers any disciplines on agricultural export credit guarantees<sup>1113</sup> we consider that it is also appropriate for us to point out that nothing in the drafting history of the provision would compel us to reach a different conclusion. Indeed, it confirms our interpretation.

7.934 The drafting history included in the record of these Panel proceedings reflects that, in July 1990, the Framework Agreement on Agriculture Reform Programme ("DeZeeuw Text") was circulated. Paragraph 20(e) of that draft text contemplated that Members would provide "data on financial outlays or revenue forgone ... in respect of export credits provided by governments or their agencies on less than fully commercial terms." Under paragraph 22, that draft envisaged concurrent negotiations to govern the use of export assistance, including "disciplines on export credits". Beyond a general reference to "export credits", there was no express reference to export credit guarantees or export credit guarantee programmes.

7.935 In June 1991, a Chairman's Note on Options in the Agriculture Negotiations was circulated. In paragraph 48 of that Note, the Chairman identified "Other key issues on which at least in principle decisions are needed are whether subsidised export credits and related practices ... would be subject to

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<sup>1112</sup> A treaty interpreter may take account of a treaty negotiating history in certain circumstances. Article 32 of the *Vienna Convention on the Law of Treaties* provides:

"Article 32

*Supplementary means of interpretation*

Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of article 31, or to determine the meaning when the interpretation according to article 31:

- (a) leaves the meaning ambiguous or obscure; or
- (b) leads to a result which is manifestly absurd or unreasonable."

<sup>1113</sup> See, e.g. United States' rebuttal submission, paras. 131 *ff.* At the second Panel meeting, we asked the United States to present its detailed argument orally concerning the drafting history, including Exhibits US-25-30.

reduction commitments." The Chairman requested decisions by the principals on "whether subsidized export credits and related practices ... would be subject to reduction commitments unless they meet appropriate criteria to be established in terms of the rules that would govern export competition."

7.936 Subsequently, in August 1991, the Chairman circulated a series of addenda on the Note on Options "aimed at exploring certain options in greater detail".<sup>1114</sup> Included among the addenda was Addendum 10 on "Export Competition: Export Subsidies to be subject to the terms of the Final Agreement".<sup>1115</sup> Section 3 of that Addendum, in paragraph 48, sets out a proposed "Illustrative List of Export Subsidy Practices." Item (h) refers explicitly to "Export credits provided by governments or their agencies on less than fully commercial terms." More relevantly, item (i) refers explicitly to: "Subsidized export credit guarantees or insurance programs."

7.937 In December 1991, the Chairman circulated for discussion a "Draft Text on Agriculture".<sup>1116</sup> Article 8.2 of that Draft Text lists "export subsidies" that "are subject to reduction commitments under this Agreement", somewhat resembling the current Article 9.1 of the *Agreement on Agriculture*.<sup>1117</sup> Article 9.1 of the Draft Text, similar to Article 10.1 of the current Agreement, provides that "Subsidies contingent on export performance that are not listed in Article 8.2...shall not be applied in a manner which results in, or which threatens to lead to, circumvention of export subsidy commitments; nor shall non-commercial transactions be used to circumvent such commitments." Paragraph 3 of Article 9 of that Draft Text states: "For the purposes of this Article, whether export credits, export credit guarantees or insurance programmes provided by governments or their agencies constitute export subsidies shall be determined on the basis of paragraphs (j) and (k) of Annex 1 to the [SCM Agreement]."

7.938 Shortly thereafter, the Chairman of the Trade Negotiations Committee issued the "Draft Final Act Embodying the Results of the Uruguay Round of Multilateral Trade Negotiations".<sup>1118</sup> The paragraph 3 of Article 9 that had appeared in the previous draft text was omitted. Article 10.2 of the Draft Final Act read as follows:

"Participants undertake not to provide export credits, export credit guarantees or insurance programs otherwise than in conformity with internationally agreed disciplines."

7.939 This draft language was subsequently replaced by the current final text of Article 10.2. The revisions that occurred do not, in our view, establish that the drafters of the final text of Article 10.2 intended to defer the application of any and all disciplines on agricultural export credit guarantees.

7.940 Rather, the current text of Article 10.2 of the *Agreement on Agriculture* reflects that, while Members may not have agreed on any new specific disciplines for agricultural export credit guarantees, they nevertheless undertook to engage in the development of such internationally agreed disciplines. They did not, however, explicitly indicate any intention to carve out the application of other, existing disciplines. The omission of paragraph 3 of Article 9 of the December 1991 Draft Text is consistent with a decision that the words were mere surplusage, because export credits, export credit guarantees and insurance programmes were within the disciplines on export subsidies according to the terms of the agreement captured. The omission is much less consistent with a decision to exclude such programmes from the disciplines altogether, considering the clear textual ability of the

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<sup>1114</sup> MTN.GNG/AG/W/1/Add.1 (2 August 1991), reproduced in Exhibit US-27.

<sup>1115</sup> MTN.GNG/AG/W/1/Add.10 (2 August 1991), reproduced in Exhibit US-27.

<sup>1116</sup> Exhibit US-28.

<sup>1117</sup> Exhibit US-28. Annex 7 of that draft text lists export subsidies that shall be subject to reduction commitments.

<sup>1118</sup> MTN.TNC/W/FA (20 December 1991), reproduced in Exhibit US-29, contains the draft text of the Draft Final Act pertaining to Agriculture.

disciplines to extend to such programmes and the lack of any attention to an explicit carve-out of such programmes from the disciplines.

7.941 The United States notes that, as part of the negotiations, Members had to prepare and submit schedules of quantities and budget outlays during a base period to derive the export subsidy reduction commitments ultimately reflected in the respective schedules of the Members. The United States argues that had Members' export credit guarantees been considered export subsidies for these purposes from the outset then the export credit guarantee activity during the relevant period would also have to have been added to the base figures from which each Member's export subsidy reduction commitments were calculated.<sup>1119</sup> According to the United States, the base period export subsidy quantity in Schedule XX of the United States for each commodity would have been much larger. The size of the quantities involved in the export credit guarantee programmes during the 1986-90 period indicate it obviously understood that export credit guarantees were not subject to export subsidy commitments. The amount of exports involved was obviously very significant and would have meant a significant difference in the level of export subsidy reduction commitments from which all Members would now be negotiating.<sup>1120</sup>

7.942 We cannot accept this view of one Member as representative of an agreed interpretation or understanding of all Members. As this dispute demonstrates, there is a difference of view between the United States and the other WTO Members that are parties and third parties concerned on this very point. As indicated in Article 3.2 of the *DSU*, a primary rationale of the dispute settlement system established by the *WTO Agreement* is to clarify the existing provisions of the covered agreements in accordance with customary rules of interpretation of public international law. Our analysis, applying those interpretative rules, indicates to us that the text of the *Agreement on Agriculture*, as finally negotiated, does not support the United States' view.

7.943 Having examined the WTO-consistency of the export subsidies for agricultural products, in the first place, under the *Agreement on Agriculture*, we observe that, in accordance with Article 13(c)(ii) of the *Agreement on Agriculture*, to the extent that the United States does not conform fully with its export subsidy commitments under Part V of the *Agreement on Agriculture*, it is susceptible to challenge under Articles 3.1(a) and 3.2 of the *SCM Agreement* and Article XVI of the *GATT 1994*.

7.944 In the alternative, if we were to accept the United States argument that export credit guarantees cannot constitute export subsidies for the purposes of the *Agreement on Agriculture* and that the export subsidy disciplines in Article 10.1 of the *Agreement on Agriculture* do not apply to export credit guarantees, then export credit guarantees cannot "conform fully to the provisions of Part V" of that Agreement within the meaning of Article 13(c)(ii) of the Agreement. That is, they are not "export subsidies" for the purposes of the Agreement, and it is, in any event, conceptually not possible to conform with non-existent disciplines and trigger the exemption from action provided for in Article 13(c).<sup>1121</sup> They would thus not be "exempt from actions" based on Article 3 of the *SCM Agreement* (and Article XVI of the *GATT 1994*) within the meaning of Article 13(c)(ii) of the *Agreement on Agriculture*.

7.945 Having made these findings, we will now examine Brazil's claims based upon the export subsidy provisions of the *SCM Agreement*.<sup>1122</sup>

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<sup>1119</sup> United States' rebuttal submission, paras. 147-148.

<sup>1120</sup> United States' rebuttal submission, para. 149.

<sup>1121</sup> We note that the panel in *Canada – Aircraft (Article 21.5 – Brazil)* was of the view that conformity with certain disciplines could only occur when those disciplines actually *applied* to the measure in question. See Panel Report, *Canada – Aircraft (Article 21.5 – Brazil)*, paras. 5.143-5.145.

<sup>1122</sup> See *supra*, Section VII:C, "Order of analysis", as well as this Section's overview of the relationship between these provisions.

(ii) *Claims under Article 3.1(a) (and 3.2) of the SCM Agreement*

7.946 We have conducted a "contextual" analysis under item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement* for the purposes of determining whether or not an export subsidy exists within the meaning of Article 10.1 of the *Agreement on Agriculture*.<sup>1123</sup> We see no reason, and none has been pointed out to us in these Panel proceedings, why this analysis may not also be applied directly in an examination of the merits of Brazil's claims under item (j)/Article 3.1(a) of the *SCM Agreement* in respect of the export credit guarantee programmes in this factual situation.

7.947 We take into account the substantive relationship between the export subsidy provisions of the *Agreement on Agriculture* and the *SCM Agreement*<sup>1124</sup>, including that Article 3.1(a) of the *SCM Agreement* applies "[e]xcept as provided in" the *Agreement on Agriculture*. To the extent that the United States export credit guarantee programmes at issue – GSM 102, GSM 103 and SCGP – do not conform fully to these provisions in Part V of the *Agreement on Agriculture* and do not benefit from the exemption from actions provided by Article 13(c)(ii) of the *Agreement on Agriculture*, they are also export subsidies prohibited by Article 3.1(a) for the reasons we have already given.<sup>1125</sup>

7.948 Article 3.2 of the *SCM Agreement* provides: "A Member shall neither grant nor maintain subsidies referred to in paragraph 1" of Article 3. To the extent that the three United States export credit guarantee programmes at issue are inconsistent with Article 3.1(a), they are, consequently, also inconsistent with Article 3.2 of the *SCM Agreement*.

## 6. FSC Repeal and Extraterritorial Income (ETI) Act of 2000

### (a) Main arguments of the parties

7.949 **Brazil** reiterates the claims and arguments made by the European Communities under the *Agreement on Agriculture* and the *SCM Agreement* against the *FSC Repeal and Extraterritorial Income Act of 2000* (the "ETI Act of 2000") upheld by the panel and Appellate Body in the *US - FSC (Article 21.5 - EC)* dispute. In that dispute, both the panel and Appellate Body found that the ETI Act of 2000 violates Articles 8 and 10.1 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*. Brazil requests the Panel to apply the reasoning as developed by that panel, and as modified by the Appellate Body, in that case *mutatis mutandis*<sup>1126</sup>, in order to find that the ETI Act of 2000 violates Articles 8 and 10.1 of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement*.<sup>1127</sup>

7.950 Brazil submits that the ETI Act of 2000 provides an export subsidy to upland cotton. According to Brazil, this Act eliminates tax liabilities for exporters who sell products, including upland cotton, in foreign markets. The tax concessions provided under the ETI Act of 2000 constitute export subsidies within the meaning of Article 10.1 of the *Agreement on Agriculture*. The ETI Act of 2000 threatens to circumvent the United States export subsidy commitments by providing an export subsidy to upland cotton despite the fact that the United States does not have any export subsidy reduction commitments for upland cotton in violation Articles 8 and 10.1. As the ETI Act of 2000 subsidies do not fully conform to Part V of the *Agreement on Agriculture*, there is no "peace clause"

<sup>1123</sup> This led to our finding *supra*, para. 7.869

<sup>1124</sup> See, for example, our discussion of that relationship, *supra*, paras. 7.654-7.677.

<sup>1125</sup> We recall that Article 3.1(a) of the *SCM Agreement* sets out a prohibition on subsidies contingent upon export performance, "including those illustrated in Annex I". Annex I - the Illustrative List of Export Subsidies - contains item (j). We have found that the challenged United States export credit guarantee programmes meet the definitional elements of a *per se* export subsidy in item (j). As they are among those "illustrated in Annex I" for the purposes of Article 3.1(a), they are included in the subsidies contingent upon export performance prohibited by Article 3.1(a) of the *SCM Agreement*.

<sup>1126</sup> Brazil's first written submission, para. 327.

<sup>1127</sup> Brazil's first written submission, para. 352.

exemption from actions under the *SCM Agreement*. The ETI Act of 2000 also constitutes a prohibited export subsidy within the meaning of Articles 3.1(a) and 3.2 of the *SCM Agreement*.<sup>1128</sup>

7.951 The **United States** asserted early in the proceedings that Brazil failed to make a prima facie case with respect to the ETI Act of 2000. Brazil's approach would put the Panel in the position of having to violate its obligation under Article 11 of the *DSU* to "make an *objective assessment of the matter* before it, including an *objective assessment of the facts* of the case and the *applicability of and conformity with* the relevant covered agreements" (emphasis added). As a result of Brazil's "*mutatis mutandis*" approach, the Panel is in no position to exercise its judgment to follow, or decline to follow, prior dispute settlement findings concerning the ETI Act of 2000, nor even in a position to make factual findings concerning the Act. In the absence of a prima facie case by Brazil, the United States submits that the Panel should reject Brazil's claims concerning the ETI Act of 2000.<sup>1129</sup>

7.952 The United States asserted that it was confident that the ETI Act of 2000 would be repealed in the reasonably near future.<sup>1130</sup>

(b) Main arguments of the third parties

7.953 With respect to the export subsidies granted to upland cotton under the ETI Act of 2000 which provide fiscal incentives in respect of United States exports, **Argentina** recalls that the ETI Act of 2000 was found to be inconsistent with Article 3.1(a) of the *SCM Agreement* and Articles 10.1 and 8 of the *Agreement on Agriculture*.<sup>1131</sup>

7.954 **China** submits that the panel and Appellate Body's reasoning and their conclusion in *US – FSC (Article 21.5 – EC)* concerning the very same ETI Act of 2000 are of "extraordinary value" to the Panel. Any substantive deviation from the reasoning and conclusions in the earlier case may disturb and offend Members' legitimate expectations<sup>1132</sup> created through the adopted dispute settlement reports and cast doubt on the DSB's authority and reputation. In addition, China submits that the DSB's authorization for the EC to impose countermeasures strengthens the weight of the panel and Appellate Body reports and that the benefits of efficiency far outweigh any need to repeat work already completed by the panel and Appellate Body. Too, the adopted reports reflect the collective will of Members and the requirement of prompt compliance with dispute settlement rulings means that adjudication in one case must benefit all Members.<sup>1133</sup>

7.955 The **European Communities** submits that, pursuant to Article 17.14 of the *DSU*, parties to a dispute must "unconditionally accept" adopted Appellate Body Reports as "a final resolution to that dispute." The United States must be assumed to have unconditionally accepted the findings of the Appellate Body in the *US – FSC (21.5)* dispute, which, by definition also included a finding that the United States was illegally providing export subsidies to unscheduled agricultural products such as upland cotton. The European Communities fails to see how the United States can argue that Brazil needs to establish a prima facie case. The European Communities is of the view that Brazil simply needs to assert a claim.<sup>1134</sup>

7.956 **New Zealand** supports the claims made by Brazil, based on the findings already made in *US – FSC (Article 21.5 – EC)*, that the tax incentives under the ETI Act of 2000 threaten to circumvent United States export subsidy commitments within the meaning of Article 10.1 of the *Agreement on*

<sup>1128</sup> Executive summary of Brazil's first written submission, para. 43.

<sup>1129</sup> Executive summary of the United States' first written submission, para. 44.

<sup>1130</sup> See United States' response to Panel Question No. 119 (of 11 August 2003).

<sup>1131</sup> Argentina's written submission to the first session of the first substantive meeting, para. 95.

<sup>1132</sup> China cites Appellate Body Report, *Japan – Alcoholic Beverages II* and Panel Report, *India – Patents (EC)*, para. 7.30.

<sup>1133</sup> China's written submission to the first session of the first substantive meeting, paras 20-25.

<sup>1134</sup> European Communities' oral statement at the first session of the first substantive meeting, para. 45.

*Agriculture* and therefore cannot be exempt from actions under the *SCM Agreement* under Article 13(c)(ii) of the *Agreement on Agriculture*. In addition, the Appellate Body found that there was a prohibited subsidy under Article 3.1(a) of the *SCM Agreement*. Accordingly if the Panel finds, as New Zealand believes it should, that the tax cuts under the ETI Act of 2000 are prohibited subsidies under Article 3.1(a) of the *SCM Agreement*, the Panel is required to recommend under Article 4.7 of the *SCM Agreement* that the United States withdraw the subsidies without delay.<sup>1135</sup>

(c) Evaluation by the Panel

7.957 In the *US – FSC (Article 21.5 – EC)* dispute, the panel and Appellate Body found that the United States ETI Act of 2000 and export subsidies provided thereunder were inconsistent with Articles 3.3, 8 and 10 of the *Agreement on Agriculture*, as well as Articles 3.1(a) and 3.2 of the *SCM Agreement*. We note, as a matter of fact, that the United States has not yet repealed the ETI Act of 2000.

7.958 In this dispute, Brazil submits that the same measure is at issue and asks us to refer to the claims and arguments made by the European Communities, and to apply the reasoning of the panel and Appellate Body in that case, in order to find violations of Articles 8 and 10 of the *Agreement on Agriculture*, as well as Articles 3.1(a) and 3.2 of the *SCM Agreement* in respect of upland cotton.

7.959 Brazil argues that its reference to the panel and Appellate Body reports is evidence reflecting the nature, function and WTO-inconsistency of the ETI Act of 2000. Brazil directs the Panel and the United States to a European Communities web-page where all of the European Communities' submissions can be viewed and downloaded.<sup>1136</sup> However, Brazil has not submitted any direct evidence to us. Brazil has not, for example, even submitted a direct quotation from the underlying legal instrument in question, nor has Brazil itself asserted its own specific claims or arguments on the matter dealt with in the previous dispute, beyond purporting to incorporate by reference the claims and arguments made by the European Communities, and the reasoning, findings and conclusions of the panel and Appellate Body in the previous dispute.<sup>1137</sup>

7.960 We understand that the panel and Appellate Body findings in the previous *US – FSC (Article 21.5 – EC)* dispute between the European Communities and the United States provide relevant guidance and we may – indeed must – take them into account.<sup>1138</sup> As with all adopted panel and Appellate Body reports<sup>1139</sup>, they provide valuable guidance. They create legitimate expectations among WTO Members, and, therefore, should be taken into account where they are relevant to any dispute.<sup>1140</sup> However, they are not legally binding, except with respect to resolving the particular dispute between the parties to that dispute.<sup>1141</sup>

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<sup>1135</sup> New Zealand's written submission to the first session of the first substantive meeting, paras. 3.18-3.19.

<sup>1136</sup> Brazil's oral statement at the first session of the first substantive meeting, para. 137, footnote 187.

<sup>1137</sup> See Brazil's response to Panel Question No. 121, where Brazil states that it is appropriate for us to "make similar findings of fact, conclusions of law, and recommendations as the panel and Appellate Body in *US – FSC (21.5)*".

<sup>1138</sup> Panel Report, *India – Patents (EC)*, para. 7.30.

<sup>1139</sup> In Appellate Body Report, *US – Shrimp (Article 21.5 – Malaysia)*, the Appellate Body clarified that the same principle applies to Appellate Body reports.

<sup>1140</sup> The panel in *India – Patents (EC)* examined the relevance of prior GATT Panel cases dealing with the same measure. See Panel Report, *India – Patents (EC)*, paras. 7.26-7.29.

<sup>1141</sup> See Appellate Body Report, *Japan – Alcoholic Beverages II*, p. 14. Footnote 106 of that report states: "It is worth noting that the Statute of the International Court of Justice has an explicit provision, Article 59, to the same effect. This has not inhibited the development by that Court (and its predecessor) of a body of case law in which considerable reliance on the value of previous decisions is readily discernible." See also Panel Report, *India – Patents (EC)*, para. 7.28 and footnote 106.

7.961 We understand Brazil to nevertheless seek a Panel process whereby we would simply apply the reasoning, and findings and conclusions of the panel, as modified by the Appellate Body, in the *US – FSC (Article 21.5 – EC)* dispute, without going through the ordinary procedural steps constituting panel proceedings set out in the *DSU*, including the examination of the legal claims against the measures constituting the matter before this Panel on the basis of direct evidence and argumentation submitted by the complaining and defending parties in this dispute. While Brazil has supplemented the evidence and argumentation in that dispute<sup>1142</sup>, it has not purported directly to establish the elements comprising the basis of the findings and conclusions in that dispute.

7.962 We see no basis in the text of the *DSU* as it currently stands for such incorporation by reference of claims and arguments made in a previous dispute nor for a quasi-automatic application of findings, recommendations and rulings from a previous dispute. Nowhere is such a procedure required or envisaged in the *DSU* or the relevant special rules and procedures. Rather, Articles 12.1 and 12.2 provide that:

1. Panels shall follow the Working Procedures in Appendix 3 unless the panel decides otherwise after consulting the parties to the dispute.

2. Panel procedures should provide sufficient flexibility so as to ensure high-quality panel reports, while not unduly delaying the panel process."

7.963 We are aware that, in terms of the resolution of a particular dispute between the parties to that dispute, Article 17.14 of the *DSU* provides:

*"Adoption of Appellate Body Reports*

An Appellate Body report shall be adopted by the DSB and unconditionally accepted by the parties to the dispute unless the DSB decides by consensus not to adopt the Appellate Body report within 30 days following its circulation to the Members." (footnote omitted)

7.964 Brazil submits that Article 17.14 of the *DSU* requires that after the adoption of an Appellate Body report, the parties to the dispute are unconditionally bound by the results of that report.<sup>1143</sup>

7.965 We do not disagree with Brazil that panel and Appellate Body reports adopted by the DSB must be considered final resolutions to a particular dispute between the parties to that dispute.<sup>1144</sup> Appellate Body Reports that are adopted by the DSB are, "... unconditionally accepted by the parties to the dispute", and, therefore, must be treated by the parties to a particular dispute as a final resolution to that dispute.<sup>1145</sup> At a given point in time, disputes must be viewed as definitely *settled*

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<sup>1142</sup> For example, before us, Brazil has referred to the following elements that were not addressed in that dispute: Article 13(c) of the *Agreement on Agriculture* and evidence that Brazil made inquiries to the United States about the extent to which upland cotton benefited from the prohibited export subsidy addressed in that dispute.

<sup>1143</sup> Brazil's response to Panel Question No. 121.

<sup>1144</sup> We find support for this proposition in the Appellate Body Reports in *US – Shrimp (Article 21.5 – Malaysia)* and *EC – Bed Linen (Article 21.5 – India)*.

<sup>1145</sup> Appellate Body Reports that are adopted by the DSB are, as Article 17.14 provides, "[...] unconditionally accepted by the parties to the dispute", and therefore, must be treated by the parties to a particular dispute as a final resolution to that dispute. See Appellate Body Report, *US – Shrimp (Article 21.5 – Malaysia)*, paras. 96-97. The same principle [as that expressed in Article 17.14] applies to those aspects of the Panel's report that are not appealed and are thus not addressed by the Appellate Body. Thus, the portions of the original Report of the Panel that are not appealed, together with the Appellate Body report resolving the issues appealed must be considered as the final resolution of the dispute. See Appellate Body Report, *EC – Bed Linen (Article 21.5 – India)*, paras. 90-96.

by the WTO dispute settlement system.<sup>1146</sup> Moreover, it is clear to us that panels in implementation proceedings are entitled to use Appellate Body findings in the same dispute as a tool for their own reasoning.<sup>1147</sup>

7.966 However, while the United States, as the defending party in the *US – FSC (Article 21.5 – EC)* dispute, is "unconditionally bound" to accept the adopted reports in that dispute, the bounds of that dispute are limited to the parties to that dispute.

7.967 We thus hasten to point out that we are not dealing here with the same *dispute* as *US – FSC (Article 21.5 – EC)*. Our terms of reference in this dispute were set by the DSB upon the establishment of the Panel, and refer to Brazil's request for establishment of a panel.<sup>1148</sup> We are not an implementation panel constituted under Article 21.5 of the *DSU* charged with examining the existence or consistency with the covered agreements of measures taken to comply with recommendations and rulings in DS108. Although the defending Member is the same in both cases, Brazil was *not* a party to that dispute. Thus, the panel and Appellate Body reports in that dispute cannot be taken as providing a final resolution to the part of the matter before us concerning the ETI Act of 2000.<sup>1149</sup>

7.968 Nor was Brazil a third party in that previous dispute. We nevertheless note that a third party considering that a measure already the subject of panel proceeding nullifies or impairs benefits accruing to it under any covered agreement may have recourse to "normal dispute settlement procedures under [the *DSU*]".<sup>1150</sup> If "normal dispute settlement procedures under [the *DSU*]" apply to such a "follow-up" case brought by a third party then, *a fortiori* such normal dispute settlement procedures must apply *vis-à-vis* a Member which was *not* a third party in the dispute.

7.969 Moreover, we disagree with Brazil that there is a complete identity between the "measure" and the "claims" in this case and the *US – FSC (Article 21.5 – EC)* dispute and that it would therefore be appropriate for us to make similar findings of fact, conclusions of law, and recommendations as the panel and Appellate Body in *US – FSC (Article 21.5 – EC)*.<sup>1151</sup>

7.970 The ETI Act of 2000 examined in the *US – FSC (Article 21.5 – EC)* dispute applies in respect of a range of industrial and agricultural products. It therefore applies not only with respect to products falling within the product scope of the *Agreement on Agriculture*<sup>1152</sup>, but also in respect of products outside that scope. By contrast, the measure subject to this particular claim by Brazil is the ETI Act of 2000 in respect of upland cotton *only*. As we have already noted, upland cotton falls within the product scope of the *Agreement on Agriculture*.<sup>1153</sup>

7.971 Moreover, in this case, we are adopting a different order of analysis than the one followed in the *US – FSC (Article 21.5 – EC)* dispute. In that dispute, the panel and Appellate Body first examined the complainant's claims under the *SCM Agreement*, before considering the claims under the *Agreement on Agriculture*. By contrast, we have decided to begin our analysis of Brazil's claims

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<sup>1146</sup> Appellate Body Report, *EC – Bed Linen (Article 21.5 – India)*, para. 98.

<sup>1147</sup> Appellate Body Report, *US – Shrimp (Article 21.5 – Malaysia)*, paras. 107-109.

<sup>1148</sup> WT/DS267/7.

<sup>1149</sup> In its response to Panel Question No. 121, Brazil asserts that there is no precedent in the WTO or the GATT that would require the Panel to find that the United States *alone* is bound in this case. We do not rely on any "precedent" here, but rather on the text of the *DSU* as it currently stands.

<sup>1150</sup> Article 10.4 of the *DSU*. Such a dispute shall be referred to the original panel wherever possible.

<sup>1151</sup> Brazil's response to Panel Question No. 121.

<sup>1152</sup> Article 2 and Annex 1 of the *Agreement on Agriculture* indicate the product coverage of that Agreement.

<sup>1153</sup> Brazil's request for establishment expressly refers to an upland-cotton related claim ("Export subsidies provided to exporters of US upland cotton under the FSC Repeal and Extraterritorial Income Exclusion Act of 2000 ('ETI Act')"). Brazil's only claim in this dispute dealing with products other than upland cotton relates to the United States export credit guarantee programmes as export subsidies.

against the measure under the *Agreement on Agriculture*.<sup>1154</sup> This is but one example of a panel's mandate and authority to conduct an independent, thorough and objective assessment of the matter before it rather than merely adopting findings in another, previous, dispute. We note, however, the different order of analysis we have adopted would not necessarily compel a different conclusion in this case.

7.972 Furthermore, in contrast to the present case, there was no discussion of, or findings made on, issues arising under Article 13 of the *Agreement on Agriculture* in the prior dispute settlement proceeding. Brazil itself states that "[b]ecause the United States never raised the peace clause as a defence in [*US – FSC (Article 21.5 – EC)*] there were no findings by the panel or the Appellate Body regarding the peace clause...".<sup>1155</sup> While Brazil submitted arguments in the present Panel proceedings linking the Part V claims in the previous case to the terms of the peace clause in the present case, it is not clear to us that we may directly transpose findings of violation of the substantive obligations in Part V to a finding that the conditions of Article 13(c) of the *Agreement on Agriculture* are not fulfilled. The legal nature of Article 13 is distinct from the positive obligations contained in the legal provisions of Part V of the *Agreement on Agriculture*.<sup>1156</sup>

7.973 Nor are there any findings in the previous panel and Appellate Body report on whether, in respect of upland cotton specifically, the ETI Act of 2000 is an export subsidy which is in violation of the United States' legal obligations under Part V of the *Agreement on Agriculture*. That is, the prior dispute settlement proceeding would only give an answer to the intermediate question of whether an export subsidy exists in general under the ETI Act of 2000. It would not furnish a commodity-specific answer pertaining to upland cotton in particular.<sup>1157</sup> In order to complete our examination under Part V of the *Agreement on Agriculture* in this dispute, we would need to examine whether cotton was a commodity eligible to benefit from the fiscal incentives available under the ETI Act of 2000. Furthermore, if that was the case, we would have to go further and apply the Articles 10 and 8 reasoning specifically to upland cotton (i.e. we would have to apply and develop the panel and Appellate Body's reasoning in that case: as the United States has made no upland cotton-specific export subsidy reduction commitments, it is not entitled to have any export subsidy on upland cotton).<sup>1158</sup>

7.974 These inquiries would require us to be presented with, and to examine, evidence concerning these matters. We do not understand Brazil to be asking us to seek the evidence and construct the case on their behalf. However, that would be the effect of their request, if the Panel decided that it needed to pursue Brazil's claim to its logical end-point. Rather, we understand Brazil to simply be putting before us the proposition that the ETI Act has been found to grant prohibited subsidies and that therefore we should endorse that conclusion in this case as well. Viewed in this way, Brazil's use of the *US – FSC (Article 21.5 – EC)* dispute as part of its argumentation is no different from the use any party might make of an Appellate Body report which the party believes supports its case, *except that the facts and argumentation necessary to make out the claim before this Panel are entirely missing*.

7.975 In light of these distinctions between the evidence and argumentation presented in the *US – FSC (Article 21.5 – EC)* dispute and in this case, we are of the view that no direct transposition or

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<sup>1154</sup> See *supra*, Section VII:C, "Order of analysis".

<sup>1155</sup> Brazil's response to Panel Question No. 120, para. 218.

<sup>1156</sup> See *supra*, Section VII:C.

<sup>1157</sup> Brazil indicated that, in the course of consultations, as well as in what it asserts were questions in the context of the SCM Annex V exercise, it asked the United States about the amount of ETI Act of 2000 subsidies that went to upland cotton, but never received a response. Brazil's first written submission, para. 330, footnote 581. See also Exhibits BRA-49 and BRA-101. In our view, this issue of specific data on cotton is not a legally relevant consideration here because the substance of the measure itself was never properly put in issue before us.

<sup>1158</sup> See *supra*, para. 7.666.

incorporation of the panel and Appellate Body findings and conclusions would, in any event, be appropriate on the basis of the evidence and argumentation submitted in this dispute.

7.976 Articles 3.2 and 3.3 of the *DSU* reflect the importance to the multilateral trading system of security, predictability and the prompt settlement of disputes.<sup>1159</sup> However, these essential elements must be balanced against fundamental concerns of due process and procedural fairness in WTO dispute settlement.

7.977 We are compelled by Article 11 of the *DSU* to carry out "an objective assessment of the matter" before us. We, as a panel, have extensive discretionary authority to request information from any source (including a Member that is a party to the dispute). Such authority is essential in order properly to discharge a panel's mandate and responsibility under the *DSU* and the other covered agreements.

7.978 The United States has not attempted to rebut the substance of Brazil's claims in respect of the ETI Act of 2000, and has indicated that it intends to implement the rulings and recommendations of the DSB *in the previous dispute*. In the Panel's view, that does not constitute an admission that relieves Brazil of its duty to make a *prima facie* case, as Brazil submits.<sup>1160</sup> Rather, as a respondent, the United States is entitled to expect Brazil to prove its own case in the present dispute.

7.979 Brazil has been on notice since the United States' first written submission that its duty to make a *prima facie* case was in issue. The United States submitted that Brazil had failed to make such a case by simply citing to and quoting from prior panel and Appellate Body reports and failing to offer a description of the ETI Act of 2000.<sup>1161</sup> Brazil has chosen not to offer its own arguments or description of the Act.

7.980 In its 5 September 2003 communication, the Panel indicated to the parties that, "on the basis of the evidence and arguments presented to date, it is unable to form any view on whether the ETI Act of 2000 satisfies the relevant provisions of the *Agreement on Agriculture*". We thereby put Brazil on notice that the evidence and arguments submitted up to that point in the Panel proceedings did not provide a sufficient basis for us to make a finding.

7.981 This communication was made in the context of the unique procedural and substantive circumstances of these Panel proceedings. It allowed Brazil an additional possibility to redress deficiencies in its case.

7.982 In its further submission of 9 September 2003, Brazil acknowledged the Panel's view, but nonetheless submitted no new evidence.<sup>1162</sup> Rather, Brazil expressed its belief that it had demonstrated that the ETI Act of 2000 violated the export subsidy provisions of the *Agreement on Agriculture* and the *SCM Agreement*, although it offered to submit any additional arguments and evidence on issues the Panel believed had not been addressed in sufficient detail.

7.983 Mindful of our extensive discretionary authority to put questions to the parties to clarify the factual and legal aspects of the matter before us, we considered whether we should specifically indicate any deficiencies we perceived in the case brought by Brazil in order to give Brazil an opportunity to remedy any such deficiencies at that stage of the proceedings.

7.984 We are well aware that the fact that it is for the party asserting the affirmative of a particular claim or defence to discharge the burden of proof does not mean that a panel is "frozen into

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<sup>1159</sup> See, e.g., Panel Report *US – Section 301 Trade Act*, para. 7.75, with respect to Article 3.2 of the *DSU*.

<sup>1160</sup> Brazil's further written submission, para. 469.

<sup>1161</sup> United States' first written submission, paras 184-189.

<sup>1162</sup> Brazil's further written submission, para. 469.

inactivity".<sup>1163</sup> A panel's extensive authority to put questions to the parties in order to inform itself of the relevant facts of the dispute and the legal considerations applicable to such facts is not conditional in any way upon a party having established, on a prima facie basis, a claim or defence.<sup>1164</sup>

7.985 In considering the nature of any further questioning to the parties, we were, however, equally conscious that, in our assessment of the matter, we may not relieve Brazil, as complaining party, of its task of establishing the inconsistency of United States measures with the relevant provisions of the covered agreements. In particular, we were and remain mindful that, in our questions posed to the parties, we must not "overstep the bounds of legitimate management or guidance of the proceedings ... in the interest of efficiency and dispatch."<sup>1165</sup> We are not permitted to make Brazil's case for Brazil.

7.986 For all of these reasons, on the basis of the evidence and arguments submitted, we are not in a position to conclude that Brazil has established a prima facie case that the ETI Act of 2000 and subsidies granted thereunder are inconsistent with Articles 8 and 10.1 of the *Agreement on Agriculture* in respect of upland cotton.

7.987 Having examined the WTO-consistency of the export subsidies for agricultural products, in the first place, under the *Agreement on Agriculture*, we observe that, in accordance with Article 13(c)(ii) of the *Agreement on Agriculture*, to the extent that Brazil has not demonstrated that the United States ETI Act of 2000 is not in conformity with the United States export subsidy commitments under Part V of the *Agreement on Agriculture* in respect of upland cotton, the United States is "exempt from actions based on" Articles 3.1(a) and 3.2 of the *SCM Agreement*. We therefore decline to examine Brazil's claims based on those provisions.<sup>1166</sup>

## 7. Claims under Article XVI:3 of the *GATT 1994*

### (a) Main arguments of the parties

7.988 **Brazil** requests us to rule that the United States export and actionable subsidies provided during MY 1999-2002 caused and continue to cause serious prejudice to the interests of Brazil by resulting in the United States having more than an equitable share of world exports of upland cotton in violation of Articles XVI:1 and XVI:3 of the *GATT 1994*.

7.989 The **United States** contends that that Brazil has failed to demonstrate a prima facie case of inconsistency with Article XVI:3 of the *GATT 1994*, which applies only in respect of export subsidies.

### (b) Main arguments of the third parties

7.990 **New Zealand** agrees with Brazil that the subsidies of the United States have operated to increase United States' exports of upland cotton resulting in the United States having a "more than equitable share" of world export trade in upland cotton within the meaning of Article XVI:3 of the *GATT 1994* and thus have caused serious prejudice to the interests of Brazil within the meaning of Article XVI:1 of the *GATT 1994*.<sup>1167</sup> The **European Communities**, without stating whether it supports or opposes Brazil's claims on this issue, "put on record" its support on certain elements of

<sup>1163</sup> See, for example, Panel Report, *Thailand – H-Beams*, para. 7.50.

<sup>1164</sup> Appellate Body Report, *Canada – Aircraft*, para. 185.

<sup>1165</sup> Appellate Body Report, *Korea – Dairy*, para. 149.

<sup>1166</sup> See *supra*, Section VII:C "Order of Analysis" and Section VII:E, overview of the relationship between the export subsidy provisions of the *Agreement on Agriculture* and the *SCM Agreement*.

<sup>1167</sup> Paragraphs 2.35 and 2.36 of its further third party submission. See also its response to Panel Question No. 56.

interpretation advanced by the United States on Article XVI:3 of the *GATT 1994*.<sup>1168</sup> In response to the question from the Panel, the European Communities further notes that "[i]t is conceivable ... that one and the same measure may be at the same time an 'export subsidy' in the sense of Article XVI:3 and 'domestic support' within the meaning of the Agreement on Agriculture."<sup>1169</sup> **Australia, China and Chinese Taipei** have offered, in response to the Panel's question, their views on the interpretation of Article XVI:3 of the *GATT 1994*.<sup>1170</sup> Specifically, Australia argues that it is unambiguous that agricultural domestic support programmes are challengeable under Article XVI:3 of the *GATT 1994*. Australia also sheds light on the relationship between Articles XVI:1 and XVI:3 of the *GATT 1994* in the context of the analysis of Article 13(b)(ii) of the *Agreement on Agriculture*.<sup>1171</sup> China and Chinese Taipei argue that agricultural domestic support programmes are not challengeable under this provision. **Benin** has also offered its views on certain aspects of this issue.<sup>1172</sup>

(c) Evaluation by the Panel

7.991 We understand that Brazil's claims under Article XVI:1 and XVI:3 of the *GATT 1994* envisage a joint application of these two provisions. That is, Brazil does not seem to make independent claims under paragraphs 1 and 3 of Article XVI, but rather requests us to rule that the United States subsidies provided during MY 1999-2002 caused and continue to cause serious prejudice to the interests of Brazil by resulting in the United States having more than an equitable share of world exports of upland cotton in joint violation of Articles XVI:1 and XVI:3 of the *GATT 1994*.

7.992 For the reasons that follow, we do not believe that these provisions are susceptible to such joint application. We do not believe that Brazil may assert a "serious prejudice" claim under Article XVI:3. Rather, each provision – Article XVI:1 and Article XVI:3 -- requires application in accordance with its own terms in respect of measures that fall within its respective scope of application. We thus examine the terms of these two distinct treaty provisions separately. Our examination of Brazil's claim under Article XVI:1 of the *GATT 1994* is included in Section VII:G below, in conjunction with our actionable subsidies analysis.<sup>1173</sup>

7.993 We limit our examination here to Brazil's claims under Article XVI:3 of the *GATT 1994*.

7.994 We see the first issue before us as whether or not Article XVI:3 of the *GATT 1994* applies only to export subsidies, or whether it also applies to other types of subsidies that may cause serious prejudice within the meaning of Article XVI.1 of the *GATT 1994* (and Article 5(c) of the *SCM Agreement*).<sup>1174</sup>

7.995 **Brazil** disagrees with the **United States'** assertion that the only subsidies governed by Article XVI:3 are "export subsidies".

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<sup>1168</sup> The European Communities supports the interpretation of the term "more than equitable share" in Article XVI:3 of the *GATT* advanced by the United States. See paragraph 3 of its oral statement at the resumed session of the first substantive meeting.

<sup>1169</sup> See the European Communities' response to Panel third party Question No. 56.

<sup>1170</sup> See respective responses to Panel third party Question No. 56, which asked, *inter alia*, whether agricultural domestic support programmes are challengeable under this provision.

<sup>1171</sup> See paragraph 19 and 20 of its submission to the first session of the first substantive meeting.

<sup>1172</sup> See Benin's response to Panel third party Question No. 44, in which it argues that the Panel is required to take account of the effects of the US subsidies on the interest of Members other than the complaining Member.

<sup>1173</sup> See *infra*, Section VII:G.

<sup>1174</sup> By virtue of footnote 13 of the *SCM Agreement*.

7.996 The **Panel** begins its interpretation with the text of Article XVI:3 of the *GATT 1994*.<sup>1175</sup> Article XVI:3 appears in Section B of Article XVI. Entitled "Additional provisions on export subsidies", it reads:

"Accordingly, contracting parties should seek to avoid the use of *subsidies on the export of primary products*. If, however, a contracting party grants directly or indirectly any form of *subsidy which operates to increase the export of any primary product* from its territory, such subsidy shall not be applied in a manner which results in that contracting party having more than an equitable share of world export trade in that product, account being taken of the shares of the contracting parties in such trade in the product during a previous representative period, and any special factors which may have affected or may be affecting such trade in the product." (emphasis added)

7.997 We believe that the text of Article XVI:3 of the *GATT 1994* itself indicates that the provision is limited to "export subsidies" and does not address rights and obligations of Members relating to other types of subsidies.

7.998 We see that Article XVI of the *GATT 1994* consists of two distinct "parts". Part A is entitled "Subsidies in General". Part B of Article XVI is entitled "Additional Provisions on Export Subsidies". Paragraph 3 of Article XVI is found in Part B entitled "Additional Provisions on Export Subsidies". It is not found in Part A of Article XVI, entitled "Subsidies in General".

7.999 The text of paragraph 3 of Article XVI of the *GATT 1994* refers to subsidies which "operate[...] to increase the export of any primary product".<sup>1176</sup> The first sentence of Article XVI:3 of the *GATT 1994* refers to "subsidies *on* the export of primary products".(emphasis added) These aspects of the text and context of paragraph 3 support an interpretation that it deals with export subsidies only, rather than domestic support subsidies.

7.1000 We take note that the second sentence of paragraph 3 reads:

"If, however, a contracting party grants directly or indirectly any form of subsidy which operates to increase the export of any primary product from its territory..."

7.1001 **Brazil** asserts that a reading of this part of Article XVI:3 of the *GATT 1994* as pertaining to "export subsidies" only would reduce this part of the treaty provision to redundancy or inutility, as this sentence speaks not only of subsidies contingent upon export, but also of subsidies that operate to increase the export of any primary product from a Member's territory.<sup>1177</sup>

7.1002 The **United States** submits that there is now a general prohibition of export subsidies in the *SCM Agreement* which moves away from this statement in Article XVI:3 of the *GATT 1994*.<sup>1178</sup>

7.1003 **We** are well aware of our duties as a treaty interpreter. It is clear to us that the provisions of the *Agreement on Agriculture*, the *SCM Agreement* and the *GATT 1994* must be read in conjunction

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<sup>1175</sup> We refer to our "order of analysis" examination in Section VII:C, as well as our examination of the relationship between the provisions of the other covered agreements and those of Article XVI of the *GATT 1994* in Sections VII:E and F. We note that, unlike Article XVI:4, which by its terms clearly applies to "the export of any product other than a primary product", Article XVI:3 applies to "subsidies on the export of primary products". It therefore also potentially relates to products within the product coverage of the *Agreement on Agriculture*.

<sup>1176</sup> The first sentence of Article XVI:3 commences with the word "Accordingly...". We believe that this indicates a conceptual *sequitur* to the recognition expressed in Article XVI:2 that "...subsidies *on the export of primary products* may have harmful effects for other Members..." (emphasis added).

<sup>1177</sup> Brazil's response to Panel Question No. 185 (a).

<sup>1178</sup> United States' response to Panel Question No. 186.

and that, unless explicitly indicated, provisions of the *Agreement on Agriculture* and/or the *SCM Agreement* cannot be taken to replace, subsume or exclude provisions of the *GATT 1994*. We are also well aware that WTO obligations generally apply "cumulatively" and that an appropriate reading of the "inseparable package of rights and disciplines" in these covered agreements must, accordingly, be a harmonious one that gives meaning to *all* the relevant provisions of these three equally binding agreements.<sup>1179</sup>

7.1004 As we have already seen, the term "export subsidy" – a subsidy contingent upon export performance – is now defined in the current *Agreement on Agriculture* and the *SCM Agreement*. Such a definition did not exist when Article XVI was originally drafted.

7.1005 Particularly in view of the rules pertaining to potential conflicts in Article 21.1 of the *Agreement on Agriculture* and the General Interpretative Note to Annex 1A of the *WTO Agreement* which would give precedence to the provisions of the *Agreement on Agriculture* and then the *SCM Agreement* over a provision of the *GATT 1994* to the extent of any conflict<sup>1180</sup>, we do not believe that it is appropriate to apply a separate or different definition of "export subsidies" under Article XVI:3 than that which is now applicable for the purposes of Articles 3.3, 8, 9, 10 and 1(e) of the *Agreement on Agriculture* and Article 3.1(a) of the *SCM Agreement*. We see that the *Agreement on Agriculture* contains scheduled export reduction commitments on export subsidies listed in Article 9.1 and a general prohibition on export subsidies not listed in Article 9.1 which are applied in a manner which results in, or threatens to lead to, circumvention of these commitments (Article 10.1). Except as provided in the *Agreement on Agriculture*, the *SCM Agreement* contains a *general prohibition on export subsidies* in Article 3.1(a).

7.1006 This reading of the text of Article XVI:3 of the *GATT 1994*, in its context, supports a conclusion that Article XVI:3 applies only to "export subsidies" as that term is currently understood in the *WTO Agreement*.<sup>1181</sup> This reading finds support in the object and purpose of the agreement.<sup>1182</sup>

7.1007 While it is not necessary to resort to drafting history under these circumstances<sup>1183</sup>, we nevertheless observe that such an interpretation finds confirmation in the drafting history. The relevant provisions of the *Tokyo Round Subsidies Code* clearly distinguished between export and other subsidies.

7.1008 Article 8 dealt with "subsidies in general", with Article 8.2 referring to "export subsidies" and Articles 8.3(c) and 8.4 dealing with "serious prejudice" in the sense of Article XVI:1. Article 9 dealt with "export subsidies on products other than certain primary products", with Article 9.1 providing:

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<sup>1179</sup> See, e.g. Appellate Body Report, *Argentina – Footwear (EC)*, paras. 81, 83-84; Panel Report, *Indonesia – Autos*, paras. 14.28 ff. In *Brazil – Dessicated Coconut*, the Appellate Body agreed with the panel that:

"[...] the question for consideration is not whether the SCM Agreement supersedes Article VI of GATT 1994. Rather, it is whether Article VI creates rules which are separate and distinct from those of the SCM Agreement, and which can be applied without reference to that Agreement, or whether Article VI of GATT 1994 and the SCM Agreement represent an inseparable package of rights and disciplines that must be considered in conjunction." See Appellate Body Report, *Brazil – Dessicated Coconut*, p. 15.

<sup>1180</sup> See our other examination of these provisions above in Section VII:E, paras. 7.654 ff.

<sup>1181</sup> We do not mean to suggest that export subsidies may never be included in a serious prejudice analysis under Article XVI:1. Rather, we mean that subsidies other than export subsidies may not form the basis for an examination under Article XVI:3.

<sup>1182</sup> See e.g. *supra*, footnote 920.

<sup>1183</sup> See Articles 31 and 32 of the *Vienna Convention*, previously addressed *supra*, footnote 1112.

"Signatories shall not grant export subsidies on products other than certain primary products". Article 10 dealt with "export subsidies on certain primary products". Article 10 provided:

"1. In accordance with the provisions of Article XVI:3 of the General Agreement, signatories agree not to grant directly or indirectly any export subsidy on certain primary products in a manner which results in the signatory granting such subsidy having more than an equitable share of world export trade in such product, account being taken of the shares of the signatories in trade in the product concerned during a previous representative period, and any special factors which may have affected or may be affecting trade in such product." (emphasis added)

7.1009 This suggests that the drafters of the *Tokyo Round Subsidies Code* considered that the export subsidies in Article 10 of the *Tokyo Round Subsidies Code* were those subject to Article XVI:3 of the *GATT 1994*.

7.1010 Article 11 of the *Tokyo Round Subsidies Code* addressed "subsidies other than export subsidies". Article 11.2 provided, in part:

"Signatories recognize, however, that subsidies other than export subsidies .. may cause or threaten to cause injury to a domestic industry of another signatory or serious prejudice to the interests of another signatory or may nullify or impair benefits accruing to another signatory under the General Agreement, in particular where such subsidies would adversely affect the conditions of normal competition. Signatories shall therefore seek to avoid causing such effects through the use of subsidies."

7.1011 Read together with Article 10, this provision similarly suggests that the drafters of the *Tokyo Round Subsidies Code* distinguished between the export subsidies referred to in Article XVI:3 of the *GATT 1994* and other subsidies. The drafters indicated in Articles 9 and 10 that export subsidies were subject to certain disciplines, while subsidies *other than export subsidies* were subject to *other* disciplines and could form the main basis for a serious prejudice claim. This confirms our view of the distinction between export subsidies and other (actionable) subsidies maintained in the current text of the *SCM Agreement*.<sup>1184</sup>

7.1012 Returning to the current text of the treaty, we note that, other than the common reference to "export subsidies" found in all of the three relevant texts (i.e. (i) Article XVI:3; (ii) the export subsidies provisions of the *Agreement on Agriculture*; and (iii) Article 3.1(a) of the *SCM Agreement*) there is no further explicit textual linkage or cross-reference between any relevant provision of the *Agreement on Agriculture*, any provision of the *SCM Agreement* – including Articles 3, 5 and 6 (in

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<sup>1184</sup> See *supra*, footnote 1181.

particular, Article 6.3(d))<sup>1185</sup> – and Article XVI:3 of the *GATT 1994* that would compel us to find any other scope of application for the obligation contained in Article XVI:3 of the *GATT 1994*.<sup>1186</sup>

7.1013 We look to Article 13 of the *Agreement on Agriculture* to discern whether there is any clear articulation of the relationship between the rights and obligations in the *Agreement on Agriculture* and the *SCM Agreement* and Article XVI:3 of the *GATT 1994* during the implementation period that would lead us to a different conclusion. We see that Article 13(b)(ii) of the *Agreement on Agriculture*, relating to domestic support, contains no reference to Article XVI:3 of the *GATT 1994*.<sup>1187</sup>

7.1014 We understand this omission, in Article 13(b)(ii) of the *Agreement on Agriculture*, of any reference to paragraph 3 of Article XVI of the *GATT 1994*, to indicate that the drafters of Article 13(b)(ii) of the *Agreement on Agriculture* did not believe that a domestic support measure could ever be subject to actions under the "export subsidy" provisions of Article XVI:3 (and there was thus no need to refer to that provision in Article 13(b)).

7.1015 In light of the extensive package of substantive rights and obligations on domestic and export subsidies resulting from the Uruguay Round in the *Agreement on Agriculture* and the *SCM Agreement*, and the focus in both agreements upon disciplines governing domestic support and export subsidies, we do not consider it plausible that the drafters of Article 13(b)(ii) of the *Agreement on Agriculture* simply overlooked the possibility that actions under Article XVI:3 might arise in respect of domestic support and that such actions were not covered by the "exemption from actions" provided by Article 13 of the *Agreement on Agriculture*. Indeed, we are not entitled to presume that this was the case. Had the drafters wished to refer to all of Article XVI in Article 13(b)(ii) they could have. However, they did not. They explicitly identified only paragraph 1 of the provision as potentially applicable to the domestic support measures in question.

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<sup>1185</sup> At first blush, there appear to be similarities between Article XVI:3 of the *GATT 1994* and Article 6.3(d) of the *SCM Agreement*. Both call for a comparison of a Member's quantitative share in a certain world phenomenon – "export trade" (Article XVI:3) or "market share" (Article 6.3(d)) – with a corresponding share during a previous period. The tests contained in Article 6.3(d) and Article XVI:3 may be similar, but they are certainly not textually or conceptually identical. For example, Article 6.3(d) does not contain the terms "equitable share" and "special factors". It also defines a "previous representative period" for comparison as three years. It also refers to "market share" rather than "export trade". We do not believe that the language of Articles 5(c)/6.3(d) of the *SCM Agreement* suggests an intention by the Uruguay Round negotiators directly to *develop and refine* the requirements of Article XVI:3 of the *GATT 1994* within the *SCM Agreement* insofar as export subsidies are concerned. At least, if there were such an intention, they have not clearly so indicated in the text of these two covered agreements.

<sup>1186</sup> There is an explicit textual linkage between Article 6.3(d) and Article 5(c) of the *SCM Agreement*: the chapeau of Article 6.3 states that "[s]erious prejudice in the sense of paragraph (c) of Article 5 may arise where one of the following [including the elements in Article 6.3(d)] apply...". We discuss the cross-reference further *infra.*, Section VII:G, in our examination of Brazil's claims under Article XVI:1.

<sup>1187</sup> We see that Article 13(a)(ii) of the *Agreement on Agriculture* provides that "Green Box" domestic support measures shall be "exempt from actions based on Article XVI of the *GATT 1994* and Part III of the Subsidies Agreement...".

Article 13(b)(ii) of the *Agreement on Agriculture* provides that certain "domestic support measures" shall be "exempt from actions based on paragraph 1 of Article XVI of the *GATT 1994* and Articles 5 and 6 of the Subsidies Agreement...". This provision refers only to paragraph 1 of Article XVI. It does *not* refer to Article XVI:3.

Article 13(c)(ii) of the *Agreement on Agriculture* stipulates that certain "export subsidies" shall be "exempt from actions based on Article XVI of the *GATT 1994* and Articles 3, 5 and 6 of the *SCM Agreement*". In contrast to Article 13(b)(ii) which contains the limited reference to *paragraph 1* of Article XVI of the *GATT 1994*, Article 13(c)(ii) refers to Article XVI in its entirety, necessarily including both paragraphs 1 and 3, to the extent relevant and applicable.

7.1016 We therefore find that Article XVI:3 applies only to export subsidies as that term is now defined in the *Agreement on Agriculture* and the *SCM Agreement*.

7.1017 In any event, even if Article XVI:3 of the *GATT 1994* is still susceptible to independent application in respect of export subsidies, in light of our findings above that the challenged export subsidy measures concerned – that the user marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 and export credit guarantees under the GSM 102, GSM 103 and SCGP programmes – constitute prohibited subsidies in violation of the United States' obligations under the export subsidy provisions (Articles 3.3, 8 and/or 10) of the *Agreement on Agriculture* and Articles 3.1(a) and 3.2 of the *SCM Agreement* – we do not believe that it is necessary to conduct an examination of challenged export subsidy measures also under Article XVI:3 of the *GATT 1994* for the purposes of resolving this dispute.

## F. IMPORT SUBSTITUTION SUBSIDY

### 1. Measure at issue

7.1018 This Section of our report deals with an alleged import substitution subsidy under Articles 3.1(b) and 3.2 of the *SCM Agreement*. Brazil's claim relates to section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users<sup>1188</sup>, as described in Section VII:C.

### 2. Claim under Article 3.1(b) (and 3.2) of the *SCM Agreement*

#### (a) Main arguments of the parties

7.1019 **Brazil** challenges section 1207(a) of the FSRI Act of 2002 as a *per se* import substitution subsidy that is inconsistent with Articles 3.1(b) and 3.2 of the *SCM Agreement*. Brazil argues that user marketing (Step 2) payments to domestic users are "subsidies" as defined in Article 1 of the *SCM Agreement*. The subsidies are contingent on the use of domestic over imported goods within the meaning of Article 3.1(b) of the *SCM Agreement*: they are "conditional" on proof of consumption of domestically produced upland cotton. Article 3.2 of the *SCM Agreement* requires that such subsidies be neither granted nor maintained.

7.1020 According to Brazil, there is no inherent conflict between the prohibition on import substitution subsidies in Article 3.1(b) of the *SCM Agreement* and the provisions of the *Agreement on Agriculture*. Articles 1(a), 3.2 and paragraph 7 of Annex 3 of the *Agreement on Agriculture* deal with the calculation of a Member's AMS and envisage that measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products. However, according to Brazil, these provisions do not require, nor grant permission, for a Member to grant subsidies contingent upon import substitution.

7.1021 In Brazil's view, the introductory phrase to Article 3 of the *SCM Agreement* ("[e]xcept as provided in the *Agreement on Agriculture*"), in conjunction with Article 21.1 and other provisions of that Agreement, does not have the effect of carving agricultural domestic support out from the prohibition imposed by Article 3.1(b) of the *SCM Agreement*. Brazil submits that the absence of any conflict, coupled with the absence of any explicit exemption for import substitution subsidies in

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<sup>1188</sup> See section 1207(a) of the FSRI Act of 2002, reproduced in Exhibits BRA-29 and US-1. The implementing regulations are found in 7 CFR 1427.100 *et seq.*, reproduced in Exhibit BRA-37. The FAIR Act of 1996 provided for user marketing (Step 2) payments to domestic users in section 136, reproduced in Exhibits BRA-28 and US-22.

In this Section of our report, we limit our examination to Brazil's claim relating to user marketing (Step 2) payments to domestic users. We address user marketing (Step 2) payments to exporters under section 1207(a) of the FSRI Act of 2002 in Section VII:E.

Article 13(b) or anywhere else in the *Agreement on Agriculture*, supports the conclusion that import substitution subsidies related to agricultural goods violate Article 3.1(b) of the *SCM Agreement*.

7.1022 The **United States** acknowledges that user marketing (Step 2) payments are "subsidies"<sup>1189</sup> and that, to receive a payment under the Step 2 programme, a domestic user "must open a bale of domestically produced baled upland cotton".<sup>1190</sup>

7.1023 However, according to the United States, user marketing (Step 2) payments are included in measures which comply with "domestic support reduction commitments" under the *Agreement on Agriculture* within the meaning of Article 6.3 of the *Agreement on Agriculture*.

7.1024 The United States submits that the introductory language to Article 3 of the *SCM Agreement* ("[e]xcept as provided in the *Agreement on Agriculture*") renders that provision subject to the terms of the *Agreement on Agriculture*. Under Article 6.3 of the *Agreement on Agriculture*, if a Member is providing support within its domestic support reduction commitments, then such support may not be challenged under Article 3.1(b) of the *SCM Agreement*. This is because Article 3.1(b) of the *SCM Agreement* applies "except as provided in the *Agreement on Agriculture*". Paragraph 7 of Annex 3 of the *Agreement on Agriculture* recognizes that a Member has a right to provide subsidies contingent upon use of domestic products under the *Agreement on Agriculture*. Moreover, pursuant to Article 21 of the *Agreement on Agriculture*, all of the Annex 1A agreements (including the *SCM Agreement*) apply subject to the provisions of the *Agreement on Agriculture*. The United States asserts that, inasmuch as Article 3.1(b) does not apply, the operation of the user marketing (Step 2) programme also cannot violate Article 3.2 of the *SCM Agreement*.

(b) Main arguments of the third parties

7.1025 **Argentina** contends that there is no conflict between Article 3.1(b) and any provision of the *Agreement on Agriculture*. Paragraph 7 of Annex 3 of the *Agreement on Agriculture* does not refer to the "subsidies contingent [...] upon the use of domestic over imported goods" mentioned in Article 3.1(b) of the *SCM Agreement*. Moreover, paragraph 7 of Annex 3 contains no mention of the *SCM Agreement*. If the intention had been to exempt these measures from the prohibition contained in Article 3.1(b) of the *SCM Agreement*, this would have been expressly stated.<sup>1191</sup>

7.1026 **Australia** asserts that user marketing (Step 2) payments to domestic users are contingent upon the use of domestic over imported goods.<sup>1192</sup> Australia does not consider that the phrase "provide support in favour of domestic producers" in Article 3.2 of the *Agreement on Agriculture* permits subsidies contingent upon the use of domestic goods. In Australia's view, the legal issue in question relates to the condition attached to the grant of a subsidy, not the grant of a subsidy *per se* or who might benefit from the subsidy. The fact that a measure may benefit an agricultural producer ("support in favour of domestic producers") does not serve to override measures otherwise prohibited. In the case of subsidies contingent upon the use of domestic goods, there is no conflict between either the *Agreement on Agriculture* and the *SCM Agreement* or the *GATT 1994*, which discipline or prohibit certain conditions attached to subsidies, including subsidies in favour of agricultural producers (subject only to the provisions of Article III:8(b) of the *GATT 1994*). There is no provision in the *Agreement on Agriculture* which provides for an exception to, or cover for, import substitution conditions attached to the grant of a subsidy.<sup>1193</sup> Australia emphasizes that Article 13(b)(ii) does not

<sup>1189</sup> United States' response to Panel Question No. 108.

<sup>1190</sup> United States' response to Panel Question No. 144.

<sup>1191</sup> Argentina's response to Panel third party Question No. 40.

<sup>1192</sup> Australia's response to Panel third party Question Nos. 38 and 39.

<sup>1193</sup> Australia's response to Panel third party Question No. 40.

exempt non-"green box" domestic support measures from actions based on Article 3 of the *SCM Agreement*.<sup>1194</sup>

7.1027 The **European Communities** agrees with the United States that subsidies contingent upon the use of domestic goods which are maintained consistently with the *Agreement on Agriculture* are not inconsistent with the *SCM Agreement*. The European Communities argues that subsidies contingent upon the use of domestic goods are consistent with Article 3.2 of the *Agreement on Agriculture*. The European Communities puts an emphasis on the phrase "in favour of", as not requiring that support be "to" domestic producers. The same term is used in Article 1(a) (the definition of AMS) and in Article 1(h) (definition of Total AMS). Paragraph 7 of Annex 3 recognizes that a Member has a right to provide subsidies contingent upon use of domestic products under the *Agreement on Agriculture*.<sup>1195</sup>

7.1028 According to the European Communities, Article 21.1 of the *Agreement on Agriculture* provides that the other goods agreements will apply "subject to" the provisions of the *Agreement on Agriculture*. A finding that a measure was an import substitution subsidy would mean that such a subsidy would be prohibited under Article 3.1(b) of the *SCM Agreement*. In such an event, the consequences of such a finding would have to be subordinated to the right to adopt such measures under the *Agreement on Agriculture* (provided reduction commitments are respected). Moreover, the chapeau of Article 3.1 of the *SCM Agreement* clearly exempts from the scope of that Article domestic content subsidies which are maintained consistently with the *Agreement on Agriculture*.<sup>1196</sup>

7.1029 **New Zealand** does not agree that a right to provide subsidies contingent upon the use of domestic products contrary to Article 3 of the *SCM Agreement* can be found in the requirement that subsidies "directed at agricultural producers [...] to the extent that they benefit producers of the basic agricultural product" be included in the calculation of AMS. There is no basis for reading such a right into the *Agreement on Agriculture*. To do so would allow the possibility for exemption from action under the *SCM Agreement* to exist other than by virtue of Article 13 of the *Agreement on Agriculture*. Article 13 of the *Agreement on Agriculture* explicitly does not provide such exemption from action under Article 3 of the *SCM Agreement* when it quite clearly could have done so. In New Zealand's view that indicates that there was no intention on the part of the drafters that domestic support measures, whether they conform with Article 6 of the *Agreement on Agriculture* or not, should be so exempt.<sup>1197</sup>

### 3. Examination by the Panel

(a) Relationship between Article 3.1(b) of the *SCM Agreement* and the domestic support provisions of the *Agreement on Agriculture*

(i) *Overview*

7.1030 Article 3.1 of the *SCM Agreement* states:

"3.1 *Except as provided in the Agreement on Agriculture*, the following subsidies, within the meaning of Article 1, shall be prohibited: ...

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<sup>1194</sup> Australia's response to Panel third party Question No. 40.

<sup>1195</sup> European Communities' oral statement at the first session of the first substantive meeting, paras. 33-36.

<sup>1196</sup> European Communities' oral statement at the first session of the first substantive meeting, paras. 37-39.

<sup>1197</sup> New Zealand's response to Panel third party Question No. 40.

(a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I; ...

(b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods." (emphasis added, footnotes omitted)

7.1031 We recall once again that Article 3.2 of the *DSU* recognizes that interpretative issues arising in WTO dispute settlement are to be resolved through the application of customary rules of interpretation of public international law. It is well settled that the principles codified in Articles 31 and 32 of the *Vienna Convention* are such customary rules.<sup>1198</sup> The task of interpreting a treaty provision must begin with its specific terms.

7.1032 We thus look to the specific terms of the treaty text. The relationship between the *Agreement on Agriculture* and the *SCM Agreement* is defined, in part, by the text of Article 3.1 of the *SCM Agreement*. That provision contains an introductory clause: "[e]xcept as provided in the Agreement on Agriculture".

7.1033 In giving effect to this introductory phrase of Article 3.1 of the *SCM Agreement*, we have a duty to read all the provisions of WTO agreements as a whole<sup>1199</sup>, in a manner which respects and gives effect to the text of all relevant provisions read in light of their context, object and purpose. Indeed, we have already noted the interlocking nature of the *SCM Agreement* and the *Agreement on Agriculture*.<sup>1200</sup> The respective texts of these agreements expressly provide for a general order of precedence among them, when certain conditions prevail.

7.1034 The introductory clause of Article 3.1 of the *SCM Agreement* ("[e]xcept as provided in the Agreement on Agriculture") indicates that any examination of the WTO-consistency of a subsidy for agricultural products under the *SCM Agreement* may depend upon the provisions of the *Agreement on Agriculture*.<sup>1201</sup>

7.1035 Article 21.1 of the *Agreement on Agriculture* states:

"The provisions of GATT 1994 and of the other Multilateral Trade Agreements in Annex 1A to the WTO Agreement shall apply subject to the provisions of this Agreement".

7.1036 This provision expressly acknowledges the application of the *GATT 1994* and the *SCM Agreement* to agricultural products, while indicating that the *Agreement on Agriculture* would take precedence in the event, and to the extent, of any conflict.<sup>1202</sup>

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<sup>1198</sup> We recall, once again, that Article 31(1) of the *Vienna Convention* provides in relevant part that: "A treaty shall be interpreted in good faith 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."

<sup>1199</sup> See Appellate Body Reports: *Korea – Dairy* and *Argentina – Footwear (EC)*.

<sup>1200</sup> We recall our general discussion of "order of analysis" in Section VII:C.

<sup>1201</sup> As already mentioned in Section VII:C, we find support for our approach in the Appellate Body Report in *Canada – Dairy (Article 21.5 – New Zealand and US)*.

<sup>1202</sup> Neither the introductory phrase in Article 3.1 of the *SCM Agreement*, nor Article 21.1 of the *Agreement on Agriculture* mean that the *Agreement on Agriculture* must necessarily contain a provision that would have the effect of carving out certain domestic support measures from the prohibition on import substitution subsidies in Article 3.1(b) of the *SCM Agreement* or rendering those disciplines inapplicable to agricultural domestic support. This view does not reduce the introductory phrase to inutility. For example, the

7.1037 We recall that the *WTO Agreement* is a "single undertaking". All of the "covered agreements"<sup>1203</sup> in Annexes 1, 2 and 3 are integral parts of the same *WTO Agreement*<sup>1204</sup>, subject to the integrated dispute settlement system established by the *DSU*. Each covered agreement contains distinct obligations, which govern Members' conduct within the parameters of the substance and subject-matter of the particular provision and of the particular covered agreement. It is clear to us that the same measure can be subject to more than one WTO obligation or commitment, although the specific *aspects* of the measure that may be subject to an obligation or commitment may vary depending upon the particular agreement or legal provision in question.

7.1038 We understand that Article 21.1 of the *Agreement on Agriculture* could speak to a situation where, for example, the domestic support provisions of the *Agreement on Agriculture* would prevail in the event that an explicit carve-out or exemption from the disciplines in Article 3.1(b) of the *SCM Agreement* existed in the *text* of the *Agreement on Agriculture*. Another situation would be where it would be impossible for a Member to comply with its domestic support obligations under the *Agreement on Agriculture* and the Article 3.1(b) prohibition simultaneously. Another situation might be where there is an explicit authorization in the text of the *Agreement on Agriculture* that would authorize a measure that, in the absence of such an express authorization, would be prohibited by Article 3.1(b) of the *SCM Agreement*.

7.1039 For the purposes of resolving this dispute, it is not necessary for us to decide upon any single fixed meaning of a "conflict" or to identify a particular situation that might fall to be decided subject to the order of precedence set out in Articles 21.1 of the *Agreement on Agriculture* and the introductory clause to Article 3.1(b) of the *SCM Agreement*. This flows from our view that none of the situations just mentioned arise in this dispute from the relevant provisions in the *Agreement on Agriculture*.

7.1040 For the reasons that follow, we believe the domestic support provisions of the *Agreement on Agriculture*, on the one hand, and Article 3.1(b) of the *SCM Agreement*, on the other, do not present any conflict.<sup>1205</sup>

7.1041 We turn to the relevant provisions of the *Agreement on Agriculture* in order to discern whether, and/or to what extent, these provisions affect a claim concerning the prohibition on import substitution subsidies in Article 3.1(b) of the *SCM Agreement*.<sup>1206</sup>

(ii) *Article 13 of the Agreement on Agriculture*

7.1042 We first consider whether Article 13 of the *Agreement on Agriculture* articulates any clear expression that the drafters intended the domestic support provisions of the *Agreement on Agriculture* to affect a claim under Article 3.1(b) during the implementation period.

introductory clause in Article 3.1 also relates to the export subsidy prohibition in Article 3.1(a), and our view is without prejudice to that relationship.

<sup>1203</sup> The "covered agreements" are listed in Appendix 1 to the *DSU*.

<sup>1204</sup> Article II:2 of the *WTO Agreement*.

<sup>1205</sup> We recall and find support in the approach of certain previous panels, which have referred to a presumption against conflict. Panel Report, *Indonesia – Autos*, para. 14.28; *Turkey – Textiles*, paras. 9.92-9.95.

<sup>1206</sup> We find support in Appellate Body Reports, *US – Carbon Steel* and *US – Corrosion-Resistant Steel Sunset Review*. These reports underline the importance of the text and the role of cross-references and clear textual indications about the relationship between and among treaty provisions. We also note that other Appellate Body reports – for example, Appellate Body Report, *EC – Sardines*, paras. 201-208 and Appellate Body Report, *EC – Hormones*, para. 128 – address relationships among certain treaty provisions, and, in particular, situations where large groups of measures are (or are not) exempted from disciplines. In *EC – Sardines*, para. 208, the Appellate Body stated: "[...] we must conclude that, if the negotiators had wanted to exempt the very large group of existing technical regulations from the disciplines of a provision as important as Article 2.4 of the *TBT Agreement*, they would have said so explicitly."

7.1043 Brazil argues that Article 13(b)(ii) of the *Agreement on Agriculture* does not exempt user marketing (Step 2) payments to domestic users under section 1207(a) of the FSRI Act of 2002 from challenges under Article 3 of the *SCM Agreement*. Brazil therefore considers that it is entitled to assert a claim that user marketing (Step 2) payments to domestic users under section 1207(a) of the FSRI Act of 2002 are subsidies contingent upon the use of domestic over imported goods, within the meaning of Article 3.1(b) of the *SCM Agreement*.

7.1044 The United States seemed to indicate in its initial brief<sup>1207</sup> that Article 3.1(b) claims are "exempt from action" by virtue of Article 13 of the *Agreement on Agriculture*. However, in responding to Panel questioning, the United States observes that Article 13(b) "does not reference ... Article 3" of the *SCM Agreement*, and that, on the United States' view, while Article 13(b) addresses domestic support measures, Article 13 "would not appear to be applicable" to domestic support measures constituting import substitution subsidies under Article 3.1(b) of the *SCM Agreement*.<sup>1208</sup>

7.1045 We therefore do not understand the parties to disagree that Article 13 of the *Agreement on Agriculture* does not affect claims under Article 3.1(b) of the *SCM Agreement*.

7.1046 In any event, our own analysis, based on the text of Article 13 of the *Agreement on Agriculture*, leads us to endorse what appears to be the shared view of the parties based on their submissions to the Panel.

7.1047 Article 3.1 of the *SCM Agreement* prohibits two types of subsidies: (i) those contingent on export performance (so-called "export subsidies") in paragraph (a); and (ii) those contingent on the use of domestic over imported goods (so-called "import substitution" subsidies) in paragraph (b).

7.1048 Article 13(b)(ii) of the *Agreement on Agriculture* exempts certain domestic support measures in respect of agricultural products from actions based on Articles 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994*, but does not refer to Article 3 of the *SCM Agreement* at all.

7.1049 Article 13(c)(ii) of the *Agreement on Agriculture* states that "*export subsidies* that conform fully to the provisions of Part V of this Agreement, as reflected in each Member's Schedule, shall be exempt from actions based on Article XVI of GATT 1994 or Articles 3, 5 and 6 of the Subsidies Agreement." (emphasis added) The negotiators were therefore fully aware of how to insert a reference to Article 3 of the *SCM Agreement* when they deemed it appropriate to do so (as they did in Article 13(c)). However, they inserted no such cross-reference when addressing obligations relevant to domestic support measures in Article 13(b).

7.1050 As noted, Article 13(c)(ii) of the *Agreement on Agriculture* explicitly and exclusively refers to "export subsidies", which are those dealt with in Article 3.1(a) of the *SCM Agreement*. Article 13(c) of the *Agreement on Agriculture* does not refer to import substitution subsidies, or, indeed, to any type of subsidy other than *export* subsidies. Therefore, claims relating to alleged import substitution subsidies, under Article 3.1(b), do not fall within the ambit of Article 13(c) of the *Agreement on Agriculture*.

7.1051 Had the drafters of Article 13 of the *Agreement on Agriculture* intended to exempt certain measures from actions based on Article 3.1(b) in Article 13(c), they would have so indicated, either by referring explicitly to "import substitution" subsidies in the chapeau of Article 13(c) or by using the more general reference to "subsidies" rather than qualifying the term "subsidies" by the term

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<sup>1207</sup> In United States' initial brief, footnote 2, the United States included Article 3.1(b) of the *SCM Agreement* in the list of provisions in respect of which the United States asserted that "Brazil cannot maintain any action – and the United States cannot be required to defend any such action – based on provisions specified in the Peace Clause since the U.S. support measures for upland cotton conform to the Peace Clause." (footnote omitted)

<sup>1208</sup> United States' response to Panel Question No. 111.

"export" in the chapeau. Moreover, the provisions of the *Agreement on Agriculture* referred to in the chapeau of Article 13(c) refer to the provisions of "Part V" of the *Agreement on Agriculture*. That part contains export subsidy disciplines. They do not relate to domestic support.<sup>1209</sup>

7.1052 Thus, we believe that Article 13 of the *Agreement on Agriculture* does not affect our analysis of Brazil's claim under Article 3.1(b) of the *SCM Agreement*.

(iii) *Domestic support provisions in the Agreement on Agriculture*

7.1053 We next turn to the substantive provisions relating to domestic support in the *Agreement on Agriculture* to check whether they affect our examination of Brazil's claim under Article 3.1(b) of the *SCM Agreement*.

7.1054 Articles 6 and 7 of the *Agreement on Agriculture* and Members' schedules contain domestic support commitments. Article 6.3 of the *Agreement on Agriculture* provides that "[a] Member shall be considered to be in compliance with its domestic support reduction commitments in any year in which its domestic support in favour of agricultural producers expressed in terms of Current Total [Aggregate Measurement of Support] does not exceed the corresponding annual or final bound commitment level specified in Part IV of the Member's Schedule."<sup>1210</sup>

7.1055 Annex 3 of the *Agreement on Agriculture* is entitled "Domestic Support: Calculation of Aggregate Measurement of Support". Paragraph 7 of Annex 3 provides:

"7. The AMS shall be calculated as close as practicable to the point of first sale of the basic agricultural product concerned. Measures directed at agricultural processors shall be included to the extent that such measures benefit the producers of the basic agricultural products."

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<sup>1209</sup> That part of the *Agreement on Agriculture* consists of Article 8 ("Export Competition Commitments"); Article 9 ("Export Subsidy Commitments"); Article 10 ("Prevention of Circumvention of Export Subsidy Commitments") and Article 11 ("Incorporated Products"). Article 11 deals with incorporated agricultural primary products. It therefore addresses certain obligations relating to incorporated products, but does not deal with the concept of contingency upon import substitution in general. This gives further contextual support to our view that actions based on Article 3.1(b) of the *SCM Agreement* are not affected by Article 13 or the substantive domestic support provisions of the *Agreement on Agriculture*.

<sup>1210</sup> Article 1(a) of the *Agreement on Agriculture* reads, in part:

"(a) 'Aggregate Measurement of Support' and 'AMS' mean the annual level of support, expressed in monetary terms, *provided for an agricultural product in favour of the producers of the basic agricultural product* or non-product-specific support provided in favour of agricultural producers in general, other than support provided under programmes that qualify as exempt from reduction under Annex 2 to this Agreement, which is: ...

(i) with respect to support provided during any year of the implementation period and thereafter, calculated in accordance with the provisions of Annex 3 of this Agreement and taking into account the constituent data and methodology used in the tables of supporting material incorporated by reference in Part IV of the Member's Schedule;"

Article 3.2 of the *Agreement on Agriculture* provides:

"2. Subject to the provisions of Article 6, a Member shall not provide support *in favour of domestic producers* in excess of the commitment levels specified in Section I of Part IV of its Schedule." (emphasis added)

7.1056 The United States asserts that this provision requires the United States to include its user marketing (Step 2) payments in favour of domestic upland cotton producers, even though such payments are made to processors, within its calculation of its AMS. The United States asserts that if Members could not discriminate in favour of domestic producers when making subsidy payments through processors, there would be no reason for paragraph 7 of Annex 3.<sup>1211</sup> The United States thus contends that user marketing (Step 2) payments to upland cotton domestic users that provide support to domestic producers contingent on the use of domestic goods is consistent with the *Agreement on Agriculture*.

7.1057 We do not agree. Domestic support reduction commitments are adopted pursuant to the domestic support provisions contained in the *Agreement on Agriculture*, and the terms of Article 6.3 define the circumstances in which a Member shall be deemed to be in conformity with those commitments.

7.1058 However, Article 6.3 does *not* provide that compliance with such "domestic support reduction commitments" shall necessarily be considered to be in compliance with other applicable WTO obligations. Nor does it contain an explicit textual indication that otherwise prohibited measures are necessarily justified by virtue of compliance with the domestic support reduction commitments. The obligations are parallel, and the operation of Article 6.3 of the *Agreement on Agriculture* does not preempt or exclude the operation of the obligation under Article 3.1(b) of the *SCM Agreement*.

7.1059 We believe there is a clear distinction between a provision that requires a Member to include a certain type of payment (or part thereof) in its AMS calculation and a provision that requires inclusion in the AMS of subsidies contingent upon import substitution. The United States, in this dispute, would have us read such provisions synonymously. We decline to do so.

7.1060 Support "in favour of" domestic producers does not *require* or *authorize* contingency upon use of domestic over imported goods.

7.1061 The fact that the *Agreement on Agriculture* foresees that certain domestic support measures actually paid to other recipients may also "benefit" the producers of the basic agricultural products, and require inclusion in the AMS of an amount to the extent this is the case, does not permit a measure that is otherwise prohibited. Annex 3 provides guidance on the calculation of the AMS. Nowhere in the text is there recognition that a Member has a *right* to provide subsidies contingent upon use of domestic products under the *Agreement on Agriculture*. Support "in favour of" or that "benefits" domestic producers need not necessarily be support *conditional upon* the use of domestic over imported goods.

7.1062 The provision of funds to processors of the product concerned need not have the consequence of limiting access to such subsidies *exclusively* to domestic production, so as to ensure that it is only available upon use of domestic over imported goods.

7.1063 The specific reference to subsidies that benefit the producers of the basic agricultural products in paragraph 7 of Annex 3 does not *entitle* a Member to maintain subsidies contingent on the use of domestic over imported goods consistently with the *Agreement on Agriculture* and the *SCM Agreement*. The phrase "to the extent" in paragraph 7 of Annex 3 implies a requirement for Members to make an annual determination and allocation of support that *actually* benefits the "producers" of the subsidizing Member. All types of "domestic support in favour of agricultural producers" must be tabulated for the purposes of setting and enforcing a Member's domestic support reduction commitments. To the extent the subsidy benefits processors or other parties besides the domestic producers, then, pursuant to paragraph 7 of Annex 3, that portion of the funds would not be included

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<sup>1211</sup> United States' response to Panel Question No. 116.

within AMS. The provision envisages that not all support paid to processors may benefit domestic producers, and provides guidance as to the calculation of AMS in this situation.

7.1064 Indeed, the reference in the text to "to the extent that" clearly indicates that there is a range of degrees to which a measure could be "in favour of" domestic producers. It is not possible to read this language as requiring or allowing conditionality upon the use of domestic products.

7.1065 We can conceive of domestic support measures provided to processors which provide support "in favour of domestic producers" and that are *not* contingent upon the use of domestic over imported goods (and that would therefore be consistent with Article 3.1(b) of the *SCM Agreement*).<sup>1212</sup>

7.1066 Article 3 of the *Agreement on Agriculture* is entitled "*Incorporation of Concessions and Commitments*". Pursuant to Article 3.1,

"1. The domestic support and export subsidy commitments in Part IV of each Member's Schedule constitute commitments limiting subsidization and are hereby made an integral part of GATT 1994."

7.1067 From this, we understand that the limitation of subsidization imposed by the domestic support reduction commitments in the *Agreement on Agriculture* relates to the object and purpose of imposing quantitative limitations at certain defined levels. It does not address all of the *qualitative* aspects of subsidization. That is, it sets permitted levels of support subject to reduction commitments and does not deal exhaustively with all of the other potential characteristics of the support measure itself. The issue of the grant of a subsidy *per se* or the general identification of potential recipients or beneficiaries of the subsidy is therefore not legally relevant to the particular *condition* we are currently examining that is attached to the grant of a subsidy, i.e. contingency upon the use of domestic over imported goods.<sup>1213</sup>

7.1068 The terms "domestic support reduction commitment", AMS and Total AMS are germane to the *Agreement on Agriculture* and, in fact, do not appear in Article 3 (or any other provision) of the *SCM Agreement*.

7.1069 By contrast, the definition of a subsidy for the purposes of the *SCM Agreement* is contained in Article 1 of that Agreement. The definitional elements of, and prohibition upon, an import substitution subsidy are set out in Article 3.1(b) of the *SCM Agreement*. Nowhere in the texts of these or any other provisions of the covered agreements do we find a statement that, should a measure satisfying the conception of a compliant domestic support measure in Article 6 of the *Agreement on Agriculture* also happen to meet the definitional criteria of an import substitution subsidy within the meaning of Article 3.1(b) of the *SCM Agreement*, the prohibition in that provision would not apply, or the subsidy would be effectively exempted from that prohibition.

7.1070 We find further support for our view in the absence we have already found of *any* reference to import substitution subsidies under Article 3.1(b) in Article 13 of the *Agreement on Agriculture*.<sup>1214</sup> Article 13 of the *Agreement on Agriculture* sets out certain specific rules concerning the relationship between the obligations in the *SCM Agreement* and the *Agreement on Agriculture* during the implementation period, when Members sought to provide a degree of clarity which might not

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<sup>1212</sup> e.g., subsidies paid to processors regardless of the origin of the basic agricultural product.

<sup>1213</sup> In this regard, we also note that the preamble to the *Agreement on Agriculture* records the commitment of Members "to achiev[e] specific binding commitments in ... market access, domestic support; export competition...". This preamble statement cannot, of course, override any provision which gives primacy to the *Agreement on Agriculture* over a specific binding commitment in another covered agreement. However, it is useful context to assist us in our interpretation that obligations in the covered agreements are different in their nature and capable of applying in parallel.

<sup>1214</sup> *Supra*, paras. 7.1042-7.1052.

otherwise have been entirely evident from the other substantive provisions defining the relationship. The silence of Article 13 of the *Agreement on Agriculture* on Article 3.1(b) relating to import substitution subsidies can be taken as a further indication that Members did not believe that such subsidies were of such a nature as to merit the articulation of any particular treatment other than the treatment already indicated in the substantive obligations under the *SCM Agreement* and the *Agreement on Agriculture*.

7.1071 We do not see an inherent conflict between compliance with the domestic support reduction commitments in Article 6.3 of the *Agreement on Agriculture* and the prohibition of import substitution subsidies under Article 3.1(b) of the *SCM Agreement* so as to render the simultaneous application of the provisions untenable. Article 3.1(b) of the *SCM Agreement* can be read together with the *Agreement on Agriculture* provisions relating to domestic support in a coherent and consistent manner which gives full and effective meaning to all of their terms. There is, therefore, no necessity to apply the rules in Article 21.1 of the *Agreement on Agriculture* in order that the provisions of that agreement would prevail over a conflicting provision.

7.1072 We recall the introductory phrase of Article 3 of the *SCM Agreement* ("[e]xcept as provided in the *Agreement on Agriculture*"). We have concluded that the *Agreement on Agriculture* does not "provide" otherwise so as to affect the prohibition on import substitution subsidies in Article 3.1(b) of the *SCM Agreement*.

7.1073 We do not see the application of the Article 3.1(b) prohibition in respect of *both* industrial and agricultural products as being manifestly contrary to the object and purpose of the *Agreement on Agriculture* or the *SCM Agreement*. The fundamental prohibition in Article 3.1(b) is a cornerstone of the subsidy disciplines imposed by the *SCM Agreement* – and indeed, appears in Part II of that Agreement containing the most stringent SCM disciplines. It relates to the basic national treatment provision in Article III:4 of the *GATT 1994*, which is a cornerstone of the GATT/WTO multilateral trading system.<sup>1215</sup>

7.1074 As the drafters indicated in the preamble of the *Agreement on Agriculture*, the "long-term objective is to provide for substantial progressive reductions in agricultural support and protection". The drafters did not indicate there an intention to undermine the fundamental disciplines applicable to import substitution subsidies. Had they desired to do so, they would have so indicated.<sup>1216</sup> It is not our task to read in to the text such a caveat or exemption for subsidies that are contingent upon the use of domestic over imported goods and subject to the Article 3.1(b) prohibition.<sup>1217</sup>

(b) Is there a subsidy contingent upon import substitution within the meaning of Article 3.1(b)?

7.1075 We once again recall that Article 3.1 of the *SCM Agreement* states:

"3.1 Except as provided in the Agreement on Agriculture, the following subsidies, within the meaning of Article 1, shall be prohibited: ...

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<sup>1215</sup> See, for example, Appellate Body Report, *US – Section 211 Appropriations Act*, para. 241.

<sup>1216</sup> We are aware that, for example, scheduled agricultural products are subject to certain quantitative limits imposed by the export subsidy disciplines of the *Agreement on Agriculture*. These quantitative limits may be considered less stringent than the outright prohibition on export subsidies found in Article 3.1(a) of the *SCM Agreement*. However, these less stringent obligations are explicitly spelled out in the text of the Agreement, with further guidance provided in Articles 13 and 21 of the Agreement. We find no such guidance in the text of either agreement relating to subsidies governed by Article 3.1(b) of the *SCM Agreement*.

<sup>1217</sup> We can conceive of examples where issues of consistency with other provisions of the covered agreements might arise where a Member grants agricultural domestic support: e.g. domestic support funded by an internal tax collected only on imports might raise issues of consistency with a Member's obligations in the *SCM Agreement* or Article III of the *GATT 1994*; or a measure requiring the use of domestic over imported goods might raise issues of consistency with the *Agreement on Trade-Related Investment Measures*.

(a) subsidies contingent, in law or in fact, whether solely or as one of several other conditions, upon export performance, including those illustrated in Annex I ...

(b) subsidies contingent, whether solely or as one of several other conditions, upon the use of domestic over imported goods." (footnote omitted)

7.1076 Article 3.1(b) of the *SCM Agreement* provides that subsidies "within the meaning of Article 1" which are "contingent...upon the use of domestic over imported goods" are prohibited. Consequently, in order for a measure to be an import substitution subsidy within the meaning of Article 3.1(b) of the *SCM Agreement*, it must be a "subsidy" within the meaning of Article 1 of that Agreement.

7.1077 There is no dispute between the parties that user marketing (Step 2) payments under section 1207(a) of the FSRI Act of 2002 constitute a "subsidy" for the purposes of Article 1 of the *SCM Agreement*.<sup>1218</sup> Our own analysis confirms that this is the case.<sup>1219</sup>

7.1078 We therefore turn to the issue of contingency "upon the use of domestic over imported goods" within the meaning of Article 3.1(b) of the *SCM Agreement*.

7.1079 We note that, under section 1207(a) of the FSRI Act of 2002, the condition of "use" of United States domestic upland cotton pertains to all user marketing (Step 2) payments (i.e. those to domestic users *and* exporters). Brazil has confirmed to us that its claim under Article 3.1(b) of the *SCM Agreement* relates only to user marketing (Step 2) payments to *domestic users* under section 1207(a) of the FSRI Act of 2002.<sup>1220</sup>

7.1080 We recall our earlier observation – in the context of our examination of section 1207(a) of the FSRI Act of 2002 under Article 9.1(a) of the *Agreement on Agriculture* and Article 3.1(a) of the *SCM Agreement* -- that the text of the single legal provision governing user marketing (Step 2) payments identifies two distinct situations in which user marketing (Step 2) payments are made:<sup>1221</sup> eligible exporters and eligible domestic users. The text of the measure itself therefore compels us to examine separately the conditions pertaining to the grant of the subsidy in these two distinct factual situations addressed by the measure that involve two distinct sets of eligible recipients.

7.1081 We further recall our earlier observation<sup>1222</sup> that the meaning of "contingent" in Article 3.1(a) of the *SCM Agreement* is "conditional" or "dependent for its existence upon", and that contingency "in law" may be demonstrated on the basis of the words of the relevant legal instrument. Such conditionality may also be derived by necessary implication from the words actually used in the measure. This legal standard applies not only to contingency under Article 3.1(a), but also to contingency under Article 3.1(b) of the *SCM Agreement*.<sup>1223</sup>

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<sup>1218</sup> See United States' response to Panel Question No. 108.

<sup>1219</sup> We refer to our findings, *supra* in Section VII:E, that a "subsidy" exists under section 1207(a) of the FSRI Act of 2002 in the context of our examination of user marketing (Step 2) payments to exporters. The measure makes no differentiation in the defining elements of a "subsidy" between payments to exporters and domestic users. Nor has the United States argued that such a differentiation exists.

<sup>1220</sup> Brazil's response to Panel Question No. 94.

<sup>1221</sup> See our findings *supra*, in Section VII:E.

<sup>1222</sup> See our findings *supra*, in Section VII:E.

<sup>1223</sup> Appellate Body Report, *Canada – Autos*, para. 123.

7.1082 The United States acknowledges that to receive a payment under the user marketing (Step 2) programme, a domestic user must open a bale of domestically produced baled upland cotton.<sup>1224</sup> We therefore understand the United States does not dispute that user marketing (Step 2) payments to domestic users constitute a subsidy conditional or dependent upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the *SCM Agreement*.<sup>1225</sup>

7.1083 In any event, our own analysis confirms this view. Section 1207(a) of the FSRI Act of 2002 provides that during the period beginning on the date of the enactment of the FSRI Act of 2002 through 31 July 2008, " .. the Secretary shall issue marketing certificates or cash payments, at the option of the recipient, to domestic users and exporters for documented purchases by domestic users and sales for export by exporters..." made during a week following a period during which certain cotton price conditions are fulfilled. "Eligible upland cotton" is "*domestically produced* baled upland cotton..." (emphasis added).<sup>1226</sup> Eligible upland cotton "must not be imported cotton".<sup>1227</sup> "Eligible domestic users" are defined as follows:

"(1) A person regularly engaged in the business of opening bales of eligible upland cotton for the purpose of manufacturing such cotton into cotton products in the United States (domestic user), who has entered into an agreement with CCC to participate in the upland cotton user marketing certificate program;"

7.1084 Moreover, "[p]ayments ... shall be made available upon application for payment and submission of supporting documentation, including *proof of purchase and consumption of eligible cotton by the domestic user* or proof of export of eligible cotton by the exporter, as required by the CCC-issued provisions of the Upland Cotton Domestic User/Exporter Agreement" (emphasis added).<sup>1228</sup>

7.1085 Therefore, user marketing (Step 2) payments to domestic users under section 1207(a) of the FSRI Act of 2002 will not be made except upon proof of consumption of eligible upland cotton – which must be "domestically produced", and "not imported". It is not just that it will invariably be easier for domestic users to meet the conditions for user marketing (Step 2) payments to domestic users by using domestic -- rather than imported -- upland cotton. The text of the measure explicitly *requires* the use of domestically produced upland cotton as a pre-condition for receipt of the payments.

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<sup>1224</sup> United States' response to Panel Question No. 144. The United States also confirms, in response to Panel questioning concerning the relevance of Article III:8 of the *GATT 1994*, that the user marketing (Step 2) payment is not made exclusively to domestic producers. See also, United States' response to Panel Question No. 118.

<sup>1225</sup> See e.g., Appellate Body Report, *Canada – Autos*, para. 126.

<sup>1226</sup> As defined in 7 CFR 1427.103, reproduced in Exhibit BRA-37.

<sup>1227</sup> 7 CFR 1427.103(c)(2), reproduced in Exhibit BRA-37.

<sup>1228</sup> According to 7 CFR 1427.108, entitled "Payment", reproduced in Exhibit BRA-37, under the terms of the agreement, upland cotton eligible for payment is cotton consumed by the domestic user within the United States fulfilling certain conditions. In order to receive payments, domestic users of upland cotton must submit proof of consumption in the form of reports of weekly consumption of eligible upland cotton. Exhibit BRA-65 contains a sample cotton domestic user/exporter agreement, which the United States admitted "appeared to be accurate versions of old Step 2 program documents" - see United States' response to Panel Question No. 92. The United States submitted an updated version of the "Upland Cotton Domestic User/Exporter Agreement", reproduced in Exhibit US-21 and also indicated that the official documents for the upland cotton (step 2) program can be found at the FSA website ([www.fsa.usda.gov/daco](http://www.fsa.usda.gov/daco)). Section B-1 of that Agreement indicates that in the event that the cotton is not used for the purpose (by a domestic user as a person regularly engaged in manufacturing eligible upland cotton into cotton products within the United States) "the payment received shall be returned immediately and with interest." Section B-5 of the Agreement indicates that failure to submit an application or the weekly reports will result in delays in payments until all delinquent application/ reports are received.

7.1086 The use of United States domestically produced upland cotton is a condition for obtaining the subsidy. User marketing (Step 2) payments to domestic users under section 1207(a) of the FSRI Act of 2002 are clearly conditional, or dependent upon, such use.

7.1087 As we have already found, the fact that the user marketing (Step 2) payments are also available in another factual situation explicitly identified in the text of the measure – i.e. exporters -- would not have the effect of dissolving such contingency in respect of domestic users, particularly in a situation where the other factual contingency (upon export performance) also gives rise to a prohibited subsidy. As we have previously noted, it would in our view be extremely odd, indeed, if a Member could make a subsidy dependent upon two alternative conditions, each of which would separately give rise to a prohibited subsidy and a violation, but which would somehow become "unprohibited" when combined.

7.1088 For these reasons, we find that section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users is a subsidy contingent upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the *SCM Agreement*.<sup>1229</sup>

(c) Is the measure mandatory?

7.1089 Finally, we consider whether the measure is mandatory.<sup>1230</sup>

7.1090 Turning to the text of the relevant legal provision, pursuant to section 1207(a)(1) of the FSRI Act of 2002, "the Secretary *shall* issue marketing certificates or cash payments, at the option of the recipient, to domestic users and exporters" (emphasis added).<sup>1231</sup> We recall our conclusion above that user marketing (Step 2) payments to exporters are mandatory. We are of the view that the same principles are brought to bear here.<sup>1232</sup>

7.1091 The United States does not disagree that, subject to the availability of funds (that is, the availability of CCC borrowing authority), user marketing (Step 2) payments must be made to all those who meet the conditions for eligibility.<sup>1233</sup>

7.1092 We are of the view that section 1207(a)(1) of the FSRI Act of 2002 mandates the granting of subsidies in that the United States authorities have no discretion not to allow it if domestic users fulfil certain conditions.

7.1093 This is not a situation where the executive branch of the United States government enjoys a discretion that may, or may not, be exercised in a WTO-consistent manner. *Any* grant of a user marketing (Step 2) payment to a domestic user under section 1207(a) of the FSRI Act of 2002 will inevitably be contingent upon the use of United States upland cotton and therefore constitute a prohibited import substitution subsidy.

7.1094 The fact that the actual payment of subsidies is triggered only if certain market conditions prevail does not impact upon our analysis of the normative nature and operation of the measure within the United States legal system. The prevailing world market conditions are not exclusively within the control of the United States government. Nor are the underlying determinative prices triggering the existence and magnitude of user marketing (Step 2) payments to domestic users under section 1207(a) of the FSRI Act of 2002. When certain market conditions exist, the Secretary of Agriculture has no discretion. The payments are automatically triggered.

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<sup>1229</sup> We note, in passing, the relatively low level of imports of upland cotton into the United States. See USDA Fact Sheet: Upland Cotton, January 2003, reproduced in Exhibit BRA-4.

<sup>1230</sup> See *supra*, Section VII:C, in particular, para. 7.336.

<sup>1231</sup> Exhibit BRA-29.

<sup>1232</sup> See *supra*, Section VII:E.

<sup>1233</sup> United States' response to Panel Question No. 109.

7.1095 We recall that, pursuant to section 1601(e) of the FSRI Act of 2002, the Secretary is authorized to adjust support to the maximum extent practicable to comply with total allowable domestic support levels under the Uruguay Round Agreements. This authority applies to certain aspects of the user marketing (Step 2) programme.<sup>1234</sup> However, this authority pertains exclusively to the *level* of United States domestic support commitments under the *Agreement on Agriculture*<sup>1235</sup>, an issue distinct from the constituent qualitative elements and conditionality of subsidies governed by the *SCM Agreement*.<sup>1236</sup>

7.1096 As we have already observed, compliance with the domestic support reduction commitments does not *authorize* or *require* the provision of subsidies contingent upon the use of domestic over imported goods. Moreover, the level of domestic support is not legally relevant to whether or not that domestic support is conditional upon import substitution. Therefore, section 1601(e) of the FSRI Act of 2002 is not legally determinative of whether the measure is of binding normative nature and operation within the United States domestic legal system.

7.1097 For these reasons, we conclude that section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users is inconsistent with Article 3.1(b) of the *SCM Agreement*.<sup>1237</sup>

7.1098 Article 3.2 of the *SCM Agreement* provides: "A Member shall neither grant nor maintain subsidies referred to in paragraph 1" of Article 3. To the extent that section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users is inconsistent with Article 3.1(b), it is, consequently, also inconsistent with Article 3.2 of the *SCM Agreement*.

#### 4. Claim under Article III:4 of the *GATT 1994*

##### (a) Main arguments of the parties

7.1099 **Brazil** claims that user marketing (Step 2) payments to domestic users violate Article III:4 of the *GATT 1994* and are not covered by Article III:8 (b) of the *GATT 1994*. Brazil argues that these payments are subject to the disciplines of Article III:4 of the *GATT 1994* because they are made to domestic *users* of United States upland cotton and therefore, they are not exclusively paid to domestic *producers* within the meaning of Article III:8(b) of the *GATT 1994*. Brazil, therefore, requests the Panel to find that the United States acts inconsistently with its obligations under Article III:4 of the *GATT 1994* by providing user marketing (Step 2) payments to domestic users of United States upland cotton.<sup>1238</sup>

7.1100 The **United States** submits that the user marketing (Step 2) programme provides benefits in favour of United States upland cotton producers within the meaning of the *Agreement on Agriculture*. According to the United States, Article 3.1 of the *Agreement on Agriculture* provides that the domestic support commitments in Part IV of each Member's Schedule are made an integral part of the *GATT 1994* and therefore, the domestic support commitments of the United States are integral part of

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<sup>1234</sup> Section 1601(e) pertains to expenditures under subtitles A through E of the FSRI Act of 2002. Section 1207(a) is in Subtitle B of that Act. Levels of expenditures under section 1207(a) are therefore covered by the provision.

<sup>1235</sup> United States' response to Panel Question No. 253. In response to Panel Question No. 253(b), the United States confirmed that "section 1601(e) applies to the Aggregate Measure of Support commitments under the Uruguay Round Agreement on Agriculture."

<sup>1236</sup> We have discussed this in more detail *supra*, paras. 7.1053 *ff.*

<sup>1237</sup> This finding is specific to the text of Article 3.1(b) of the *SCM Agreement* and Article 6.3 and related domestic support provisions of the *Agreement on Agriculture*. It is without prejudice to issues arising under Articles 3.3, 8 and 21 of the *Agreement on Agriculture* and Article 3 of the *SCM Agreement* in relation to Members' rights and obligations with respect to export subsidies.

<sup>1238</sup> Brazil's first written submission, paras. 342-351.

the *GATT 1994* itself. The user marketing (Step 2) programme exists in favour of agricultural producers within Current Total AMS, and the text of the *Agreement on Agriculture* does not prohibit any particular form of delivery of such "amber box" domestic support. The United States notes that Brazil's submission focuses exclusively on GATT jurisprudence involving Article III:8(b), which predates the Uruguay Round Agreements. The *Agreement on Agriculture* imposed, for the first time, rigorous disciplines on agricultural support and the commitments of the United States constitute an integral part of the *GATT 1994*.<sup>1239</sup>

7.1101 The United States also asserts that paragraph 7 of Annex 3 of the *Agreement on Agriculture* specifically requires that "[m]easures directed at processors shall be included" in the calculation of AMS to subject these measures to the domestic support reduction commitments established for the first time in the *Agreement on Agriculture*. Therefore, according to the United States, it would be illogical to include such payments in the required calculations and subject them to reduction commitments if they were already prohibited under Article III:4 of the *GATT 1994*. The United States submits that a coherent reading of the *Agreement on Agriculture* with the *GATT 1994* indicates that the user marketing (Step 2) programme, in conformity with the *Agreement on Agriculture*, does not violate Article III:4 of the *GATT 1994*.<sup>1240</sup>

(b) Main arguments of the third parties

7.1102 **Argentina** submits, in response to the Panel's question, that Article III:4 of the *GATT 1994* prohibits discrimination against imported products, and so that provision is "also applicable" to the present case.<sup>1241</sup>

7.1103 The **European Communities** agrees with the United States that subsidies contingent upon the use of domestic goods, which are maintained consistently with the *Agreement on Agriculture*, are not inconsistent with either Article 3 of *SCM Agreement* or Article III:4 of the *GATT 1994*.<sup>1242</sup>

7.1104 **New Zealand** submits that Brazil has demonstrated that marketing (Step 2) payments are prohibited subsidies under Article 3.1(b) of the *SCM Agreement*, and that "on that basis, they also violate" Article III:4 of the *GATT 1994*.<sup>1243</sup>

(c) Evaluation by the Panel

7.1105 We recall that we need not examine all claims before us. Rather, we need only address those claims that must be addressed in order to resolve the matter in issue in the dispute<sup>1244</sup>, provided that we address those claims on which a finding is necessary in order to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance by a Member in order to ensure effective resolution of disputes to the benefit of all Members.<sup>1245</sup>

7.1106 In light of our findings above under Article 3.1(b) and Article 3.2 of the *SCM Agreement*, we do not believe that it is necessary to address Brazil's claim relating to the same measure – section

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<sup>1239</sup> United States' first written submission, paras. 146-149.

<sup>1240</sup> United States' first written submission, para. 150.

<sup>1241</sup> Argentina's response to Panel third party Question No. 40.

<sup>1242</sup> European Communities' oral statement at the first session of the first substantive meeting, paras. 33-38. See also European Communities' response to Panel third party Question No. 40.

<sup>1243</sup> New Zealand's written submission to the first session of the first substantive meeting, para. 4.01. See also New Zealand's response to Panel third party Question No. 40.

<sup>1244</sup> Appellate Body Report, *US – Wool Shirts and Blouses*, p. 19. See also e.g., Appellate Body Report, *Canada – Autos*, paras. 112-117, where the Appellate Body refers to and endorses that panel's exercise of the "discretion" implicit in the principle of judicial economy.

<sup>1245</sup> Appellate Body Report, *Australia – Salmon*, para. 223.

1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users – under Article III:4 of the *GATT 1994*.

G. ACTIONABLE SUBSIDIES: CLAIMS OF "PRESENT" SERIOUS PREJUDICE

1. Measures at issue

7.1107 This Section of our report deals with alleged actionable subsidies, including certain alleged subsidies that are not "exempt from actions" based on Articles 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* within the meaning of Articles 13(b)(ii) and 13(c)(ii) of the *Agreement on Agriculture* as a result of our findings in Sections VII:D, E and F of the Panel's report. These are the following measures<sup>1246</sup>, as described in Section VII:C of this report:

- (i) user marketing (Step 2) payments to domestic users and exporters;
- (ii) marketing loan programme payments;
- (iii) production flexibility contract payments;
- (iv) market loss assistance payments;
- (v) direct payments;
- (vi) counter-cyclical payments;
- (vii) crop insurance payments;
- (viii) cottonseed payments for the 2000 crop; and
- (ix) legislative and regulatory provisions currently providing for the payment of measures in (i), (ii), (v), (vi) and (vii) above.<sup>1247</sup>

2. Overview of Brazil's present serious prejudice claims under the *SCM Agreement* and the *GATT 1994*

7.1108 Brazil alleges present serious prejudice under Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*, and Articles XVI:1 and XVI:3 of the *GATT 1994*. Brazil claims that United States subsidies provided during MY 1999-2002 have caused, cause and continue to cause "serious prejudice" to Brazil's interests by:

- (i) significantly suppressing upland cotton prices in the United States, world and Brazilian markets in violation of Articles 5(c) and 6.3(c) of the *SCM Agreement*,
- (ii) increasing the United States share of the upland cotton world market in violation of Articles 5(c) and 6.3(d) of the *SCM Agreement*; and

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<sup>1246</sup> With regard to Brazil's claims concerning United States' export credit guarantee programmes, Brazil clarified, in response to Panel Question Nos. 129 and 139, that Brazil's serious prejudice claims relating to export credit guarantee programmes involve only GSM 102. According to Brazil, this is because either no cotton allocations were made, or only negligible amounts of cotton were exported, under the GSM 103 and SCGP export credit guarantee programmes during the years in question. In light of our findings in Section VII:E, *supra*, we do not consider it necessary to include export credit guarantees under the GSM 102 programme in our analysis here. We therefore exercise judicial economy with respect to this claim of Brazil.

<sup>1247</sup> See also Brazil's *per se* actionable subsidy claims in Section VII:I.

- (iii) resulting in the United States having more than an equitable share of world export trade in violation of Articles XVI:1 and XVI:3 of the *GATT 1994*.

### 3. Claims under Articles 6.3(c) and 5(c) of the *SCM Agreement*

#### (a) Introduction

7.1109 Part III of the *SCM Agreement* is entitled "Actionable Subsidies". It comprises Articles 5, 6 and 7. Article 5 of the *SCM Agreement* is entitled "Adverse Effects". According to its chapeau: "No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e. ...". Article 5(c) identifies "serious prejudice to the interests of another Member" as one such adverse effect. Article 6.3(c) states that serious prejudice in the sense of Article 5(c) may arise where "the effect of the subsidy" is "significant price suppression" "in the same market". Article 7 deals with remedies.

7.1110 Article 5 of the *SCM Agreement* provides: "No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members...". Therefore, to be an "actionable subsidy" for the purposes of Part III of the *SCM Agreement*, there must first be a specific subsidy within the meaning of Articles 1.1 and 1.2 of the *SCM Agreement*. We therefore now examine whether the measures at issue are such specific subsidies.

#### (b) Are the challenged measures "subsidies" for the purposes of an actionable subsidies analysis?

7.1111 Article 1 of the *SCM Agreement* provides, in part, that:

"1.1 For the purpose of this Agreement, a subsidy shall be deemed to exist if:

(a)(1) there is a financial contribution by a government or any public body within the territory of a Member (referred to in this Agreement as "government"), i.e. where:

- (i) a government practice involves a direct transfer of funds (e.g. grants, loans, and equity infusion), potential direct transfers of funds or liabilities (e.g. loan guarantees); ...

and

(b) a benefit is thereby conferred."

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; marketing loan programme payments; production flexibility contract payments; market loss assistance payments; direct payments; counter-cyclical payments; crop insurance subsidies<sup>1248</sup>; and cottonseed payments – provide "financial contributions" in the form of "grants" to participating United States producers,

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<sup>1248</sup> Brazil clarifies in response to Panel Question No. 130 that its claim pertains to "two different types of subsidies": the United States FCIC pays a portion of the premiums that farmers would otherwise have to pay for obtaining crop insurance. Exhibit BRA-30 (section 508(e) of the Federal Crop Insurance Act); Exhibit BRA-59 ("Briefing Room: Farm and Commodity Policy: Crop Yield and Revenue Insurance") Second, the FCIC covers losses under crop insurance policies that exceed the amount of premiums collected, thus "providing free reinsurance for private insurance companies offering crop insurance." Exhibit BRA-30 (section 508(k) of the Federal Crop Insurance Act). Reinsurance agreement standards are set out in 7 CFR 400.161 *et seq.*, reproduced in Exhibit BRA-39.

processors, users or exporters of upland cotton within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*.<sup>1249</sup>

7.1113 Moreover, Brazil alleges that all of the measures concerned confer a "benefit" within the meaning of Article 1.1(b) of the *SCM Agreement* upon United States upland cotton producers and/or users because the recipients of such payments were placed in a better, more advantageous, position than would have been secured on the market.<sup>1250</sup>

7.1114 The **Panel** does not understand the **United States** to dispute that many of the challenged measures – i.e. user marketing (Step 2) payments to domestic users and exporters; marketing loan programme payments; crop insurance payments and cottonseed payments – constitute "subsidies" for the purposes of Article 1 of the *SCM Agreement*.<sup>1251</sup>

7.1115 Nor, in the Panel's view, could the United States properly do so in respect of any of these payments. User marketing (Step 2) payments to domestic users and exporters<sup>1252</sup>; marketing loan programme payments, crop insurance payments<sup>1253</sup> and cottonseed payments are financial contributions, essentially in the form of "grants" within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*.

7.1116 These grants are made by a United States government agency (CCC or FCIC).<sup>1254</sup> Each of these United States government grants confers a benefit within the meaning of Article 1.1(b) of the *SCM Agreement* as they place the recipient in a better position than the recipient otherwise would have been in the marketplace.

7.1117 The United States, however, raises objections to Brazil's "subsidy" allegations concerning PFC, DP, MLA and CCP payments. The United States contends that Brazil has not established the "amount" or "portion" of the subsidy properly attributable to upland cotton producers pursuant to Article 1 of the *SCM Agreement*.<sup>1255</sup>

7.1118 We are of the view that PFC, DP, MLA and CCP payments constitute "financial contributions" in the form of "grants" within the meaning of Article 1.1(a)(1)(i) of the *SCM Agreement*. These grants are made by the CCC (which is a United States government agency).<sup>1256</sup> These United States government grants confer a benefit within the meaning of Article 1.1(b) of the *SCM Agreement* as they place the recipient in a better position than they otherwise would have been in the market.

7.1119 In our view, the argument of the United States relating to the "amount" or "portion" of the subsidy "properly attributable to upland cotton producers" is not germane to the inquiry that is to be conducted under Article 1 of the *SCM Agreement*. Here, we are asking whether a "financial contribution" exists, and whether a "benefit" is thereby conferred. We are not required precisely to establish, at this stage, the quantity of that benefit in respect of upland cotton. Although the United States questions whether Brazil has established the amount of the subsidy in respect of upland cotton, we do not understand the United States to assert that *no benefit whatsoever* is conferred in respect of

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<sup>1249</sup> Brazil's further written submission, para. 32.

<sup>1250</sup> Brazil's further written submission, para. 33.

<sup>1251</sup> United States' responses to Panel Question Nos. 108 and 127.

<sup>1252</sup> We have already found *supra*, that user marketing (Step 2) payments to domestic users and exporters are "subsidies" within the meaning of Article 1 of the *SCM Agreement*. We refer to, and incorporate, these findings in Sections VII:E and F.

<sup>1253</sup> In the case of crop insurance payments, the FCIC pays a portion of the premium that a producer of upland cotton would otherwise have to pay.

<sup>1254</sup> See description of the measures in Section VII:C. See also Sections VII:E and F.

<sup>1255</sup> United States' response to Panel Question No. 129.

<sup>1256</sup> See description of the measures in Section VII:C. See also Sections VII:E and F.

upland cotton by these payments. In any event, we have found that these payments do, in fact, manifest a strongly positive relationship to upland cotton.<sup>1257</sup> We therefore do not change our view that these payments, too, constitute "subsidies" within the meaning of Article 1 of the *SCM Agreement*.

7.1120 In conclusion, the Panel finds that user marketing (Step 2) payments to domestic users and exporters<sup>1258</sup>; marketing loan programme payments; PFC payments; MLA payments; DP payments; CCP payments; crop insurance payments; and cottonseed payments constitute "subsidies" within the meaning of Articles 1.1(a) and (b) of the *SCM Agreement*.

(c) Are the challenged subsidies "specific" for the purposes of an actionable subsidies analysis?

(i) *Main arguments of the parties*

7.1121 **Brazil** claims that the United States subsidies at issue – i.e. user marketing (Step 2) payments to domestic users and exporters; marketing loan programme payments; production flexibility contract payments; market loss assistance payments; direct payments; counter-cyclical payments; crop insurance subsidies; and cottonseed payments – are "specific" within the meaning of Article 2 of the *SCM Agreement*.

7.1122 Brazil alleges such specificity as each of the programmes is provided to "discrete segments" of the United States economy.<sup>1259</sup> None are widely available throughout the United States economy to a multitude of diverse industries. Eligibility for the domestic support and export subsidies at issue is either "explicitly" limited to the subset of the United States industry producing agricultural crops, to subgroups of industries producing *certain* agricultural crops, or to upland cotton *only*. None of the subsidies are generally available for all agriculture, much less any non-agricultural product.

7.1123 Brazil also alleges that user marketing (Step 2) payments to domestic users and exporters, are "deemed to be specific" within the meaning of Article 2.3 of the *SCM Agreement* as they are prohibited subsidies falling under the provisions of Article 3 of the *SCM Agreement*.<sup>1260</sup>

7.1124 The **United States** submits that, in principle, a subsidy that is limited to a small proportion of United States commodities would be limited and thus "specific". However, the *SCM Agreement* does not establish any quantitative standard for determining when a subsidy is so limited, and the determination must be made on a case-by-case basis.

7.1125 The United States does not expressly contest that user marketing (Step 2) payments to domestic users and exporters; marketing loan programme payments; PFC payments; MLA payments; DP payments; CCP payments; and cottonseed payments are "specific" within the meaning of Article 2 of the *SCM Agreement*.

7.1126 However, the United States contends that Brazil has not established that crop insurance subsidies are specific within the meaning of Article 2 of the *SCM Agreement*. According to the United States, crop insurance subsidies are available to the whole United States agricultural sector and the United States contends that this is too broad and diverse to constitute a single "enterprise or industry or group of enterprises or industries".<sup>1261</sup>

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<sup>1257</sup> *Supra*, Section VII:D.

<sup>1258</sup> We again recall that we have already found *supra* that user marketing (Step 2) payments to domestic users and exporters are "subsidies" within the meaning of Article 1 of the *SCM Agreement*. *Supra*, Sections VII:E and F.

<sup>1259</sup> Brazil's further written submission, para. 42.

<sup>1260</sup> Brazil's further written submission, footnote 16.

<sup>1261</sup> United States' response to Panel Question No. 131(a).

(ii) *Main arguments of the third parties*

7.1127 **Argentina** stresses that the concept of "specificity" in Article 2 of the *SCM Agreement* is very broad, since it refers to the subsidies for an enterprise or an industry or group of enterprises or industries. According to Argentina, agricultural subsidies are specific within the meaning of Article 2, since they are not available for all products. Further, a subsidy in respect of all agricultural crops (i.e. but not to other agricultural commodities, *such as livestock*) is specific, as is a subsidy in respect of certain identified agricultural products specific to producers of certain agricultural products and a subsidy in respect of upland cotton, but not other products.<sup>1262</sup>

7.1128 **Canada** is of the view that, based on the ordinary meaning of the phrase "is specific to", read in context and in light of the object and purpose of Article 2 and of the *SCM Agreement*, the specificity test is concerned with the actual availability of a programme.

7.1129 Canada shares the view of the United States that, as a general matter, "all agriculture" is too broad to qualify as a "group of enterprises or industries" for specificity purposes. Whether a subsidy is specific in respect of all agricultural crops except other agricultural commodities, such as livestock depends on: (1) the facts of a given case, as a panel would have to consider, *inter alia*, the number of enterprises or industries (based on standard industrial classification) within the jurisdiction of the granting authority that are actually eligible to receive the subsidy, and the level of diversification of the "all agricultural crops" universe and (2) on the nature of the measure in question and whether it excludes enterprises or industries that might otherwise be reasonably or practically included.<sup>1263</sup>

7.1130 Canada further submits that where a programme appears *de jure* non-specific under Articles 2.1(a) and (b), predominant use of a programme by "certain enterprises" (a defined term in Article 2.1) would indicate, in the absence of any other reasonable explanation, that the availability of the subsidy is limited in fact to such enterprises or industries under Article 2.1(c) and 2.4. Likewise, where a programme appears *de jure* non-specific under Articles 2.1(a) and (b), the granting of disproportionately large amounts of subsidy to certain enterprises would indicate, in the absence of any other reasonable explanation, that the availability of the subsidy is limited in fact to such enterprises or industries under Article 2.1(c) and 2.4. In both cases, any predominance or disproportionality should be measured over an appropriate period of time and in relation to the value of production in question as compared to the total value of all agricultural production.<sup>1264</sup>

7.1131 **China** argues that "agricultural commodity" can be understood as equivalent to "agricultural product" under the *Agreement on Agriculture*. In light of the respective definitions of "industry" and "agriculture", the latter term meets the definition of the former as it is the "science and practice of using productive labour". China is of the view that: (1) any subsidy to agricultural commodities must be considered as specific for the purpose of Article 2 of the *SCM Agreement*; (2) agriculture producing all agricultural products is an industry and consists of "group of enterprises" by definition. In addition, "subsidies in respect of 'all agricultural crops'" "certain identified agricultural products" (i.e. but not to other agricultural commodities, such as livestock), "certain identified agricultural products" and "upland cotton, but not other products" should all be deemed specific since "group of enterprises" producing crops are targeted in all cases and the use of "a certain proportion of the value of total United States commodities" or "a certain proportion of United States farmland" will necessarily be equivalent to "an enterprise or industry or group of enterprises or industries" because the "proportion" has to be generated by adding up those data from specific "enterprise or industry or group of enterprises or industries".<sup>1265</sup>

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<sup>1262</sup> Argentina's response to Panel third party Question No. 51.

<sup>1263</sup> Canada's response to Panel third party Question No. 51.

<sup>1264</sup> Canada's response to Panel third party Question No. 51.

<sup>1265</sup> China's response to Panel third party Question No. 51.

7.1132 **India** submits that the United States subsidies at issue are explicitly limited to certain enterprises or industries, as none of the subsidies at issue are widely available throughout the United States economy across industries. Eligibility for the domestic support and export subsidies is either "explicitly" limited to the subset of the United States industry producing agricultural crops, to subgroups of industries producing certain agricultural crops, or to only upland cotton. None of the subsidies are available for any non-agricultural product.<sup>1266</sup>

7.1133 The **European Communities** asserts that a subsidy granted to an economic operator which does not require any production of agricultural products, and in which the subsidy may be used for any purpose, does not appear, to the European Communities, to be specific in the sense of Article 2.1(a).<sup>1267</sup> With respect to crop insurance subsidies, the European Communities understands that different crop insurance policies apply to different agricultural products and if such differences had the consequence that some agricultural products will receive a benefit in circumstances where other products will receive no benefit, or only a smaller benefit, the difference would be clearly "specific".<sup>1268</sup>

7.1134 **New Zealand** submits that crop insurance subsidies to upland cotton producers enhances United States upland cotton production, as the payments act as a direct production stimulant by keeping marginal upland cotton land in production. According to New Zealand, Brazil has demonstrated that the crop insurance programme is limited to certain enterprises and thus is not generally available but is effectively available only in respect of crops.<sup>1269</sup>

7.1135 **Chinese Taipei** states that a further reason for excluding "non-specific subsidies" from being prohibited should be that the subsidies are generally available and no competitive advantage is provided to a particular sector or some specific sectors. If there is competitive advantage provided to one or more sectors with the effect of excluding other sectors from receiving the advantages, it should be considered as specific.<sup>1270</sup>

(iii) *Evaluation by the Panel*

7.1136 Pursuant to Article 1.2 of the *SCM Agreement*: "A subsidy as defined in paragraph 1 shall be subject to the provisions of Part II or shall be subject to the provisions of Part III or V only if such a subsidy is specific in accordance with the provisions of Article 2." Therefore, in order to qualify as an "actionable subsidy" for the purposes of Part III of the *SCM Agreement*, a measure must be a "specific" subsidy, as defined in Article 2 of the *SCM Agreement*.

7.1137 Article 2 of the *SCM Agreement* provides:

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<sup>1266</sup> India's oral statement at the resumed session of the first substantive meeting, p. 1.

<sup>1267</sup> European Communities' response to Panel third party Question No. 51.

<sup>1268</sup> European Communities' oral statement at the resumed session of the first substantive meeting, paras. 5-6.

<sup>1269</sup> New Zealand's oral statement at the resumed session of the first substantive meeting, paras. 12-13.

<sup>1270</sup> Chinese Taipei's response to Panel third party Question No. 51.

"Article 2

*Specificity*

2.1 In order to determine whether a subsidy, as defined in paragraph 1 of Article 1, is specific to an enterprise or industry or group of enterprises or industries (referred to in this Agreement as "certain enterprises") within the jurisdiction of the granting authority, the following principles shall apply:

- (a) Where the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific.
- (b) Where the granting authority, or the legislation pursuant to which the granting authority operates, establishes objective criteria or conditions<sup>2</sup> governing the eligibility for, and the amount of, a subsidy, specificity shall not exist, provided that the eligibility is automatic and that such criteria and conditions are strictly adhered to. The criteria or conditions must be clearly spelled out in law, regulation, or other official document, so as to be capable of verification.
- (c) If, notwithstanding any appearance of non-specificity resulting from the application of the principles laid down in subparagraphs (a) and (b), there are reasons to believe that the subsidy may in fact be specific, other factors may be considered. Such factors are: use of a subsidy programme by a limited number of certain enterprises, predominant use by certain enterprises, the granting of disproportionately large amounts of subsidy to certain enterprises, and the manner in which discretion has been exercised by the granting authority in the decision to grant a subsidy.<sup>3</sup> In applying this subparagraph, account shall be taken of the extent of diversification of economic activities within the jurisdiction of the granting authority, as well as of the length of time during which the subsidy programme has been in operation.

2.2 A subsidy which is limited to certain enterprises located within a designated geographical region within the jurisdiction of the granting authority shall be specific. It is understood that the setting or change of generally applicable tax rates by all levels of government entitled to do so shall not be deemed to be a specific subsidy for the purposes of this Agreement.

2.3 Any subsidy falling under the provisions of Article 3 shall be deemed to be specific.

2.4 Any determination of specificity under the provisions of this Article shall be clearly substantiated on the basis of positive evidence."

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<sup>2</sup> Objective criteria or conditions, as used herein, mean criteria or conditions which are neutral, which do not favour certain enterprises over others, and which are economic in nature and horizontal in application, such as number of employees or size of enterprise.

<sup>3</sup> In this regard, in particular, information on the frequency with which applications for a subsidy are refused or approved and the reasons for such decisions shall be considered.

7.1138 Pursuant to this provision, subsidies that are, either in fact or in law, specifically granted to an "enterprise" or "industry" (or group of enterprises or industries) meet the "specificity" criteria in Article 2 of the *SCM Agreement*. Pursuant to Article 2.1(a) of the *SCM Agreement*, "[w]here the granting authority, or the legislation pursuant to which the granting authority operates, explicitly limits access to a subsidy to certain enterprises, such subsidy shall be specific." Pursuant to Article 2(c), other factors (such as the use of a subsidy programme by a limited number of certain enterprises or predominant use by certain enterprises) may be considered where there is an appearance of non-specificity.

7.1139 According to the text of Article 2 of the *SCM Agreement*, a subsidy is "specific" if it is specific to an enterprise or industry or group of enterprises or industries (referred to in the *SCM Agreement* as "certain enterprises") within the jurisdiction of the granting authority. This is one way in which the *SCM Agreement* serves to define requirements as to the "recipients" of the benefit bestowed by a subsidy.<sup>1271</sup> Beyond setting out this rather general principle, Article 2 of the *SCM Agreement* does not speak with precision about when "specificity" may be found.

7.1140 Looking more closely at the textual terms used in the chapeau of Article 2 of the *SCM Agreement*, the term "industry" may be defined as "a particular form or branch of productive labour; a trade; a manufacture".<sup>1272</sup> "Specificity" extends to a group of industries because the words "certain enterprise" are defined broadly in the opening terms of Article 2.1, as an enterprise or industry or group of enterprises or industries.

7.1141 The provision does not offer any technical definition or additional, detailed indication about how broadly or narrowly we are to classify an "industry". Nor is it necessary for the purposes of this dispute to develop any fixed definition of the scope of an "industry" within the meaning of the chapeau of Article 2.

7.1142 We nevertheless believe that an industry, or group of "industries", may be generally referred to by the type of products they produce.<sup>1273</sup> To us, the concept of an "industry" relates to producers of certain products. The breadth of this concept of "industry" may depend on several factors in a given case. At some point that is not made precise in the text of the agreement, and which may modulate according to the particular circumstances of a given case, a subsidy would cease to be specific because it is sufficiently broadly available throughout an economy as not to benefit a particular limited group of producers of certain products. The plain words of Article 2.1 indicate that specificity is a general concept, and the breadth or narrowness of specificity is not susceptible to rigid quantitative definition. Whether a subsidy is specific can only be assessed on a case-by-case basis.

7.1143 We see merit in the shared view of the parties that the concept of "specificity" in Article 2 of the *SCM Agreement* serves to acknowledge that some subsidies are broadly available and widely used throughout an economy and are therefore not subject to the Agreement's subsidy disciplines. The footnote to Article 2.1 defines the nature of "objective criteria or conditions" which, if used to determine eligibility, would preclude an affirmative conclusion of specificity. Such criteria are "neutral, which do not favour certain enterprises over others, and which are economic in nature and horizontal in application, such as number of employees or size of enterprise."

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<sup>1271</sup> See e.g., Appellate Body Report, *US – Countervailing Measures on Certain EC Products*, paras. 112-113.

<sup>1272</sup> *The New Shorter Oxford English Dictionary*, (1993).

<sup>1273</sup> See Panel Report, *US – Softwood Lumber IV*, para. 7.120.

7.1144 Furthermore, the concept of specificity in Article 2 of the *SCM Agreement* is germane to the disciplines imposed by the *SCM Agreement*. The *SCM Agreement* is an agreement on trade in goods, in Annex 1A of the *WTO Agreement*. By its own terms, subject to considerations reflected in the text of some of its provisions, it applies in respect of *all* goods. The concept of specificity must be considered within the legal framework and frame of reference of that agreement as a whole.<sup>1274</sup>

7.1145 We do not understand that there is a dispute between the parties that many of the challenged subsidies – i.e. user marketing (Step 2) payments to domestic users and exporters; marketing loan programme payments; PFC payments; MLA payments; DP payments; CCP payments; and cottonseed payments – are "specific" within the meaning of Article 2 of the *SCM Agreement*.

7.1146 In any event, a textual analysis of "the legislation pursuant to which the granting authority operates", to discern whether or not it "explicitly limits access to a subsidy to certain enterprises" leads us to conclude that such subsidies are "specific" within the meaning of Article 2.1(a).

7.1147 Certain of the measures at issue were or are available specifically in respect of upland cotton: user marketing (Step 2) payments depend on the domestic use or export of upland cotton. Other products or industries are not eligible for the subsidy. Cottonseed payments went to first handlers, while also, to some extent, benefiting producers of upland cotton. We believe that a subsidy that is limited to a small proportion of industries, such as those producing one or two individual United States products would be limited and thus "specific" within the meaning of Article 2 of the *SCM Agreement*. These subsidies are "specific" as they are not even available in respect of a number of commodities.

7.1148 Other measures before us pertain to a restricted number of agricultural products, but are not widely or generally available in respect of all agricultural production, let alone the entire universe of United States production of goods. These measures include the marketing loan programme payments.<sup>1275</sup> They also include the measures available in respect of upland cotton as part of a restricted basket of agricultural commodities. These are the four types of domestic support which permit production flexibility (PFC, MLA, DP and CCP payments) that were or are provided in respect of certain agricultural production in a base period which satisfies certain eligibility criteria. These criteria have the effect of limiting eligibility to a subset of basic agricultural products, including upland cotton or certain other programme crops. We therefore find that these subsidies are "specific" within the meaning of Article 2. The fact that some of the subsidies go to farmers who may produce different commodities, or, in theory, may not produce a given commodity does not mean, by some process of reverse reasoning, that the specificity that is apparent from the face of the grant instrument no longer exists.

7.1149 The United States disagrees with Brazil's allegation that crop insurance subsidies are "specific".

7.1150 Crop insurance subsidies are, generally, available for most crops but they are not generally available in respect of the entire agricultural sector in all areas.<sup>1276</sup> Each insurance plan is available

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<sup>1274</sup> There is no analogous concept of specificity in, for example, the *Agreement on Agriculture*.

<sup>1275</sup> Section 1202 of the FSRI Act of 2002 identifies 17 "loan commodities"; Section 131 of the FAIR Act of 1996 identified several commodities, including upland cotton. The statute and regulations implementing the marketing loan programme set out specific provisions regarding upland cotton. See *supra*, Section VII:D.

<sup>1276</sup> Exhibit BRA-30 (Section 518 of the Federal Crop Insurance Act) contains a list of the "agricultural commodities" covered by insurance policies that are subsidized under the Federal Crop Insurance Act. The text of this legislative instrument indicates that the term "agricultural commodity" includes, *inter alia*, cotton and other United States crops. Livestock (while not expressly enumerated) would fall under the blanket reference to "any other agricultural commodity". The fact that the definition expressly excludes "stored grain" supports this, in that there is no analogous exclusion for livestock). We note that, even assuming *arguendo* that the text of the granting instrument shows any appearance of non-specificity, record evidence indicates that there are pilot

for a defined list of crops to which the FCIC determines that it is adapted.<sup>1277</sup> The proportion of the premium borne by the FCIC is set out in each plan. The major plan type (actual production history) is available for approximately 100 agricultural commodities, and specifies upland cotton as one of them.<sup>1278</sup> The other four plan types (group risk, crop revenue coverage, income protection and revenue assurance) are available only for a limited number of eight commodities or less and they each specify upland cotton as one of them.<sup>1279</sup> Certain sample policy provisions specify "cotton".<sup>1280</sup> There are no subsidized crop insurance policies on the record available to all agricultural producers. They are therefore, in fact, not even generally available to the industry which can be categorized as the agricultural industry.

7.1151 In our view, the industry represented by a portion of United States agricultural production that is growing and producing certain agricultural crops (and certain livestock in certain regions under restricted conditions) is a sufficiently discrete segment of the United States economy in order to qualify as "specific" within the meaning of Article 2 of the *SCM Agreement*.

7.1152 As a factual matter, we have found that the crop insurance subsidy is not universally available for all agricultural production. Rather, it is generally limited to certain "crops", it differentiates among such crops and it is only available in certain regional "pilot programmes" in respect of livestock. The facts of this case therefore do not require us to address the United States argument that the crop insurance subsidy is generally available to the United States agricultural sector as a whole, and thus, according to the United States, would not be specific within the meaning of Article 2.

7.1153 Finally, we address the "specificity" of user marketing (Step 2) payments to domestic users and exporters under Article 2.3 of the *SCM Agreement*. Pursuant to Article 2.3 of the *SCM Agreement*: "Any subsidy falling under the provisions of Article 3 shall be deemed to be specific." By virtue of this provision, a subsidy falling within the provisions of Article 3 (i.e. a subsidy contingent upon export performance within the meaning of Article 3.1(a) of the *SCM Agreement* or a subsidy contingent upon the use of domestic over imported goods within the meaning of Article 3.1(b) of the *SCM Agreement*) is "deemed to be specific" for the purposes of Part I of the *SCM Agreement*. We recall our findings that user marketing (Step 2) payments to domestic users and exporters under section 1207(a) of the FSRI Act of 2002 are prohibited subsidies under Articles 3.1(a) and (b) of the *SCM Agreement*.<sup>1281</sup> As we have found that user marketing (Step 2) payments to domestic users and exporters under section 1207(a) of the FSRI Act of 2002 "fall within the provisions of Article 3", we consequently find that these are "specific" subsidies within the meaning of Article 2.3 of the *SCM Agreement*. Furthermore, because of the substantial similarities between user marketing (Step 2) payments to domestic users and exporters under section 1207(a) of the FSRI Act of 2002 and under section 136 of the FAIR Act of 1996, we find that the latter are also specific within the meaning of Article 2.3 of the *SCM Agreement*.

7.1154 For these reasons, we conclude that all of the subsidies at issue – i.e. 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 – are "specific" within the meaning of Article(s) 2.1(a) and/or 2.3 of the *SCM Agreement*.

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programmes for livestock – AGR and "AGR-lite" in certain regions – but that these programmes are not universally available in respect of all livestock within the United States. See, for example, Exhibits BRA-174 through -176, -271 and -272.

<sup>1277</sup> See, for example, Exhibit BRA-175 concerning USDA FCIC "Cotton Crop Provisions".

<sup>1278</sup> See USDA Risk Management Agency lists of crops covered under the 2002 and 2003 crop years crop insurance programs, reproduced in Exhibits BRA-62 and BRA-57, respectively; Brazil's rebuttal submission, para. 55, and United States' 27 August comments, footnote 48.

<sup>1279</sup> See also *supra*, para. 7.517.

<sup>1280</sup> See "Income Protection – Cotton Crop Provisions" USDA FCIC, 2000-321 and "Cotton Crop Provisions" USDA FCIC, 99-021, reproduced in Exhibits BRA-174 and BRA-175.

<sup>1281</sup> Sections VII:E and F.

7.1155 Having found that the measures at issue constitute specific subsidies within the meaning of Articles 1.1 and 1.2 of the *SCM Agreement*, we continue our examination of Brazil's claims under Articles 5(c) and 6.3(c) in Part III of the *SCM Agreement*.

(d) Panel's approach to serious prejudice claims under Articles 5(c) and 6.3(c) of the *SCM Agreement*

(i) *Relevant legal provisions*

7.1156 Article 5 of the *SCM Agreement*, entitled "Adverse effects" states, in part:

"No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.:

- (a) injury to the domestic industry of another Member<sup>11</sup>;
- (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular the benefits of concessions bound under Article II of GATT 1994<sup>12</sup>;
- (c) serious prejudice to the interests of another Member.<sup>13</sup>"

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<sup>11</sup> The term "injury to the domestic industry" is used here in the same sense as it is used in Part V.

<sup>12</sup> The term "nullification or impairment" is used in this Agreement in the same sense as it is used in the relevant provisions of GATT 1994, and the existence of such nullification or impairment shall be established in accordance with the practice of application of these provisions.

<sup>13</sup> The term "serious prejudice to the interests of another Member" is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice.

7.1157 Article 6.3(c) of the *SCM Agreement* provides:

"Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply:

...

- (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;"

7.1158 Brazil submits that the United States subsidies at issue have caused serious prejudice to its interests within the meaning of Article 5(c) in the form of "significant price suppression" under Article 6.3(c) of the *SCM Agreement*. The United States disagrees. Before examining specific elements of Brazil's claims, we outline our treatment of certain arguments put to us by the parties, as well as the considerations that will guide our analysis of these claims.

(ii) *Panel's treatment of certain arguments of the parties*

7.1159 We recall that the United States reproaches Brazil for not identifying the "subsidized product for each of the types of subsidies from which it claims serious prejudice".<sup>1282</sup>

7.1160 Specifically, the **United States** argues that Brazil has failed to properly take account of, or "expense", the duration of the "benefit" associated with certain annually recurring subsidies and has, furthermore, not demonstrated "how much" or "to what extent" United States cotton exports are subsidized.

7.1161 According to the United States, because payments which permit planting flexibility are not "tied to the production or sale" of upland cotton, as suggested by Annex IV of the *SCM Agreement*, they must be allocated by Brazil across the total value of production of each recipient.<sup>1283</sup> The United States asserts that Brazil has failed to demonstrate which product benefits from the subsidy. In order to perform the calculation, under the Annex IV guidelines, one must know what the subsidized product is. The United States asserts that, in the context of this dispute, a subsidy provided to a recipient who does not produce upland cotton cannot be said to provide a benefit to upland cotton and cannot be regarded as having one of the effects described in Article 6.3 insofar as upland cotton is concerned.<sup>1284</sup>

7.1162 The United States further argues that paragraph 7 of Annex IV of the *SCM Agreement* indicates that the drafters took it for granted that the benefits of certain subsidies should be allocated to future production. According to the United States, Brazil cannot have it both ways: it cannot expense the entire value of payment to a particular crop year for which the payment was received but also claim that the subsidy continues to exist in a later year in which new recurring subsidies are made.<sup>1285</sup>

7.1163 The United States submits that the Panel must utilize some methodology to determine the benefit to upland cotton from a subsidy not tied to production of upland cotton and considers that Annex IV continues to provide useful context for the necessary task of identifying the products that benefit from a subsidy not tied to the production or sale of a given product.<sup>1286</sup>

7.1164 **Brazil** states that the only legal basis for the alleged "allocation" requirement of "untied" subsidies cited by the United States is Annex IV of the *SCM Agreement* which, like Article 6.1(a), is now defunct.<sup>1287</sup> Brazil is of the view that the United States continues to try and transform this dispute into a countervailing duty investigation based on the now-defunct Annex IV of the *SCM Agreement*.

7.1165 Brazil emphasizes that 100 per cent of the four types of payments which permit planting flexibility (i.e., PFC, DP, MLA and CCP payments) are paid to the bank accounts of current upland cotton producers, conferring for each a "benefit" to upland cotton producers. Brazil further asserts that, under existing countervailing duty procedures, 100 per cent of the contract payments would be allocated across the production value of the producers because the total amount of benefits to the company producing the subsidized goods would first be calculated. According to Brazil, no deductions are made depending on how the subsidy is used by the recipients (i.e. to pay rents). Only

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<sup>1282</sup> United States' oral statement at the resumed session of the first substantive meeting, para. 9.

<sup>1283</sup> United States' response to Panel Question No. 125 (9), para. 24.

<sup>1284</sup> United States' further rebuttal submission, paras. 13-14.

<sup>1285</sup> United States' oral statement at the second substantive meeting, para. 32.

<sup>1286</sup> United States' response to Panel Question No. 231.

<sup>1287</sup> Brazil's further rebuttal submission, paras. 103-104.

in case the subsidy is not *de facto* tied to the production of the subsidized product, is there in a second step an allocation of the benefit (100 per cent) over the total value of the company's production.<sup>1288</sup>

7.1166 The **Panel** sees a common thread in these arguments of the United States: the nature of the examination that we are to conduct in examining Brazil's claims under Part III of the *SCM Agreement*. In particular, certain of these arguments by the United States raise the question of the appropriateness of applying certain relatively precise quantitative and/or "countervailing duty" methodologies and concepts, found in Part V of (or elsewhere in) the *SCM Agreement*, when conducting a "serious prejudice" analysis under Part III of the *SCM Agreement*.

7.1167 On the basis of the text of Part III, and for the reasons that follow, we are of the view that, while they may provide contextual – and general conceptual – guidance, the more precise quantitative concepts and methodologies found in Part V of the *SCM Agreement* are not directly applicable in our examination of Brazil's actionable subsidy claims under Part III of the *SCM Agreement*.<sup>1289</sup>

7.1168 Governed by the provisions of Part V of the *SCM Agreement*, a unilateral countervailing duty investigation by a Member aims to establish whether imports of a subsidized product are causing material injury to a given Member's domestic industry and the level of any permissible countervailing duty. Accordingly, Articles 10-23 of the *SCM Agreement* set forth obligations relating to the imposition of countervailing duties. In particular, Article 10 of the *SCM Agreement* provides that:

"Members shall take all necessary steps to ensure that the imposition of a countervailing duty<sup>36</sup> on any product of the territory of any Member imported into the territory of another Member is in accordance with the provisions of Article VI of GATT 1994 and the terms of this Agreement. Countervailing duties may only be imposed pursuant to investigations initiated and conducted in accordance with the provisions of this Agreement and the Agreement on Agriculture." (footnotes omitted in part)

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<sup>36</sup> The term "countervailing duty" shall be understood to mean a special duty levied for the purpose of offsetting any subsidy bestowed directly or indirectly upon the manufacture, production or export of any merchandise, as provided for in paragraph 3 of Article VI of GATT 1994.

According to Article 32.1 of the *SCM Agreement*:

"[n]o specific action against a subsidy of another Member can be taken except in accordance with the provisions of GATT 1994, as interpreted by this Agreement." (footnote omitted)

Article VI:3 of the *GATT 1994* reads:

"[n]o countervailing duty shall be levied on any product of the territory of a Member imported into the territory of another Member in excess of an amount equal to the estimated bounty or subsidy determined to have been granted, directly or indirectly, on the manufacture, production or export of such product in the country of origin or exportation... The term "countervailing duty" shall be understood to mean a special

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<sup>1288</sup> Brazil's 28 January 2004 comments on United States' response to Panel Question No. 242, paras. 197-198.

<sup>1289</sup> By this, we do not mean to say that we entirely disagree that the general order of magnitude of a subsidy may be a relevant consideration in a serious prejudice analysis in a particular case (where such information is probative and readily available).

duty levied for the purpose of offsetting any bounty or subsidy bestowed, directly, or indirectly, upon the manufacture, production or export or any merchandise."

7.1169 By contrast, Article XVI of the *GATT 1994* contains certain rights and obligations concerning subsidies, as do Parts II and III of the *SCM Agreement*. Under the multilateral "actionable subsidies" disciplines in Part III of the *SCM Agreement*, a WTO panel established by the DSB assesses the extent to which a Member's subsidy causes "adverse effects" to the "interests" of other Members.<sup>1290</sup> Pursuant to Article 5(c), one form of adverse effects is "serious prejudice to the interests of another Member". Pursuant to Article 6.3(c), such serious prejudice may arise where the effect of the subsidy is significant price suppression in the same market.

7.1170 The remedies available in a Member's unilateral countervailing duty action under Part V of the *SCM Agreement* also contrast sharply with the remedies available for successful multilateral actions under Part III of the *SCM Agreement*.<sup>1291</sup> Footnote 35 of the *SCM Agreement* sets out rules pertaining to the relationship between these two sets of obligations and remedies. The role of the WTO dispute settlement system is different than the role of a national investigating authority imposing countervailing duties: where a claim under Part III prevails, the subsidizing Member concerned is obligated to take appropriate steps to remove the adverse effects or withdraw the subsidy.

7.1171 Other aspects of the current text of the provisions of Part III of the *SCM Agreement* further support the view that the focus of an "adverse effects"/"serious prejudice" analysis does not call for any precise quantification of the subsidy at issue.

7.1172 Articles 7.2-7.10 of the *SCM Agreement* are "special or additional rules and procedures" identified in Appendix 2 to the *DSU*. Entitled "Remedies", Article 7 sets out procedures and remedies

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<sup>1290</sup> Similarly, under the multilateral "prohibited subsidies" disciplines in Part II of the Agreement, a panel assesses whether or not a Member is granting or maintaining prohibited subsidies within the meaning of Article 3 of the Agreement.

<sup>1291</sup> In the unilateral trade remedy context, Article 19.1 provides:

"If, after reasonable efforts have been made to complete consultations, a Member makes a final determination of the existence and amount of the subsidy and that, through the effects of the subsidy, the subsidized imports are causing injury, it may impose a countervailing duty in accordance with the provisions of this Article unless the subsidy or subsidies are withdrawn."

By contrast, Articles 7.8-7.10 outline the multilateral remedies where an actionable subsidies claim prevails:

7.8 Where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member within the meaning of Article 5, the Member granting or maintaining such subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy.

7.9 In the event the 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, and in the absence of agreement on compensation, the DSB shall grant authorization to the complaining Member to take countermeasures, commensurate with the degree and nature of the adverse effects determined to exist, unless the DSB decides by consensus to reject the request.

7.10 In the event that a party to the dispute requests arbitration under paragraph 6 of Article 22 of the *DSU*, the arbitrator shall determine whether the countermeasures are commensurate with the degree and nature of the adverse effects determined to exist."

pertaining to dispute settlement proceedings involving actionable subsidy claims. Article 7.2 requires that a request for consultations in an actionable subsidies dispute include a statement of available evidence with regard to (a) "the *existence* and *nature* of the subsidy in question; and (b) ...the serious prejudice caused to the interests of the member requesting consultations."<sup>1292</sup> (emphasis added)

7.1173 This provision does not explicitly refer to the "magnitude" or "amount" or "value" of the subsidy, let alone to any precise quantitative methodologies pertaining to its breakdown or allocation. Rather, while it may not preclude consideration of the general order of magnitude of a subsidy where this information may be relevant and readily available, we understand it to call for a qualitative and, to some extent, quantitative analysis of the existence and nature of the subsidy and the serious prejudice caused.<sup>1293</sup> Allocating absolutely precise proportions of the subsidy to the product concerned, or trying to trace with precision where each subsidy dollar may be spent by a recipient, is not a necessary exercise on the part of the Panel. Broader considerations are at play in a serious prejudice analysis than those involved in a countervailing duty sense.

7.1174 If a request for consultations in an actionable subsidies case must set out a statement of available evidence with regard to "the existence and nature of the subsidy in question", and need not focus on its amount or value (let alone any more precise quantitative concepts or methodologies) then the focus of the claims in an actionable subsidies dispute may also logically be the existence and nature of the subsidy in question.<sup>1294</sup>

7.1175 Pursuant to Article 7.3 of the *SCM Agreement*: "The purpose of the consultations shall be to *clarify the facts* of the situation and to arrive at a mutually agreed solution." (emphasis added) These facts would necessarily pertain to the subject of the request for consultations, including the statement of available evidence. They would thus logically pertain to the existence and nature of the subsidy.

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<sup>1292</sup> Footnote 19 to the *SCM Agreement* states:

"In the event that the request relates to a subsidy deemed to result in serious prejudice in terms of paragraph 1 of Article 6, the available evidence of serious prejudice may be limited to the available evidence as to whether the conditions of paragraph 1 of Article 6 have been met or not."

Article 6.1 of the *SCM Agreement* is no longer applicable. It may nevertheless still provide relevant guidance for understanding the original architecture of the Agreement. The Panel is of the view that the Report of the Arbitrator, *US – FSC*, note 56 is relevant here. As that Arbitration noted, although Article 6.1 has lapsed, it is nevertheless "helpful ... in understanding the overall architecture of the Agreement with respect to the different types of subsidies it sought and seeks to address". We have similarly referred to this treatment *supra*, Section VII:E. Article 6.1(a) stated that "Serious prejudice in the sense of paragraph (c) of Article 5 shall be deemed to exist in the case of: (a) the total ad valorem subsidization of a product exceeding 5 per cent" (footnote omitted). The particular explicit reference to the special requirements in such a case, which dealt with calculating the total *ad valorem* subsidization of a product pursuant to the provisions of Annex IV, supports our view that in other cases, not involving Article 6.1(a), there is no requirement to quantify the amount or value of subsidization at this phase of the dispute settlement proceedings.

<sup>1293</sup> The same is true for the *SCM Agreement* multilateral disciplines on prohibited subsidies. Article 4.2 of the *SCM Agreement* similarly requires that a request for consultations in a prohibited subsidies dispute include a statement of available evidence with regard to the *existence* and *nature* of the subsidy (and not its magnitude or amount).

<sup>1294</sup> We note that Annex V of the *SCM Agreement* contains "Procedures for developing information concerning serious prejudice". Paragraph 2 of Annex V envisages that the DSB may "initiate the procedure to obtain such information from the government of the subsidizing Member as necessary to establish the existence and *amount* of subsidization...". We see this as an indication that information relating to the general order of magnitude of the subsidy could be relevant in a given case. We recall, however, that the Annex V procedures also related to the establishment of the presumption of serious prejudice in Article 6.1 and Annex IV (based upon an *ad valorem* rate of subsidization) during the period of application of that provision. See *supra*, footnote 1292.

We see no requirement in Article 7.3 that the consultations clarify the facts of the situation, including facts relating to the precise quantification of the amount of the subsidy.<sup>1295</sup>

7.1176 This contrasts with the text of Part V of the *SCM Agreement*, dealing with countervailing duty investigations. There, Article 19.4 provides that "no countervailing duty shall be levied on any import in excess of the amount of the subsidy found to exist, calculated in terms of subsidization per unit of the subsidized and exported product." Therefore, the general rationale of a unilateral countervailing duty investigation is to determine whether or not a countervailable subsidy exists and, if so, to ensure that any countervailing duty levied on any import is not in excess of the amount of the subsidy found to exist, calculated in terms of subsidization per unit of the subsidized and exported product. Logically, should a Member make an affirmative determination that a countervailable subsidy exists, these provisions in Part V necessitate calculation of the amount of the subsidy before a countervailing duty may be imposed. Moreover, they require the calculation of that amount to be performed in a certain way: "in terms of subsidization per unit of the subsidized and exported product".

7.1177 In view of the contrast in the text, context, legal nature and rationale of the provisions in Part III of the *SCM Agreement* relating to a multilateral assessment as to whether a Member is causing, through the use of any subsidy, "adverse effects" in the form of "serious prejudice to the interests of another Member" and Part V of the Agreement relating to obligations of a Member in conducting a unilateral countervailing duty investigations, we decline to transpose directly the quantitative focus and more detailed methodological obligations of Part V into the provisions of Part III of the *SCM Agreement*.<sup>1296</sup>

7.1178 We again recall the particular United States arguments we address here.

7.1179 First, the United States argues that we are under an obligation to precisely quantify the subsidies at issue in our serious prejudice analysis under Part III of the *SCM Agreement*. For the reasons we have given, we see no textual basis for this argument. If the text of Part III of the agreement imposes no such general requirement to quantify the overall amount of the subsidy, then it also, logically, cannot impose any more precise conceptual or methodological requirements. Thus, we find no textual support in the serious prejudice provisions in Part III for the United States argument that annually recurring subsidies must be "expensed" to one year alone, so that the "benefit" of the measure does not survive past that year. The concept of "benefit" is a definitional element of a subsidy pursuant to Article 1.1(a)(2) of the *SCM Agreement*.<sup>1297</sup> Inasmuch as we are not required to calculate an amount of "benefit", we cannot logically be required to conduct any sort of precise "expensing" of the "benefit".<sup>1298</sup> Moreover, we see no textual basis for reading the different terms –

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<sup>1295</sup> See Appellate Body Reports: *US – Countervailing Measures on Certain EC Products* and *US – Corrosion-Resistant Steel Sunset Review*. The presence in the text of the same *SCM Agreement* of specific provisions requiring quantitative precision demonstrates to us that negotiators were well aware of how to craft such provisions, and to indicate that certain obligations apply in serious prejudice cases. They could, for example, have inserted clear introductory language or cross-references to Part V of the *SCM Agreement*, as they did, for example, in footnote 11 of the *SCM Agreement*, indicating that "The term 'injury to the domestic industry' is used [in Article 5(a)] in the same sense as it is used in Part V." However, they have not done so in Article 5(c) relating to serious prejudice. The lack of any explicit textual indication to this effect supports a conclusion that obligations such as those in Part V of the Agreement do not apply in a serious prejudice examination under Part III of the Agreement.

<sup>1296</sup> This does not mean, however, that the concept and definition of a "specific" "subsidy" – set out in Articles 1 and 2 of the *SCM Agreement* – differs under Part III and Part V. The provisions of Articles 1 and 2 define those subsidies that are susceptible to remedies under the other parts of the Agreement.

<sup>1297</sup> We are aware that provisions in Part V of the Agreement, e.g. Article 14, speak to the identification and quantification of the benefit in certain circumstances and that this guidance has been deemed relevant in understanding of benefit as that term is used in Article 1. See Appellate Body Report, *US – Countervailing Measures on Certain EC Products*, paras. 108, 110.

<sup>1298</sup> This is not to say that we do not recognize that the "expensing" principle was devised as a "rule of thumb" and can be quite useful in certain circumstances in considering the effects of a subsidy. We do not

"benefit" and "adverse effects"/"serious prejudice" – synonymously. Were we to discern an identity between the concept of "benefit" to a recipient and the concept of "adverse effects" to another Member's interests, we would effectively reduce the provisions of Part III to redundancy. As a treaty interpreter, the Panel is precluded from doing so.<sup>1299</sup>

7.1180 Second, the United States argues that Brazil must establish the precise extent to which United States subsidies provided in respect of "upland cotton" production were actually "passed through" to the exporter, after having been processed and sold, before being traded.<sup>1300</sup> We have already cited the provisions governing the imposition of a countervailing duty in Part V of the *SCM Agreement*, and in Article VI of the *GATT 1994*.<sup>1301</sup> In addressing these provisions, the Appellate Body has recently observed:

"... GATT/WTO dispute settlement practice is consistent with and confirms our interpretation that, where countervailing duties are used to offset subsidies granted to producers of input products, while the duties are to be imposed on *processed* products, and where input producers and downstream processors operate at *arm's length*, the investigating authority must establish that the benefit conferred by a financial contribution directly on input producers is passed through, at least in part, to producers of the processed product subject to the investigation. Therefore, we agree with the Panel that:

'If it is not demonstrated that there has been such a pass-through of subsidies from the subsidy recipient to the producer or exporter of the product, then it cannot be said that subsidization in respect of that product, in the sense of Article 10, footnote 36, and Article VI:3 of GATT 1994, has been found.'<sup>1302</sup> (footnote omitted)

7.1181 These principles apply in the context of a countervailing duty investigation governed by Part V of the Agreement. As they also relate to the definitional elements of a subsidy – i.e. a financial contribution conferring a benefit – in Article 1 of the Agreement, we consider that they are also of relevance to our examination, to the extent it concerns the "subsidized product" under Article 6.3(c). However, again, the textual distinctions between Parts III and V lead us to believe that while the countervailing "pass-through" principles may well be relevant, they are not directly applicable to our examination of serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*.

7.1182 Third, the United States argues that certain subsidies that are allegedly not directly tied to current production of upland cotton would need to be allocated over total production on a recipient's farm.

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disagree with the general proposition underlying such "expensing" rules, which we understand to be that, with the passage of time, a subsidy's effects may diminish. For example, a subsidy granted 9 or 10 years ago would indubitably be less likely to affect producers decisions now than it did 8 years ago. However, we see no basis for any particular precision concerning "expensing" in the text of Part III.

<sup>1299</sup> In order to find a violation of the actionable subsidies provisions in Part III of the *SCM Agreement*, it would suffice simply to establish the existence of a subsidy – i.e. a financial contribution conferring a benefit (and possibly that the subsidy was specific under Article 2) in order to establish that such a subsidy necessarily has adverse effects. This cannot be so. A fundamental tenet of the subsidy disciplines enshrined in the *SCM Agreement* is that Members are permitted to grant or maintain specific subsidies to the extent that they do not cause adverse effects within the meaning of Articles 5 and 6 of the *SCM Agreement*. Logically, there must be some specific subsidies that do not cause such adverse effects. Otherwise, there would be no need for the drafters to have crafted any of the criteria and conditions specified in Articles 5 and 6 of the *SCM Agreement*.

<sup>1300</sup> See also *infra*, our discussion of like product and subsidized product.

<sup>1301</sup> See *supra*, para. 7.1168, citing Articles 10 and 32.1 of the *SCM Agreement* and Article VI of the *GATT 1994*.

<sup>1302</sup> Appellate Body Report, *US – Softwood Lumber IV*, para. 146.

7.1183 We recall that Article 6.1(a) of the *SCM Agreement* stated:

"6.1 Serious prejudice in the sense of paragraph (c) of Article 5 shall be deemed to exist in the case of:

(a) the total ad valorem subsidization\* of a product exceeding 5 per cent; ..."

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\* The total ad valorem subsidization shall be calculated in accordance with the provisions of Annex IV. (subsequent footnote omitted)

7.1184 Annex IV of the *SCM Agreement* was entitled "Calculation of the Total Ad Valorem Subsidization (paragraph 1(a) of Article 6)". Pursuant to its paragraph 1, "[a]ny calculation of the amount of a subsidy shall be done in terms of the cost to the granting government." Pursuant to its paragraph 2, in general, "[in] determining whether the overall rate of subsidization exceeds 5 per cent of the value of the product, the value of the product shall be calculated as the total value of the recipient firm's sales in the most recent 12-month period, for which sales data is available, preceding the period in which the subsidy is granted." (footnotes omitted) Paragraph 3 stated:

"3. Where the subsidy is tied to the production or sale of a given product, the value of the product shall be calculated as the total value of the recipient firm's sales of that product in the most recent 12-month period, for which sales data is available, preceding the period in which the subsidy is granted."

7.1185 These provisions ceased to apply at the end of 1999.<sup>1303</sup> Neither party to this dispute seeks to apply them directly.

7.1186 We agree with the United States that these provisions may nevertheless provide relevant contextual guidance for interpreting "serious prejudice" within the meaning of Articles 5(c) and 6.3 of the *SCM Agreement*.<sup>1304</sup> While we certainly do not dispute the widely held premise that subsidies to producers relate generally to the products they make, there is nothing in the text of Part III of the *SCM Agreement* that requires any particular precise calculations or the application of any particular methodology concerning this element.<sup>1305</sup>

7.1187 The reference in Annex IV, paragraph 3, to "tied to the production or sale" existed in order to inform the calculation that would form the basis for the establishment of the presumption in Article 6.1(a) that a 5 per cent subsidization rate causes serious prejudice. The text of Article 6.1(a) clearly indicated that, in order for such a presumption to be established, a specific calculation had to

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<sup>1303</sup> As already noted in footnote 1292, the Panel is of the view that the Report of the Arbitrator, *US–FSC*, note 56 is relevant: As that Arbitration noted, although Articles 8 and 9 have lapsed, they are nevertheless "helpful ... in understanding the overall Architecture of the Agreement with respect to the different types of subsidies it sought and seeks to address". The Appellate Body referred to the text of Annex IV and its reference to the "recipient firm" as one of multiple textual factors in the course of clarifying the meaning of "benefit" to the recipient for the purposes of a countervailing duty investigation without explicitly discussing the significance of it no longer applying. See Appellate Body Report, *US – Countervailing Measures on Certain EC Products*, para. 112. We do not understand this reference by the Appellate Body as indicating that the text of Article IV may still have an equivalent legal value as the current text of the Agreement.

<sup>1304</sup> United States response to Panel Question No. 231. See *e.g.*, United States' oral statement at the resumed session of the first substantive meeting, para. 20.

<sup>1305</sup> As already mentioned (see *supra*, paras. 7.1169 *ff*), there is no textual analogue in Part III to the countervailing duty provisions in Part V of the Agreement, and, in particular, Article 10 and footnote 36 of the *SCM Agreement* or Article VI:3 of the *GATT 1994*, requiring any sort of precise allocation of subsidies. See Appellate Body Report and Panel Report, *US – Softwood Lumber IV*, addressing pass-through in the countervailing context.

be undertaken and special rules were designed to further inform the nature of the calculation that had to be undertaken.<sup>1306</sup> Negotiators indicated their awareness that the creation of such a presumption dependent upon the existence of a precise numerical benchmark would require guidance as to how the numerical benchmark would be established. Among the specifications that negotiators set out were those in Annex IV, paragraph 3 (i.e. where a "subsidy [is] tied to the production or sale of a given product," the amount of that subsidy would be compared only to the value of a firm's sales of that product). Those specifications are, however, no longer applicable.

7.1188 Looking to the text of Article 6.1(a), it is clear to us that one way in which the negotiators originally countenanced that a presumption of serious prejudice could be established was through the calculation of a total *ad valorem* subsidization of a product exceeding 5 per cent. Article 6.2 tells us that notwithstanding such a total *ad valorem* subsidization, serious prejudice shall not be found if the subsidizing Member demonstrates that the subsidy in question has not resulted in any of the effects enumerated in paragraph 3.

7.1189 The text of this provision clearly distinguishes between the quantitative benchmark in Article 6.1(a) and the other, more qualitative, elements involved in discerning the effects of the subsidy spelled out in Article 6.3. This clear demarcation between, on the one hand, the quantitative benchmark of subsidization and, on the other, the effects that may or may not accompany a subsidy satisfying the quantitative level in Article 6.1(a), is at the crux of the analysis which takes place under Article 6.3. At the very least, it is distinct, and different, from a quantitative analysis intended to establish a percentage of total *ad valorem* subsidization. This confirms to us that it is not necessary to establish such a rate of subsidization under Article 6.3 (although we are not precluding the possibility that it might be relevant in a given case).

7.1190 The fact that Article 6.2 foresees that a subsidy with a certain total *ad valorem* subsidization percentage may nevertheless not cause "serious prejudice" is, to us, consistent with the view that, while the magnitude of a subsidy may be relevant in some cases where such information is probative and readily available, the magnitude of a subsidy may not, in and of itself, be determinative of the nature or extent of its effects. A massive ("inefficient") subsidy of a certain design may have relatively miniscule effects, whereas a smaller subsidy of a different nature may have relatively greater effects. Furthermore, the variable where the effects are manifest may differ.

(iii) *Considerations guiding the Panel's analysis*

7.1191 We consider it axiomatic that the nature of a given subsidy may play an important role in determining its effects. We are well aware that the subsidies before us are of differing natures, manners of operation and orders of magnitude. The effects flowing from certain of the subsidies

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<sup>1306</sup> In this respect, footnote 62 of the *SCM Agreement* indicates: "An understanding among Members should be developed, as necessary, on matters which are not specified in this Annex or which need further clarification for the purposes of paragraph 1(a) of Article 6." We note that, at its regular meeting in June 1995, the SCM Committee established an "Informal Group of Experts" ("IGE") to examine matters which were not specified in Annex IV to the Agreement or which needed further clarification for the purposes of paragraph 1 of Article 6 and to report to the Committee such recommendations as the IGE considered could assist the Committee in the development of an understanding among Members, as necessary, regarding such matters. At the Committee's regular meeting in April 1998 (see G/SCM/M/16, paras. 68-82), the SCM Committee discussed and took note of the report of the IGE in document G/SCM/W/415/Rev.1, and asked the IGE to continue to try to resolve issues that remained unresolved. Subsequently, at its November 1999 meeting (see G/SCM/M/24, paras. 14-19), the Committee discussed and took note of the IGE's supplementary report, in document G/SCM/W/415/Rev. 2/Suppl. 1, on calculation issues related to Annex IV of the *SCM Agreement*. That report indicates that: "The Group reached consensus on a recommendation regarding ad hoc loan guarantees. The Group did not reach a consensus on any of the other issues discussed. The Group considers that there are no further issues on which consensus is likely to be reached, and therefore considers that it has completed its mandate from the Committee."

certainly might, in isolation, be of a different nature and degree than those flowing from certain others.

7.1192 We recall that the chapeau of Article 5 of the *SCM Agreement* states: "No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e. ..." (emphasis added). Article 5 refers to the adverse effects caused through the use of any specific subsidy within the meaning of the *SCM Agreement*. Article 6.3(c) requires an examination of "the effect of the subsidy" through a price phenomenon ("significant price suppression") and refers to a "subsidized product". We do not see the Article 6.3(c) reference to "the effect of the subsidy" (in the singular, rather than the plural) as meaning that a serious prejudice analysis of price suppression must clinically isolate each individual subsidy and its effects.<sup>1307</sup> Rather, these textual references to "any subsidy", "the subsidy" and the "subsidized product" in Articles 5(c) and 6.3(c) suggest that while due attention must be paid to each subsidy at issue as it relates to the subsidized product, a serious prejudice analysis may be integrated to the extent appropriate in light of the facts and circumstances of a given case.<sup>1308</sup> In our view, these textual references to "any subsidy" and "the effect of the subsidy" permit an integrated examination of effects of any subsidies with a sufficient nexus with the subsidized product and the particular effects-related variable under examination. Thus, in our price suppression analysis under Article 6.3(c), we examine one effects-related variable – prices – and one subsidized product – upland cotton. To the extent a sufficient nexus with these exists among the subsidies at issue so that their effects manifest themselves collectively, we believe that we may legitimately treat them as a "subsidy" and group them and their effects together. We derive contextual support for this view from Article 6.1 and Annex IV<sup>1309</sup>, which referred to the concept of total *ad valorem* subsidization and envisaged that, "[i]n determining the overall rate of subsidization in a given year, subsidies given under different programmes and by different authorities in the territory of a Member shall be aggregated".

7.1193 Finally, the fact that, in this dispute, certain of the subsidies before us<sup>1310</sup> are also prohibited subsidies does not lead us to change our view as to the nature of the serious prejudice analysis. We note that there are different remedies available in respect of prohibited and actionable subsidies under

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<sup>1307</sup> Taken to an extreme, this could mean that separate dispute settlement proceedings, or at least separate claims, would need to be brought with respect to the serious prejudice caused by each and every individual subsidy, even where these subsidies exist contemporaneously and interact in concert in respect of a single subsidized product to produce a single result in the form of a price phenomenon.

<sup>1308</sup> We recall the approach of the panel in Panel Report, *Indonesia-Autos*, para. 14.206. In the context of deciding to examine subsidies under an expired measure, that panel observed that it had before it "... a variety of different subsidy measures provided pursuant to a single National Car programme". Under those circumstances, the panel determined,

"...that it makes little sense to treat each one separately when analysing the existence of serious prejudice. Rather, we must assess the 'effect of the subsidies' on the interests of another Member to determine whether serious prejudice exists, not the effect of 'subsidy programmes.' "

That panel was dealing with a different basket of measures, under a single programme. It was also dealing with a different issue than the precise issue here before us (which involves questions not only of temporal, but also substantive, interrelationships among the subsidies at issue). Furthermore, it was dealing with different legal claims and arguments under Article 6.3(c) and 5(c) (relating to price undercutting, rather than price suppression). We do not understand that panel to suggest that the effects of *all* challenged subsidies in existence more or less contemporaneously and with any connection whatsoever with a subsidized product *must* be aggregated in a serious prejudice analysis. However, to the extent that it does suggest such an approach, our approach here is not identical and is tailored to the particular facts and circumstances of this dispute and of the measures before us.

<sup>1309</sup> As we have already stated, this provision has lapsed, but may still be relevant in indicating the original architecture of the Agreement. See *supra*, footnote 1292.

<sup>1310</sup> i.e. user marketing (Step 2) payments to domestic users and exporters.

Articles 4.7<sup>1311</sup> and 7.8<sup>1312</sup> of the *SCM Agreement*, respectively.<sup>1313</sup> There is no indication in the text of Article 5(c), or any other provision of the *SCM Agreement*, that a Member is precluded from bringing both prohibited and actionable subsidy claims against the same measure, nor that a panel is precluded from examining such claims or from making the recommendation foreseen in Article 4.7 and also making a finding that the same measure is causing adverse effects within the meaning of Article 5 of the *SCM Agreement*, thereby triggering the operation of the remedy in Article 7.8.<sup>1314</sup>

7.1194 Consonant with this textual and contextual guidance, we will therefore undertake an analysis focusing on the existence<sup>1315</sup> and nature of the subsidies in question by examining their structure, design and operation with a view to discerning their effects. In this case, we also have readily available to us information relating to the general order of magnitude of many of the subsidies at issue (i.e. we have already established, in another context, elements relevant to the order of magnitude of the subsidies)<sup>1316</sup> and we will take this into account as an element in determining whether or not "significant price suppression" and/or "serious prejudice" exist. To the extent a sufficient nexus exists between certain subsidies and any suppression of prices of the subsidized product, we aggregate these subsidies and their effects. These guiding considerations are relevant to several aspects of our analysis, including our examination of: "subsidized product"<sup>1317</sup>; the existence of "price suppression" in the same market<sup>1318</sup>; whether the price suppression is "significant";<sup>1319</sup> and the existence of a causal

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<sup>1311</sup> Article 4.7 of the *SCM Agreement* reads:

"4.7 If the measure in question is found to be a prohibited subsidy, the panel shall recommend that the subsidizing Member withdraw the subsidy without delay. In this regard, the panel shall specify in its recommendation the time-period within which the measure must be withdrawn."

<sup>1312</sup> Article 7.8 of the *SCM Agreement* reads:

"7.8 Where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member within the meaning of Article 5, the Member granting or maintaining such subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy."

<sup>1313</sup> We recall our findings in Sections VII:E and F that the user marketing (Step 2) payments under section 1207(a) of the FSRI Act of 2002 constitute prohibited subsidies under Articles 3.1(a) and (b), and Article 3.2, of the *SCM Agreement*. As a consequence, in respect of these prohibited subsidies, we are bound by Article 4.7 of the *DSU* to "recommend that the subsidizing Member withdraw the subsidy without delay". See *infra*, Section VIII.

<sup>1314</sup> It is not unusual for a measure of a Member to be subject to multiple WTO obligations, which may result in multiple findings of inconsistency with the covered agreements. Depending upon how a Member opts to implement the rulings and recommendations of the DSB in a particular dispute, sufficient implementation may be achieved through one integrated act. That is, in a situation similar to the one before us, withdrawal of a prohibited subsidy within the meaning of Article 4.7 of the *SCM Agreement* may also be sufficient to remove its adverse effects within the meaning of Article 7.8 of the *SCM Agreement*. However, it may be, for example, that withdrawal of the prohibited contingency may not wholly achieve removal of adverse effects or that removal of the adverse effects may not equate with withdrawal of the prohibited subsidy. This would, of course, depend upon the particular facts and circumstances surrounding the implementation.

<sup>1315</sup> Which, in any event, the United States does not dispute.

<sup>1316</sup> See *supra*, Section VII:D and footnote 895. We underline that our view relating to the order of magnitude of a subsidy is specific to the circumstances we face in this particular case, and that our view might very well be different in another case where even this extent of information may either not be relevant or not be available. As we have already indicated, we see no requirement precisely to quantify the subsidy in a serious prejudice analysis under Part III of the *SCM Agreement*.

<sup>1317</sup> See *infra*, paras. 7.1216 *ff.* including footnote 1336.

<sup>1318</sup> See *infra*, paras. 7.1290 *ff.* in particular, para. 7.1303 concerning the price-contingent subsidies before us: marketing loan programme payments; user marketing (Step 2) payments; and MLAs and CCPs; and

link between certain of the subsidies and "significant price suppression".<sup>1320</sup> This approach ensures that we determine, as the text of the treaty requires, whether or not "the effect of the subsidy" is "significant price suppression" in the same market within the meaning of Article 6.3(c) which constitutes "serious prejudice" within the meaning of Article 5(c).

(e) Reference period

7.1195 Article 5(c) and Article 6.3(c) of the *SCM Agreement* do not refer to any specific time period within which we must conduct our evaluation.

7.1196 **Brazil** asserts that the Panel must select an appropriate period of time for analyzing Brazil's claims under Articles 5(c) and 6.3 of the *SCM Agreement* relating to the "present" effects of the United States measures at issue. According to Brazil, 1999-2002 is a reasonable period of time, since data for those years is essentially complete.

7.1197 The **United States** counters that the appropriate representative period for demonstrating present serious prejudice will depend on the nature of the subsidies at issue. Normally, the most recent period for which data are available will be the appropriate period. According to the United States, Brazil must demonstrate serious prejudice for MY 2002.

7.1198 The **Panel** concurs with the United States assertion that MY 2002 is a relevant year for our serious prejudice inquiry. It represents a recent period for which essentially complete data exists. The identification of "significant price suppression" flowing from "the effect of the subsidy" calls for an evaluation of this effects-based phenomenon that cannot be conducted in the abstract. Rather, discerning adverse effects of subsidies seems to us to require reference to a recent historical period. We believe, however, that it is important for the establishment of "current" serious prejudice that such prejudice would be established to exist up to, and including, a recent point in time.<sup>1321</sup>

7.1199 We also believe that subsidies granted prior to MY 2002 are relevant to our evaluation. Consideration of developments over a period longer than one year, while not necessarily required (at least in Articles 5(c) and 6.3(c)) provides a more robust basis for a serious prejudice evaluation than merely paying attention to developments in a single recent year. It may put such developments in a broader temporal context. In addition, having found that the subsidies exist and have been provided over a longer period of time than one year, it would be inappropriate to look at trends only in the last year to arrive at any conclusion on serious prejudice. It may, for example, be that the market may well already be distorted in a given year due to subsidies.

7.1200 In our examination, we are required to ensure that the "effect of the subsidy" is the situation in question (i.e. significant price suppression under Article 6.3(c)). These elements also address the concerns of the United States regarding alleged unusually high or low production or yields in a given crop year: in exercising our judgment about the causal link between the subsidies and any prejudice caused, we ensure that we are satisfied that such subsidies in respect of United States upland cotton has caused prejudice which can be said to be serious within the meaning of Article 5(c). If other causes have had effects which diminish the effects of the subsidies to a level which we conclude could not be serious, then we could not arrive at a proper serious prejudice finding under Article 5(c).

7.1201 The fact that the legal and regulatory provisions governing payment of many of the subsidies at issue – i.e. measures under the FAIR Act of 1996, *ad hoc* legislation providing for MLA payments

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para. 7.1307 concerning the non-price-contingent subsidies before us: PFC and DP payments and crop insurance payments.

<sup>1319</sup> See *infra*, paras. 7.1316 *ff*, in particular, para. 7.1332.

<sup>1320</sup> See *infra*, paras. 7.1349 and 7.1350.

<sup>1321</sup> We recall our findings in Section VII:D of our report pertaining to United States subsidies, MY 1999-2002.

and cottonseed payments for the 2000 crop – have expired is immaterial to our serious prejudice analysis. Subsidies granted under expired measures may have had adverse effects at the time they were in effect, and may still have lasting adverse effects.<sup>1322</sup>

(f) Role of econometric modelling results used by Brazil in this dispute

7.1202 Brazil initially submitted that the economist that it had retained to perform quantitative simulation modelling for this dispute, Dr. Sumner<sup>1323</sup>, had found that *but for* the United States subsidies subject to that modelling exercise, United States production of upland cotton during the period of MY 1999 to MY 2002 would have been an average of 28.7 per cent lower than actual United States production and United States exports would have declined on average by 41.2 per cent during the period of MY 1999 to 2002. According to Brazil, Dr. Sumner found that *but for* the United States subsidies provided to the United States upland cotton industry, the A-Index would have been higher by an average of 12.6 per cent or 6.5 cents per pound during the period of MY 1999 to 2002.<sup>1324</sup> Dr. Sumner also presented the results of his analysis orally, in the course of the substantive Panel meetings.

7.1203 The parties disagree as to the accuracy and adequacy of the results of the econometric model submitted by Brazil, which focuses on a "but for" examination of the production, export and price effects of the United States subsidies. The United States criticizes the model for, *inter alia*, relying on an inappropriate baseline; failing to take into account "futures price" information available to producers; effects of the subsidies on production costs; the treatment of PFC payments and crop insurance payments in the model and a number of other modelling deficiencies. It also argues that the model is ineffective for use in retrospective analysis. The United States asserts that Brazil's analysis appears flawed in several respects and as a result, the conclusions drawn are biased and misleading.

7.1204 In response to a United States request, the Panel informed the parties that it did not require (nor preclude) the parties' further rebuttal submissions, nor their oral statements during the second Panel meeting, to address the methodology, equations or parameters underlying the simulation model used by Brazil. The Panel gave the parties an additional opportunity for a written exchange and

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<sup>1322</sup> Panel Report, *Indonesia – Autos*, para. 14.206. See also ruling in Section VII:B.

<sup>1323</sup> We note that it is open for a Member to determine the composition of its own delegation for the purposes of WTO dispute settlement. Neither the *DSU* nor the *SCM Agreement* contains specific rules on any sort of qualification of experts. We would underline, that, in this dispute, we consider the participation of experts, as part of the submissions of the parties and third parties, contributed constructively to our duty to conduct an objective assessment of the matter before us.

Dr. Sumner participated in the first and resumed sessions of the first substantive meeting as well as in the second substantive meeting with the Panel. Exhibit BRA-104 contains Dr. Sumner's *curriculum vitae*. In addition to Dr. Sumner's contributions annexed to this report and to Brazil's submissions/statements, the record also includes the following material: Exhibits BRA-105, -275, -279, -280, -313 through -315, -325, -326, -342 through -346 and -396; Exhibit US-56. Dr. Sumner's modelling results involved the use of the so-called "FAPRI" model. In response to Panel Question No. 203, Brazil submitted evidence pertaining to FAPRI's status and credentials, in Exhibits BRA-376 through -380.

Without prejudice to any relevance to our serious prejudice examination, we also note that Brazil submitted expert opinion statements by Mr. Christopher Campbell of the Environmental Working Group, in his capacity as an expert in the design and use of computer software in USDA commodity subsidy database information (Exhibits BRA-316 and -368). As we note *infra*, in footnotes 1361/1375 and 1465, respectively, Mr. Andrew MacDonald and Mr. Christopher Ward also participated, and provided expert opinions, as part of Brazil's delegation in these Panel proceedings.

Dr. Glauber, a member of the United States delegation and government also contributed expert opinions and material in this capacity, and his work was cited by the parties. See, for example, Exhibit BRA-131; Exhibits US-76, -91.

Certain third party submissions/statements (e.g. of Benin and Chad) also involved the participation of experts, including Mr. Minot and Mr. Malloum. See e.g. *supra*, para. 7.54.

<sup>1324</sup> Brazil's further written submission, para. 183.

indicated that, if necessary, at the discretion of the Panel, a further Panel meeting with the parties would be held to address this specific material. The parties were advised that this was without prejudice to the relevance and significance which the Panel might ascribe to the quantitative simulation model and related evidence and argumentation in its report.<sup>1325</sup> Several further exchanges occurred between the parties in respect of this issue.<sup>1326</sup>

7.1205 We have taken note of the outcomes of the simulations submitted by Brazil<sup>1327</sup>, and the parties' exchanges of views thereon. We have not relied upon the quantitative results of the modelling exercise – in terms of estimating any numerical value for the effects of the United States subsidies, nor, indirectly, in our examination of the causal link required under Articles 5 and 6.3(c) of the *SCM Agreement*.

7.1206 Without prejudice to the relevance or utility of such simulations generally to a serious prejudice analysis under Part III of the *SCM Agreement*, we would point out our particular concern here, in ensuring procedural fairness between the parties and the reliability of evidence, that the underlying model itself was not equally accessible to the parties and, as relevant, to the Panel in these proceedings. Brazil did not itself have access to the model. While Brazil instructed the organization which owned and operated the model (FAPRI) as to the modifications and adaptations that Brazil believed needed to be made in order to produce the econometric results presented to the Panel, Brazil could not itself autonomously check the use of those modifications and adaptations. When the United States asked to be able to analyse the model and its workings, FAPRI stipulated that neither Brazil nor the Panel could have similar access.

7.1207 However, we observe that the simulations were prepared by experts, and explained to the Panel by experts. The outcomes of the simulations are consistent with the general proposition that subsidies bestowed by Member governments have the potential to distort production and trade and the elimination of subsidies would tend to reduce "artificial" incentives for production in the subsidized Member. This is one of the underlying rationales for the establishment of the subsidy disciplines in the *SCM Agreement*.

7.1208 We further do not disagree with another basic assumption underlying the modelling used by Brazil in this dispute: that the effects of a subsidy may vary depending upon the nature of the subsidy. We also note that the United States would support this proposition. Again, we consider this to make common economic sense.

7.1209 In light of the nature of our examination of Brazil's claims under Part III of the *SCM Agreement*, based upon an interpretation of the text, in light of its context, object and purpose<sup>1328</sup>, we have taken the analyses in question into account where relevant to our analysis of the existence and nature of the subsidies in question, and their effects, under the relevant provisions of the *SCM Agreement*, and have attributed to them the evidentiary weight we deemed appropriate.

(g) Role of studies by other organizations/academic institutions

7.1210 The parties have also brought to our attention a number of studies produced by the United States government, several international governmental and non-governmental organizations and

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<sup>1325</sup> See *supra*, Section VII:A.

<sup>1326</sup> See *supra*, Section VII:A.

<sup>1327</sup> Dr. Sumner estimates that the cumulative effects of the subsidies, for MY 1999-2002, are (approximately): a 28 per cent increase in United States upland cotton acreage; a 29 per cent increase in United States production, a 41 per cent increase in United States exports and a 12.6 per cent decrease in world price (A-Index). In terms of relative magnitude, from subsidies with largest to smallest effect: 1. marketing loan/LDP; 2. user marketing (Step 2) payments; 3. crop insurance payments; 4. CCP payments; 5. DP payments.

<sup>1328</sup> See *supra*, paras. 7.1156 ff.

academic institutions. Brazil asserts that many of these studies have made findings that substantiate its arguments that United States subsidies have "caused" "significant" "price suppression".<sup>1329</sup>

7.1211 Certain third parties support Brazil's arguments concerning the relevance of these studies in this dispute.<sup>1330</sup>

7.1212 We consider it relevant that numerous studies find, for various reasons, that a removal of certain of the United States subsidies, over certain time periods, would lead to an alteration in United

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<sup>1329</sup> The studies referred to include:

- Exhibit BRA-210: "Production and Trade Policies Affecting the Cotton Industry", ICAC, July 2002.
  - Exhibit BRA-224: "Factors Affecting the United States Farm Price of Upland Cotton", Leslie Meyer (USDA 1998).
  - Exhibit BRA-233: "Production and Trade Policies Affecting the Cotton Industry", ICAC, September 2001.
  - Exhibit BRA-234: "Rethinking U.S. Agricultural Policy: Changing Course to Secure Farmer Livelihoods Worldwide", Daryll E. Ray, Daniel G. De La Torre Ugarte, Kelly J. Tiller, Agricultural Policy Analysis Center, The University of Tennessee.
  - Exhibit BRA-235: "What is the Impact of Removing Agricultural Support", IMF World Economic Outlook 2002, Chapter II; IMF (2002), How Do Industrial Country Agricultural Policies Affect Developing Countries?
  - Exhibit BRA-236: "Market Access for Developing Country Exports – Selected Issues", IMF and the World Bank, 26 September 2002.
  - Exhibit BRA-237: "Rich Countries Should Show the Way to Trade: World Bank urges Action to Further Open Markets to Developing Countries", World Bank, press release 2003/094/S, 27 September 2002.
  - Exhibit BRA-238: "Trade Distortions and Cotton Markets: Implications for Australian Cotton Producers", Cotton Research and Development Corporation, April 2001.
  - Exhibit BRA-264: Goreux, "Prejudice Caused by Industrial Countries subsidies to cotton sectors in Western and Central Africa".
  - Exhibit BRA-275: "U.S. Cotton Supply Response under the 2002 Farm Act", Paul C. Westcott and Leslie A. Meyer (USDA, 2003).
  - Exhibit BRA-276: "Report of the Commission on the Application of Payment Limitations for Agriculture", Submitted in Response to Section 1605, FSRI Act of 2002 (USDA, 2003).
  - Exhibit US-62: IMF Working Paper (2003) "Measuring the Impact of Distortion in Agricultural Trade in Partial and General Equilibrium".
  - Exhibit BRA-222: Westcott and Price (USDA 2001) "Analysis of the United States Commodity Loan Programme with Marketing Loan Provisions".
- Parties' critiques of certain of these "third party" studies are found in Exhibit US-91 and Exhibit BRA-275.

<sup>1330</sup> For example, **Argentina** considers that the number and quality of the empirical and econometric analyses presented by Brazil, which were carried out by both international organizations and various prestigious United States economic research institutions such as the USDA, provide irrefutable evidence of the *collective* and *individual* effects of each subsidy programme on the price of cotton. See Argentina's written submission to the resumed session of the first substantive meeting, para. 34. According to **Benin** and **Chad**, the Oxfam report – using data from the International Cotton Advisory Committee - estimates that in 2001 alone, sub-Saharan exporters lost \$302 million as a direct consequence of United States cotton subsidies. The Report further notes that Benin's actual cotton export earnings in 2001/02 were \$124 million. However, had United States subsidies been withdrawn, Benin's export earnings are estimated to have been \$157 million. Therefore, the value lost to Benin as a result of United States subsidies was \$33 million. Chad's cotton export earnings in 2001/02 were \$63 million, although in the absence of United States subsidies, Chad would have earned \$79 million, thus reflecting a loss of \$16 million. For the period from 1999/2000 to 2001/2002, Oxfam estimates a total cumulative loss of export earnings of \$61 million for Benin and \$28 million for Chad. Benin and Chad agrees with Oxfam when it emphasizes, "the small size of several West African economies and their high levels of dependence on cotton inevitably magnify the adverse effects of United States subsidies. For several countries, US policy has generated what can only be described as a major economic shock." See Benin and Chad's written submission to the resumed session of the first substantive meeting, paras. 19-21.

States production and exportation and to a change in certain world or United States prices. This is consistent with the general proposition that subsidies bestowed by Member governments have the potential to distort production and trade flows and the elimination of subsidies would tend to reduce "artificial" incentives for production in the subsidizing Member. As we have already noted, this is one of the underlying rationales for the establishment of the subsidy disciplines in the *SCM Agreement*.

7.1213 However, none of these various studies address the precise legal issues arising under Part III of the *SCM Agreement*, based on the measures, period, facts, argumentation and evidence before us. For example, although some address possible movements in the A-Index, others, including certain studies of USDA, do not address the issue of world price movements at all, but rather focus on effects on United States prices. Furthermore, each of these studies is premised on certain econometric assumptions concerning *inter alia*, treatment of certain measures, selection of baseline, and supply and demand elasticities.

7.1214 They are, therefore, not only subject to the same considerations – in terms of the legal and factual analysis that we must conduct under the *SCM Agreement* – as we have already discussed in the context of the outcomes of the simulations used by Brazil's quantitative simulation model(s)<sup>1331</sup>, but also were not legally or factually tailored to the matter before us.

7.1215 In light of the nature of our examination of Brazil's claims under Part III of the *SCM Agreement*, based upon an interpretation of the text, in light of its context, object and purpose<sup>1332</sup>, we have taken the analyses in question into account where relevant to our analysis of the existence and nature of the subsidies, and their effects. We have attributed to them the evidentiary weight we deemed appropriate.

(h) "Like product" and "subsidized product"

7.1216 The text of Article 6.3(c) refers to "like product"<sup>1333</sup> and "subsidized product". As the identification of the "subsidized product" may affect the conception of "like product", we address them together.

7.1217 Brazil asserts that upland cotton<sup>1334</sup> is the "subsidized product" for the purposes of its allegations of serious prejudice. According to Brazil, it has submitted evidence to establish that each of the subsidies at issue is a production- and export-enhancing subsidy in respect of upland cotton lint. According to Brazil, "it is the production, export and use of upland cotton lint that benefits from the United States subsidies challenged by Brazil".<sup>1335</sup>

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<sup>1331</sup> *Supra*, paras. 7.1202 *ff.*

<sup>1332</sup> *Supra*, Section VII:C.

<sup>1333</sup> There is a clear indication in the text of Article 6.3(c) of the *SCM Agreement* that an examination of price undercutting is to focus on whether there is "significant price undercutting by the subsidized product as compared with the price of a like product of another Member in the same market" (emphasis added). However, the structure of the remaining text of the provision does not clearly indicate whether this requirement to establish a "subsidized product" and "like product" also necessarily applies to a price suppression analysis. In this regard, the text merely reads: "the effect of the subsidy is ... significant price suppression, depression or lost sales in the same market." It may therefore be asked whether or not the same requirement of a "subsidized product" and a "like product" also applies to a price suppression analysis under Article 6.3(c) of the *SCM Agreement*. We observe, however, that Article 6.3(c) calls for an examination of price suppression, and that price suppression necessarily involves the prices of certain products. Thus, our examination of "prices" in the world market necessarily relates to "prices" of certain "products". Accordingly, we address the concepts of "subsidized product" and "like product".

<sup>1334</sup> See *supra*, Section VII:C, including, in particular, footnote 258 where we discuss the product subject to this dispute.

<sup>1335</sup> See Brazil's further written submission, para. 79.

7.1218 The United States submits that Brazil needs to identify the "subsidized product" for each of the types of subsidies that Brazil alleges is causing the serious prejudice. According to the United States, Brazil has not established to whom certain payments go and whether certain payments may properly be attributed to exported upland cotton. The United States further asserts that account must be taken of the extent to which the subsidies are not tied to current upland cotton production.

7.1219 The Panel recalls that Article 6.3(c) of the *SCM Agreement* requires us to examine whether "the effect of the subsidy" is "significant price suppression".

7.1220 We understand the term "subsidized" "product", as used in Article 6.3(c), to refer to a "product" that is "subsidized", i.e. in respect of which a subsidy is directly or indirectly granted or maintained.<sup>1336</sup>

7.1221 To the extent that the United States argues that Brazil has not established that the "subsidized product" is upland cotton in the form traded on the world market, we recall Brazil's assertion in this dispute that it: "agreed with USDA's classification of upland cotton lint as a distinct agricultural product". This is the product traded in the world market. Thus, according to Brazil, the Brazilian product that is "like", i.e. identical to or which has characteristics closely resembling the subsidized United States product, is Brazilian upland cotton lint.<sup>1337</sup>

7.1222 The United States indicated that "[f]or purposes of this dispute, the United States is not arguing that all United States cotton is 'unlike' Brazilian cotton".<sup>1338</sup>

7.1223 We therefore do not understand there to be disagreement between the parties as to the core meaning of "like" product for the purposes of Article 6.3(c) of the *SCM Agreement* in this dispute.

7.1224 Furthermore, we do not understand the United States to have argued that United States production of upland cotton does not benefit from any subsidies. Rather, the United States asserts that at least certain of the subsidies at issue may not relate to upland cotton in the form that it is exported and traded in the world market.

7.1225 We note that the text of the United States legal or regulatory instruments governing the grant of a number of the subsidies before us explicitly or implicitly make the grant of the subsidy available in respect of upland cotton: (1) marketing loan programme payments<sup>1339</sup> and (2) user marketing

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<sup>1336</sup> On the basis that Brazil has identified upland cotton lint as the "subsidized product" for the purposes of its serious prejudice claims, we do not believe that the structure, design and operation of the United States cottonseed payments within our terms of reference manifest a sufficiently close nexus with the subsidized product and the alleged price effects of the subsidy at issue so as to cause significant price suppression within the meaning of Article 6.3(c). As described *supra*, Section VII:C, these cottonseed payments were paid to first handlers of cottonseed for the 2000 crop of cottonseed, and were shared with producers to the extent that revenue from the sale of that product was shared with the producer. Brazil itself separates "cottonseed revenue received by farmers" from "cotton lint price received by farmers" in, for example, Brazil's response to Panel Question No. 125(c), Exhibits BRA-169, -287, as does the USDA Fact Sheet: Upland Cotton (January 2003), reproduced in Exhibit BRA-4. Cottonseed is an oilseed, used to make cottonseed oil and meal. For this reason, we do not include cottonseed payments in the remainder of our Article 6.3(c) analysis.

<sup>1337</sup> Brazil's further written submission, paras. 80-81. See also *supra*, footnote 258.

<sup>1338</sup> United States' response to Panel Question No. 126. In its response to Panel Question No. 154, the United States indicated its agreement that upland cotton is a "primary product or commodity" within the meaning of Article 6.3 (d) of the *SCM Agreement*.

<sup>1339</sup> 7 CFR 1427.5(b)(11), reproduced in Exhibit BRA-36, in respect of marketing loan refers to conditions "for a bale of cotton to be eligible" which include that it must be "ginned" by certain ginners. With respect to LDPs, the upland cotton need not be ginned for eligibility, but the LDP is disbursed after the upland cotton is ginned.

(Step 2) payments to exporters and domestic users.<sup>1340</sup> Other subsidies are also available in respect of upland cotton. Crop insurance subsidies are granted in respect of contracts to insure against losses arising in respect of "upland cotton".<sup>1341</sup>

7.1226 The four types of domestic support which permit production flexibility (PFC, MLA, DP and CCP payments) were or are provided in respect of a restricted list of products, including upland cotton, which satisfy certain specific eligibility criteria.<sup>1342</sup> We recall our earlier observation that we do not need to make any precise quantification for the purposes of our examination under Articles 5(c) and 6.3(c)<sup>1343</sup>, nor do we need to ascertain the precise proportion of subsidies actually benefiting upland cotton. We nevertheless recall that we have established, as a matter of fact, that, in the case of these subsidies, there is a strongly positive relationship between recipients of these payments and current upland cotton production.<sup>1344</sup> The fact that some of the subsidies are paid to farmers who do not produce upland cotton presently (a small number), or that the subsidies or part of them in some cases are "captured" by landowners or others, does not alter the proposition that upland cotton production is, in fact, benefiting from the subsidies. We are, nevertheless, well aware that the particular structure, design and operation of the measures must be taken into account in discerning the effects of these subsidies in our examination of price suppression under Article 6.3(c).

7.1227 Finally, to the extent that the United States argues that it is the "subsidized product" – rather than the "effect of the subsidy" – which must cause "significant price suppression"<sup>1345</sup> within the meaning of Article 6.3(c) of the *SCM Agreement*, we disagree. The text of Articles 5 and 6 of the *SCM Agreement* support the conclusion that it is the effects of the United States subsidies – not the effects of the "subsidized product" – that are at issue in a claim of price suppression under Article 6.3(c). The chapeau of Article 5 states: "No Member should cause, through the use of any subsidy ... adverse effects to the interests of another Member." (emphasis added) Similarly, Article 6.3(c) provides: "Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where ... (c) the effect of the subsidy is ... significant price suppression ...". (emphasis added) These references in Articles 5(c) and 6.3(c) to the "effect of the subsidy" contrast with the language used in the countervailing duty provisions in Part V of the Agreement.<sup>1346</sup>

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<sup>1340</sup> 7 CFR 1427.103(b), reproduced in Exhibit BRA-37, in respect of user marketing (Step 2) payments, defines eligible upland cotton as "baled" upland cotton "lint"; "loose"; semi-processed and reginned (processed) motes. In the case of payments to exporters, the text of the measure indicates that an eligible exporter *includes* a producer. In the case of payments to domestic users, the United States has indicated that the Step 2 programme is also designed precisely to benefit the producer.

<sup>1341</sup> Some policies specify that the insured crop is upland cotton. See Exhibit BRA-174, USDA FCIC, Income Protection, Cotton Crop Provisions, section 7.

<sup>1342</sup> See *supra*, Section VII:D.

<sup>1343</sup> See *supra*, paras. 7.1177 and 7.1179

<sup>1344</sup> See *supra*, Section VII:D.

<sup>1345</sup> United States' oral statement at the resumed session of the first substantive meeting, para. 9.

<sup>1346</sup> For example, Article 15 of the *SCM Agreement* deals with the determination of injury in a countervailing duty investigation. Article 15.1 requires a determination of injury to be based "on positive evidence and involve an objective examination of both (a) the volume of the subsidized imports and the effect of the *subsidized imports* on prices in the domestic market for like products and (b) the *consequent impact of these imports* on the domestic producers of such products." (emphasis added, footnotes omitted). Article 15.2 states, in part: "... With regard to the *effect of the subsidized imports* on prices, the investigating authorities shall consider whether there has been a significant price undercutting by the subsidized imports as compared with the price of a like product of the importing Member, or whether the *effect of such imports* is otherwise to depress prices to a significant degree or to prevent price increases, which otherwise would have occurred, to a significant degree." (emphasis added) Similar additional references to the "effects of the imports"; "impact of the subsidized imports", "the effect of the subsidized imports" also exist in Article 15. Article 15.5 stipulates:

"It must be demonstrated that the *subsidized imports are, through the effects of subsidies, causing injury* within the meaning of this Agreement. The demonstration of a causal

7.1228 There is no disagreement between the parties that an examination under Article 6.3(c) may precede any examination under Article 5(c). There is also no disagreement, in this part of this dispute, that an affirmative conclusion under Article 6.3(c) is a necessary<sup>1347</sup> element for an affirmative serious prejudice finding under Article 5(c). We will therefore first examine Brazil's claim under Article 6.3(c), which calls for an examination of "price suppression" "in the same market".

7.1229 An analysis of price suppression requires an analysis of prices. The "prices" we examine will necessarily depend upon the product and the particular market under examination. We therefore turn next to an examination of the textual condition of "in the same market" in Article 6.3(c) of the *SCM Agreement*.

(i) "In the same market"

(i) *Main arguments of the parties*

7.1230 **Brazil** asserts that the term "in the same market" in Article 6.3(c) can refer to either an individual country, regional or world market since Article 6.3(c) does not specify which geographic (or even product) markets are relevant for an analysis of price suppression.<sup>1348</sup> The "same market(s)" for the purposes of Brazil's price suppression claims under Article 6.3(c) are: (i) the world market for upland cotton; (ii) the Brazilian market; (iii) the United States market; and (iv) 40 third country markets where Brazil exports its cotton and where United States and Brazilian "like" upland cotton is found.<sup>1349</sup> Brazil submits evidence in support of its argument that global price effects in the world market – Cotlook "A-Index" and B-Index and New York futures prices and spot prices reflecting global supply and demand influences – are transmitted to the other markets.

7.1231 The **United States** argues that the later use of "in the same market" in Article 6.3(c) suggests that the significant price suppression or depression must occur when "the subsidized product" is found "in the same market" as "a like product of another Member." This phrase requires identification of a particular domestic market of a Member in which price effects are alleged to have occurred so as to allow a comparison in that market. The term "same market" in Article 6.3 (c) cannot be interpreted to include the world market because that would render redundant the word "same".<sup>1350</sup>

(ii) *Main arguments of the third parties*

7.1232 **Argentina** considers that Brazil has presented sufficient evidence with respect to the significant effect of subsidies on prices for each relevant geographical market, including the United States, Brazil, the African countries, other producer countries and Brazilian export markets. Argentina states that price movements of the United States, the Cotlook "A" Index and third country (e.g. Brazilian and Argentine) market prices are directly interconnected, and this is an unquestioned and irrefutable fact. Moreover, United States cotton forms part of Cotlook's "A" Index basket, so that

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relationship between the subsidized imports and the injury to the domestic industry shall be based on an examination of all relevant evidence before the authorities." (emphasis added, footnotes omitted).

Other provisions in Part V of the *SCM Agreement* contain similar references to "through the effects of the subsidy, subsidized imports are causing injury..." e.g. Article 19.1.

<sup>1347</sup> There is, however, a disagreement between the parties as to whether this is not only a "necessary", but also a "sufficient" requirement. We address this issue *infra* paras. 7.1368 *ff.*

<sup>1348</sup> Brazil's further written submission, paras. 94-96.

<sup>1349</sup> Brazil's response to Panel Question No. 233.

<sup>1350</sup> United States' further written submission, para. 91.

the Panel cannot ignore the fact that the United States subsidies have a decisive impact on the price of cotton in the world market.<sup>1351</sup>

7.1233 **Benin and Chad** agree with Brazil that for the purposes of Article 6.3(c), the term "market" could encompass an individual country, a region, or the world market for cotton. In addition, in the view of Benin and Chad, Brazil has clearly established the causal link between United States subsidies and suppressed prices in the world market.<sup>1352</sup>

7.1234 The **European Communities** disagrees with the United States contention that the term "same market" in Article 6.3 (c) cannot be interpreted to include the world market because that would render redundant the word "same". In accordance with its ordinary meaning, the term "market" may refer to any geographical market, including not only national or regional markets but also the world market, provided that there is such a world market for the product under consideration. The European Communities' position is that there is no world market for the purposes of Article 6.3 (c) where the existence of trade barriers has the consequence that the conditions of competition, and in particular the price levels prevailing in one geographical area are significantly different from those prevailing in another geographical area. Unlike, for example, import duties, quotas or transport costs, subsidies do not, of themselves, insulate the prices in one geographical area from those in other areas and, therefore, do not lead to existence of separate geographical markets.<sup>1353</sup> The European Communities has not taken a position on the factual issue of whether, "in relation to cotton", there is a world market for the purposes of Article 6.3 (c).<sup>1354</sup>

(iii) *Evaluation by the Panel*

7.1235 The **Panel** naturally begins its examination with the text of the treaty. Article 6.3(c) of the *SCM Agreement* provides that serious prejudice within the meaning of Article 5(c) may arise in any case where the effect of the subsidy is "significant price suppression ... in the same market".

7.1236 We first examine the ordinary meaning of "market", which can be: "a place ... with a demand for a commodity or service"<sup>1355</sup>; "a geographical area of demand for commodities or services"; "the area of economic activity in which buyers and sellers come together and the forces of supply and demand affect prices".<sup>1356</sup>

7.1237 In one of its ordinary meanings, therefore, the term "market" may refer to a (geographical) area of economic activity in which buyers and sellers come together and the forces of supply and demand affect prices. While we understand there to be a geographic implication to the term, we also see that there is no limitation or restriction on the scope of such a geographic area of economic activity. It could, for example, be a local, regional, national, continental or, even, global, geographical area, provided that the conditions of competition for sales of the product in question provides an appropriate foundation for a finding that a "market" exists within that area. The degree to which a market is limited by geography will depend on the product itself and its ability to be traded across distances. If barriers exist (such as distance), the interaction between buyers and sellers which allows one price to affect another may not be apparent.

7.1238 Returning to the text of the treaty, we see that Article 6.3(c) of the *SCM Agreement* also does not identify any particular "same market" where price suppression must be demonstrated. It does not specify that there must be a particular "domestic" "same market". The ordinary meaning of the term is

<sup>1351</sup> Argentina's oral statement at the resumed session of the first substantive meeting, paras. 23-26.

<sup>1352</sup> Benin and Chad's written submission to the resumed session of the first substantive meeting, para. 6.

<sup>1353</sup> European Communities' response to Panel third party Question No. 47.

<sup>1354</sup> European Communities' response to Panel third party Question No. 45.

<sup>1355</sup> *The New Shorter Oxford English Dictionary*, (1993).

<sup>1356</sup> *Merriam-Webster Dictionary online*.

not constrained to a particular geographic area of economic activity. The text of the provision does not, therefore, exclude the possibility that the "world market" could be relevant to our inquiry into price suppression under Article 6.3(c).

7.1239 Furthermore, the text of Article 6.3(c) of the *SCM Agreement* does not refer either to "imports" into or "exports" out of any particular Member's market, or any particular market at all. It therefore leaves open the possible geographical frame of reference that might define a market as a "world market".

7.1240 The immediate context of the provision would also support the view that the term "market" refers to a geographical area, and, furthermore, that there is no geographical or conceptual limitation on the connotation of "market" in Article 6.3(c) of the *SCM Agreement*. Articles 6.3(a) and (b) of the *SCM Agreement* each identify a particular "market" and a particular trade flow. They refer, respectively to: "imports into" "the market of the subsidizing Member"; and "exports" from "a third country market". Had the drafters wished to identify or place a conceptual or geographical constraint on the particular market that must be examined for the purposes of Article 6.3(c), they could have. However, they did not. The absence of a similar reference to any particular trade flows "into" or "out of" (a) Member(s) domestic market(s), would therefore support the view that the "market" for the purposes of an Article 6.3(c) examination of price suppression is an unspecified geographical area that could include a "world market".<sup>1357</sup>

7.1241 Further contextual guidance is present in other provisions of the *SCM Agreement*.

7.1242 For example, Article 15.2 of the *SCM Agreement*, dealing with a price suppression examination in the course of a countervailing duty investigation, states, in pertinent part:

"... With regard to the effect of the subsidized imports on prices, the investigating authorities shall consider whether there has been a significant price undercutting by the subsidized imports as compared with the price of a like product of the importing Member, or *whether the effect of such imports is otherwise to depress prices to a significant degree or to prevent price increases, which otherwise would have occurred, to a significant degree...*".(emphasis added)

7.1243 That provision indicates clearly that the "market" frame of reference for the price suppression examination is the domestic market of the importing Member. The trade flow involved is "such imports", that is, the subsidized imports that are exported by the allegedly subsidizing Member into the market of the Member conducting the countervailing duty investigation. Furthermore, the Agreement itself contemplates the compartmentalization of a Member's domestic market in certain situations where there may be a localized or targeted impact in a certain geographic area within the importing Member's market.<sup>1358</sup> The absence of any such (or analogous) explicit requirement (or

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<sup>1357</sup> The existence of such a "world market" could depend on many factors. The nature of the "market" to be examined for the purposes of Article 6.3(c) may well differ from case to case depending upon the facts of the particular case, including the commodity or "subsidized product" at issue. Indeed, there may not always be a "world market" for any given product. In order to characterize a certain geographical area, whether it is the territory of one or more Members or the entire world, as a "market", the conditions of competition prevailing within that geographical area would need to manifest at least some degree of homogeneity. The conditions of competition for sales of the product in question would have to provide an appropriate foundation for a finding that a "market" exists within that area.

<sup>1358</sup> Article 16.4 of the *SCM Agreement* states:

"In exceptional circumstances, the territory of a Member may, for the production in question, be divided into two or more competitive markets and the producers within each market may be regarded as a separate industry if (a) the producers within such market sell all or almost all of their production of the product in question in that market, and (b) the demand in that

permission) in Article 6.3(c) to constrain the meaning of "market" to any particular geographic area, or to focus particularly upon a particular trade flow (i.e. imports into, or exports from, a particular areas) supports the view that we are not precluded from reading the term "market" as including a geographical area which may embrace the entire world.

7.1244 This is consistent with the object and purpose of the Agreement, which is to reduce trade distortion through the grant of subsidies by Member governments.<sup>1359</sup> Trade distortion may occur in multiple possible geographical areas.

7.1245 Here, the product we are dealing with is upland cotton. It is a fungible commodity that does not rapidly spoil and is readily transportable, and that is, in fact, regularly traded in large quantities all over the world.<sup>1360</sup> Key participants in this upland cotton market are producers and consumers of upland cotton. As with any basic, fungible commodity, prices for upland cotton are determined by supply and demand. Market prices are affected by the perception and anticipation of market participants as to current and probable future movements of production and consumption as essential determinants of demand, supply, and, consequently, price.<sup>1361</sup>

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market is not to any substantial degree supplied by producers of the product in question located elsewhere in the territory. In such circumstances, injury may be found to exist even where a major portion of the total domestic industry is not injured, provided there is a concentration of subsidized imports into such an isolated market and provided further that the subsidized imports are causing injury to the producers of all or almost all of the production within such market."

<sup>1359</sup> See *supra*, Section VII:E, footnote 920.

<sup>1360</sup> For example, International Cotton Advisory Committee, *Cotton: World Statistics* (September 2002), reproduced in Exhibit BRA-9 and International Cotton Advisory Committee, *Cotton: World Statistics* (September 2003), reproduced in Exhibit BRA-208, indicate worldwide cotton supply and use, and cotton supply and use in 68 countries, and production, consumption imports and exports of cotton lint in recent years. See also Cotton Outlook; USDA ERS, Cotton and Wool Outlook (Exhibits BRA-10, -20, -189, -253, -328, and -382). We recall, as well, for example, Chad's oral statement at the resumed session of the first substantive meeting, paras. 7-11.

USDA ERS recognizes that "Trade is particularly important for cotton. Thirty per cent of the world's consumption of cotton fiber crosses international borders before processing, a larger share than for wheat, corn, soybeans, or rice...". See USDA ERS, Briefing room, Cotton: Background (from [www.ers.usda.gov](http://www.ers.usda.gov)), reproduced in Exhibit BRA-13.

<sup>1361</sup> We recall the statement of Mr. Andrew MacDonald, retained by Brazil and a member of Brazil's delegation at the resumed session of the first substantive meeting and the second substantive meeting with the Panel. Annex II to Brazil's further written submission contains a notarized "declaration" of Mr. MacDonald dated 21 May 2003. Mr. MacDonald's statement is focused on upland cotton only, and references to "cotton" are to "upland cotton". A written version of Mr. MacDonald's oral statement at the resumed session of the first substantive meeting with the Panel is provided in Exhibit BRA-281. See, in particular, para. 4 of Exhibit BRA-281 and para. 11 of Annex II to Brazil's further written submission. See also *supra*, footnote 1323, relating to the involvement of experts as members of party and third party delegations in these Panel proceedings, and *infra*, footnote 1375 on Mr. MacDonald's further involvement. The record indicates that, at the time of this Panel proceeding, Mr. MacDonald is the Vice President and "President-elect of the Liverpool Cotton Association and will take office as its President in 2004"; President of the Private Sector Advisory Panel of the International Cotton Advisory Committee; and Chairman of the Spinners' Committee of the International Textiles Manufacturers Federation, and had worked for thirty years in the "cotton business", including purchasing and negotiating upland cotton from a variety of sources, trading cotton futures in the New York Futures market, reviewing "leading cotton trade journals" such as "Cotton Outlook" on a daily basis. Mr. MacDonald "never worked for producers of upland cotton". Mr. MacDonald indicated that his "experience is that of a businessman intimately familiar with the factors and mechanisms that are used to price and negotiate price for upland cotton in many individual countries, as well as the international market." Mr. MacDonald also provided expert opinion evidence on another issue in Exhibit BRA-401.

7.1246 While certain WTO Members and non-Members may produce, consume and/or export cotton relatively more or less upland cotton than others<sup>1362</sup>, and world trade flows of upland cotton may vary in volume over different periods of time across various countries and regions of the world, we see no factual elements in the record before us that would lead us to conclude that there is a necessity geographically to compartmentalize our analysis or to superimpose any degree of regional/continental/national/sub-national isolation or to limit our analysis to particular isolated impacts in a particular geographical area. We would also point out that it is not our task to select an appropriate market: it is for the complaining Member to identify the market for the purposes of its claim. We then determine whether it is a "market" within the meaning of Article 6.3(c) and whether the effect of the subsidy is proven in that market.

7.1247 Our conclusion that such a world market, in fact, exists in this case, does not preclude the existence of other relevant markets for the purposes of our analysis. In saying that a "world market" may exist for upland cotton, we do not mean to construct a monolithic "world market" that reads out every other possible connotation of "market" under Article 6.3(c).

7.1248 Therefore, this does not mean that we cannot also conduct another inquiry into other geographical areas within the world market, which meet the definition of "same market" in the sense of Article 6.3(c). This would not, however, permit, for example, coupling an examination of Brazil's product under the conditions of competition prevailing in one Member's market with an examination of the United States' product under the conditions of competition prevailing in *another* Member's market. This would not meet the definition of "same market" because the frame of reference would necessarily have to be, at that level, either one or the other Member's market in which both Brazilian and United States upland cotton were present and competing for sales. Applying the frame of reference of a geographic region consisting of a particular Member's market, it could not be two different such "markets".

7.1249 We therefore disagree with the United States assertion<sup>1363</sup> that, if a complaining party could merely assert price suppression or depression in the world market, the word "same" in the phrase "the same market" would be rendered inutile because the subsidized and non-subsidized products could always be deemed to be in the same "world market". If there truly is a world market for a given commodity, which we believe there is in the present case, then our price suppression analysis in the context of that world market would occur within that frame of reference. The selection of the relevant market will then impact upon the concepts of effect (of the subsidy), significance (of the price suppression) and seriousness (of the prejudice) under the relevant articles.

7.1250 We believe that our interpretation allows the text of Article 6.3(c) to be read effectively in its context. Annex V of the *SCM Agreement* contains "Procedures for Developing Information Concerning Serious Prejudice." Paragraph 1 of Annex V requires that the parties to the dispute and any third-country Member concerned shall notify to the DSB, as soon as the provisions of Article 7.4 have been invoked, the organization responsible for administration of this provision within its territory and the procedures to be used to comply with requests for information. Article 6.6 of the *SCM Agreement* states that "[e]ach Member *in the market of which* serious prejudice is alleged to have arisen shall ... make available ... all relevant information ... as to the changes in market shares of the parties to the dispute as well as concerning *prices of the products involved*" (emphasis added).

7.1251 Furthermore, the information gathered during the information-gathering process "should include, *inter alia*, data concerning the amount of the subsidy in question (and, where appropriate, the value of total sales of the subsidized firms), *prices of the subsidized product, prices of the non-subsidized product, prices of other suppliers to the market*, changes in the supply of the subsidized product *to the market in question* and changes in market shares." (emphasis added) Our

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<sup>1362</sup> See, for example, Exhibits BRA-9 and BRA-209.

<sup>1363</sup> United States' response to Panel Question No. 159.

interpretation allows these provisions to be read also as applying to particular markets where competition exists between Brazilian and United States upland cotton.

7.1252 Similarly, we do not agree with the United States' proposition that the subsidized and other products could never be found in the same geographic market and still be considered to be in the same "world market". In our view, as we have already indicated, the world market *is* a geographic market. Where price suppression is demonstrated in that market, it may not be necessary to proceed to an examination of each and every other possible market where the products of both the complaining and defending Members are found.

(j) Is there price suppression in the same world market?

(i) *Main arguments of the parties*

7.1253 **Brazil** asserts that "price suppression" in Article 6.3(c) of the *SCM Agreement* refers to the situation where prices are prevented from rising (i.e. but for the subsidies, market prices would have been higher) or where prices actually declined.<sup>1364</sup> Brazil asserts that the effects of United States subsidies in MY 1999-2002 cause "significant price suppression" in the Brazilian, United States and world markets.

7.1254 Brazil states that "significant" price suppression is such as to meaningfully affect suppliers (i.e., Brazilian, African and other non-United States suppliers) competing with the subsidized product. Brazil further argues that "significance" may also be judged in appropriate situations based on the vulnerability of a Member and its affected industry to serious prejudice from even smaller amounts of price suppression.<sup>1365</sup>

7.1255 The **United States** submits that there has been no "price suppression" within the meaning of Article 6.3(c) of the *SCM Agreement*. The United States does not agree that a world market for upland cotton can exist, as Article 6.3(c) requires an examination of a Member's domestic market where both Brazilian and American upland cotton are competing for sales. The United States disagrees that Brazil has established price suppression in any "same market" within the meaning of Article 6.3(c).

7.1256 For the United States "significant" modifies "price suppression or depression" and therefore, it is the effect on prices that must be "significant" and not the direct effect on producers. Such price suppression must be demonstrated in respect of Brazilian products alone.<sup>1366</sup> The United States disagrees with Brazil that the meaning of "significance" may vary depending upon the complaining Member. The United States asserts that Brazil's developmental status is irrelevant for purposes of Article 6.3(c).<sup>1367</sup>

(ii) *Main arguments of the third parties*

7.1257 **Argentina** states that it does not understand how the United States can simply brush aside the Panel's findings in *Indonesia - Autos*, since this was the only dispute under the GATT-WTO that dealt with the interpretation of the term "significant". Argentina also fails to understand how the United States can claim that Brazil argued that it is the effect on producers that must be significant, and not on prices, when Brazil has submitted copious evidence, based on numerous empirical and econometric analyses, of the effects of the subsidies on prices. Argentina states that an increase in the world price of cotton would be significant, even if international price suppression or depression were

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<sup>1364</sup> Brazil's further written submission, paras. 83-89.

<sup>1365</sup> Brazil's further written submission, paras. 94-97.

<sup>1366</sup> United States' further written submission, para. 86.

<sup>1367</sup> United States' further written submission, paras. 85-87.

to amount to only one per cent per pound, since such an increase would enable countries such as Brazil and Argentina to recover their competitive positions in the world cotton market. At no time does the United States seem to suggest that a suppression or depression effect of 12.6 per cent on international cotton prices is not "significant" within the meaning of Article 6.3(c).<sup>1368</sup>

7.1258 The **European Communities** takes issue with Brazil's interpretation that it is relevant to consider not only the impact on the producers concerned, but also the impact on the government of the complaining Member in assessing the "significance" of price depression or suppression for the purposes of Article 6.3 (c). The European Communities contends that Brazil's interpretation belies the correct approach it advances elsewhere that the existence of serious prejudice must be presumed whenever it is established that the effect of the subsidy is to cause, *inter alia*, significant price depression or suppression, without it being necessary to show, as an additional and separate requirement, that such price depression or suppression causes a serious prejudice to the interest of the Member concerned. The European Communities also rejects Brazil's suggestion that the threshold for establishing the existence of serious prejudice should be lower when the complaining party is a developing country Member, as Article 6.3 (c) is not special and differential treatment provision.<sup>1369</sup>

7.1259 **New Zealand** agrees with Brazil that even a very small level of price suppression may have a meaningful effect, for example where large volumes of a product may be traded. New Zealand asserts that the United States argument that the significance of the price suppressive effect of the subsidy can only be determined by reference to the effect on 'price' should be rejected since Articles 5 and 6 are concerned with the adverse effects of a subsidy and therefore, it is entirely appropriate under Article 6.3(c) to consider whether price suppression is "significant" by reference to the effect of the price suppression on the Member alleging adverse effects to its interests. According to New Zealand, what renders price suppression significant or insignificant is whether or not it causes adverse effects to the Member concerned, not whether or not an arbitrary level of numeric significance is achieved as implied by the United States.<sup>1370</sup> Such an approach is not inconsistent with the United States assertion that the drafters of Article 6.3(c) used the term "significant" to create a threshold to ensure that not just "any theoretical price effect" would suffice.<sup>1371</sup> For New Zealand, the phrase "in the same market" serves to locate the price suppressive effects rather than define their substance.<sup>1372</sup>

(iii) *Evaluation by the Panel*

i Is there a world market "price"?

7.1260 We begin our examination, as always, with the relevant text of the treaty. Article 6.3(c) of the *SCM Agreement* calls for an examination of whether "the effect of the subsidy is a ... significant price suppression, price depression or lost sales in the same market."

7.1261 "Price" suppression requires an examination of "prices". Before examining whether or not price suppression in the world market exists, we first discern which "price" we are to examine in the "world market".

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<sup>1368</sup> Argentina's oral statement at the resumed session of the first substantive meeting, paras. 18-22.

<sup>1369</sup> European Communities' written submission to the resumed session of the first substantive meeting, paras. 5-9.

<sup>1370</sup> New Zealand's written submission to the resumed session of the first substantive meeting, paras. 2.21, 2.23 and 2.24.

<sup>1371</sup> New Zealand's written submission to the resumed session of the first substantive meeting, para. 2.25.

<sup>1372</sup> New Zealand's written submission to the resumed session of the first substantive meeting, paras. 2.26-2.27.

7.1262 The ordinary meaning of "price" is: "the amount of money or goods for which a thing is bought or sold"; "value or worth".<sup>1373</sup>

7.1263 Brazil focuses on the A-Index and the New York Futures price as the bases for its world market "price suppression" allegations. The United States, contends that while these price discovery mechanisms are "price quotes", neither constitutes an actual world market "price" which may be the subject of an analysis under Article 6.3(c) of the *SCM Agreement*.

7.1264 The "A-Index" is a composite of an average of the five lowest price quotes from a selection of the principal upland cottons traded in the world market obtained by Cotlook, a private UK-based organization.<sup>1374</sup> The New York Cotton futures index reflects an exchange of a standard futures contract (Cotton No. 2 futures contract). The issue before us is whether we may consider either or both of these as a "price" for the purposes of analysing whether or not "price suppression" has occurred in the same "world market" for the purposes of Article 6.3(c) of the *SCM Agreement*.

7.1265 We first consider the A-Index. There are four main reasons why we believe that we may consider it as a "price" for the purposes of analysing whether or not "price suppression" has occurred in the same "world market" for the purposes of Article 6.3(c) of the *SCM Agreement* in this dispute.

7.1266 First, in respect of the upland cottons comprising the constituent elements of the A-Index, both Brazilian Middling 1 3/32" and United States prices for Memphis and California/Arizona Middling 1 3/32" are among the constituent quotes.

7.1267 Second, we have before us credible evidence that the A-Index "summarizes price developments of the physical market [for upland cotton] in various countries around the world" and that the A-Index is perceived by key market participants – growers, consumer and traders – as reflecting the "world" market price for upland cotton.<sup>1375</sup>

7.1268 Third, we find consistent, supporting evidence in the fact that the International Cotton Advisory Council refers to the A-Index as expressing "world" or "international" "cotton prices".<sup>1376</sup>

7.1269 Fourth, and perhaps more relevantly for the purposes of this dispute, the USDA ERS has itself referred to the A-Index as the "world price"<sup>1377</sup> and as the "indicator of world price levels"<sup>1378</sup> and as a measurement of United States relative [upland] cotton competitiveness in the "world market".<sup>1379</sup>

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<sup>1373</sup> *Concise Oxford English Dictionary* (Oxford: Clarendon Press, 1995).

<sup>1374</sup> "Cotton Outlook", April 5 2002, p. 2, reproduced in Exhibit BRA-11. See also <http://www.cotlook.com>. The prices are quoted c.i.f Northern Europe.

<sup>1375</sup> See contributions of Mr. Andrew MacDonald, retained by Brazil and a member of Brazil's delegation, in Annex II to Brazil's further written submission and Exhibit BRA-281. See also *supra*, footnote 1323, relating to the involvement of experts as members of party and third party delegations in these Panel proceedings, and footnote 1361 on Mr. MacDonald in particular. Mr. MacDonald also states: "The A and B-Index reflects how interconnected the 'world' price for cotton is with the prices of cotton in the individual country markets that make up these indices".

<sup>1376</sup> Exhibit BRA-19.

<sup>1377</sup> The United States government has itself referred to the A-Index as the "world price", USDA ERS "Cotton and Wool Outlook", p. 3, Figure 2, reproduced in Exhibit BRA-20,: "World price rises 45 per cent during March 2002-March 2003", citing source: "Cotlook Limited". The accompanying text reads: "...the world price of cotton has risen 45 per cent from March 2002 to March 2003". The United States government has also referred to the A-Index as the "indicator of world price levels", USDA ERS "Background for 1995 Farm Legislation", p.12, reproduced in Exhibit BRA-12. It has also referred to the A-Index as a measurement of United States relative cotton competitiveness in the "world market". *Ibid*, p. 19, first column: Addressing developments in the A-Index during the period MY 1991-MY 1993: "Over 85 per cent of the time U.S. cotton was selling competitively on the 'world market' ". We further recall the Appellate Body's reference to "world

7.1270 Moreover, and perhaps most importantly, the United States government relies upon the A-Index as a "price" which is a key determinant for whether or not certain of its market condition-contingent subsidies will be paid.<sup>1380</sup> The United States "adjusted world price" is precisely an adjustment of the A-Index which, by necessary implication, would mean that the A-Index represents – at least in the estimation of the United States government for the purposes of its subsidies to upland cotton – the "world price" which is achievable in the market in which United States upland cotton competes.<sup>1381</sup>

7.1271 The United States "adjusted world price" is *based on* and *derived from* the A-Index. It is adjusted to United States base quality and average location.<sup>1382</sup> The USDA announces the "adjusted world price" and CCA each Thursday, when the USDA also announces consequent loan deficiency payment rates and user marketing (Step 2) certificate payment rates for upland cotton.<sup>1383</sup>

7.1272 Rather than reflecting "disparate price quotes from around the world" as the United States asserts, the considerations we have just mentioned rather lead us to conclude, as a matter of fact, on the basis of our assessment of the evidence before us, including the oral statements of various Members of the parties' delegations at the meetings of the Panel with the parties<sup>1384</sup>, that the A-Index may serve as an indication of the "world price" – in terms of the "amount of money set for sale of upland cotton" or the "value or worth" of upland cotton – for the purposes of our analysis of whether or not price suppression has occurred in the same "world market" under Article 6.3(c) of the *SCM Agreement*.

7.1273 We next examine the New York Futures Exchange futures contract values. This value is a reflection of market forces of supply and demand at a futures market, based in New York, where daily trading is conducted, and contracts are entered into, on the basis of price levels that reflect the daily perception of the probable future direction of upland cotton prices.<sup>1385</sup> We believe that the A-Index

market prices" as a benchmark in another context. See, for example, Appellate Body Report, *Canada – Dairy(Article.21.5, – New Zealand and US)*, paras. 86ff.

<sup>1378</sup> USDA ERS "Background for 1995 Farm Legislation", p.19, reproduced in Exhibit BRA-12.

<sup>1379</sup> *Ibid.*, p. 19, first column: Addressing developments in the A-Index during the period MY 1991-MY 1993: "Over 85 per cent of the time U.S. cotton was selling competitively on the 'world market'".

<sup>1380</sup> i.e., concerning the marketing loan programme payments: Sections 1201(a)-(b), 1202(a)(6), 1202(b)(6), 1204(b), 1205(a)(1), 1205(b), 1205(c)(1), 1608 of the FSRI Act of 2002 and 7 USC 7286 (Section 166 of the FAIR Act as amended) and 7 CFR 1427.22; and concerning the user marketing (Step 2) payments, Section 1207(a) of the FSRI Act of 2002; 7 CFR 1427.107 and section 136 of the FAIR Act of 1996.

<sup>1381</sup> The United States government effectively acknowledges, in another context, that the name itself is indicative of its role: "In the case of upland cotton, the alternative repayment rate is the adjusted world price (AWP) and reflects, as the name indicates, an estimate of world prices, adjusted to the United States". See Exhibit BRA-50.

<sup>1382</sup> The adjusted world price for individual qualities is determined using the schedule of loan premiums and discounts and location differentials. A "coarse count adjustment" (CCA) may be applicable for cotton with a staple length of 1-1/32 inches or shorter and for certain lower grades with a staple length of 1-1/16 inches and longer.

<sup>1383</sup> See FSA, News Release: "USDA announces prevailing world market price, loan deficiency payment rate and user marketing certificate payment rate for upland cotton", reproduced in Exhibit US-72. This Exhibit also gives an indication as to how the AWP (and CCA) are determined.

<sup>1384</sup> Statement of Andrew MacDonald, Annex II to Brazil's further submission and Exhibit BRA-281. See *supra*, footnotes 1375 and 1323.

<sup>1385</sup> Statement of Mr. Andrew MacDonald, Annex II to Brazil's further written submission and Exhibit BRA-281: "The New York Cotton Exchange's futures market is the only important futures market for cotton in the world. Trading is conducted with price levels reflecting the daily perception of the market participants worldwide, on how prices will develop in the future, as well as in the near and medium-term[...]. It is the principle price and trend indicator for the whole worldwide cotton market, and as such the 'New York futures price' is a key mechanism used by the growers, trade and cotton consumers in determining the current market

and the New York Futures Index have different functions and rationale: one summarizes actual daily upland cotton price quotes under certain conditions; the other is, *inter alia*, an instrument for global price discovery for future delivery of cotton. While we do not understand the United States to disagree with the proposition that the New York futures values are prospectively indicative of market-based price expectations, we do not need to rely on these values as a current "world price" for the purposes of our examination under Article 6.3(c).

7.1274 We therefore find, as a factual matter, that the A-Index can be taken to reflect a world price in the world market for upland cotton that is sufficient to form the basis for our analysis as to whether there is price suppression in the same world market within the meaning of Article 6.3(c) for the purposes of this dispute.

ii Is there "price suppression"?

7.1275 The current text of Part III of the *SCM Agreement* does not provide a definition or any interpretative guidance concerning the meaning of "price suppression" or "depression" as those terms are used in Article 6.3(c) of the *SCM Agreement*.

7.1276 The ordinary meaning of "suppress" is "[p]revent or inhibit (an action or phenomenon)";<sup>1386</sup> "Depression" can be defined as: "the action of pressing down; the fact or condition of being pressed down"<sup>1387</sup>

7.1277 Thus, "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. Price depression refers to the situation where "prices" are pressed down, or reduced.<sup>1388</sup>

7.1278 This reading of the textual terms "price suppression" and "depression" in Article 6.3(c) of the *SCM Agreement* finds general contextual support in Article 15.2 of the *SCM Agreement*, which, for a Member's countervailing duty investigation, requires an examination of "...whether the effect of [the subsidized] imports is otherwise to depress prices to a significant degree or to prevent price increases, which otherwise would have occurred ...".

7.1279 The text of Article 6.3(c) of the *SCM Agreement*, in its context, indicates that we need to undertake an inquiry into whether upland cotton prices either were pressed down, prevented or inhibited from rising, or while they did actually increase the degree and magnitude of increase was less than it otherwise would have been.

7.1280 We next turn to the question of how we assess whether or not "price suppression" has occurred in the same "world market" which we have found to exist. We believe the following considerations are relevant to our examination: (a) the relative magnitude of the United States' production and exports in the world upland cotton market; (b) general price trends; and (c) the nature of the subsidies at issue, and in particular, whether or not the nature of these subsidies is such as to have discernible price suppressive effects. We examine each of these considerations in turn.

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values as well as the contract prices for forward deliveries, in both the international and domestic markets." See *supra*, footnotes 1375, 1384 and 1323.

<sup>1386</sup> *The New Shorter Oxford English Dictionary*, (1993).

<sup>1387</sup> *The New Shorter Oxford English Dictionary*, (1993).

<sup>1388</sup> In the remainder of our analysis, we use the term "price suppression" to refer both to an actual decline (which otherwise would not have declined, or would have done so to a lesser degree) and an increase in prices (which otherwise would have increased to a greater degree).

a. relative magnitude of United States' production and exports

7.1281 We begin with the relative magnitude of the United States' production and exports in the world upland cotton market in the marketing years 1999 to 2002.

7.1282 In the period under consideration, the United States was the world's second largest producer of upland cotton, accounting for approximately one-fifth of world production.<sup>1389</sup> In the marketing years 1999 to 2002, the respective shares of the United States in world production of upland cotton were approximately 19.2, 19.3, 20.6 and 19.6 per cent, respectively.

7.1283 Furthermore, the United States was the world's largest exporter of upland cotton during the marketing years 1999 to 2002. According to the record evidence, the United States share of world exports increased from approximately 23.5 per cent in MY 1999 to 24.5 per cent in MY 2000 to 37.3 per cent in MY 2001 to 39.9 per cent in MY 2002.<sup>1390</sup>

7.1284 In comparison, according to record evidence, Brazil's share of world production of upland cotton was approximately 3.8 to 5 per cent in the marketing years 1999 to 2002, while Brazil's share of world exports of upland cotton never exceeded 2.4 per cent in the same period.<sup>1391</sup>

7.1285 We believe that, due to the large relative proportion of the United States production and export of upland cotton, the United States exerted a substantial proportionate influence on prices in the world market for upland cotton.

b. general price trends

7.1286 In terms of general price trends, the United States acknowledges that market prices in recent years have been "extraordinarily low"<sup>1392</sup>, and even that there was a "dramatic plunge" in prices.<sup>1393</sup>

7.1287 We asked the parties to provide us with a chart of the weekly United States adjusted world price, the A-Index, the nearby New York futures price, the average United States spot market price and prices received by United States producers from January 1996 to the present. Brazil's submission<sup>1394</sup>, which does not materially differ from that of the United States<sup>1395</sup>, is as follows:

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<sup>1389</sup> We estimated the shares for upland cotton using the World Cotton Statistics of the International Cotton Advisory Committee (Exhibit BRA-208), by subtracting the data for production/exports of "extra-fine cotton" from production/exports of "cotton". We note that the United States share of world upland cotton production in MY 1998 was approximately 16 per cent.

<sup>1390</sup> According to data submitted by Brazil (Exhibit BRA-302), the United States share in world exports of upland cotton were 24.1 per cent, 24.7 per cent, 38.3 per cent and 41.6 per cent in the marketing years 1999 to 2002, respectively. The United States also submitted data pertaining to the United States share in world exports of upland cotton, in response to Panel Question No. 160, as well as in, for example, Exhibits US-119 and -120. They show an increase during the marketing years 1999 to 2002, as follows: 1999/2000: 24.1 per cent; 2000/01: 24.7 per cent; 2001/02: 38.2 per cent; 2002/03: 39.3 per cent. We note that while the absolute figures provided by the United States in response to Panel Question No. 160 differ slightly from those of Brazil, they are of the same general order of magnitude and direction. Our analysis is not materially affected by the slight differences in the figures submitted by the parties.

<sup>1391</sup> We estimated the shares for upland cotton using the World Cotton Statistics of the International Cotton Advisory Committee (Exhibit BRA-208), by subtracting the data for production/exports of "extra-fine cotton" from production/exports of "cotton".

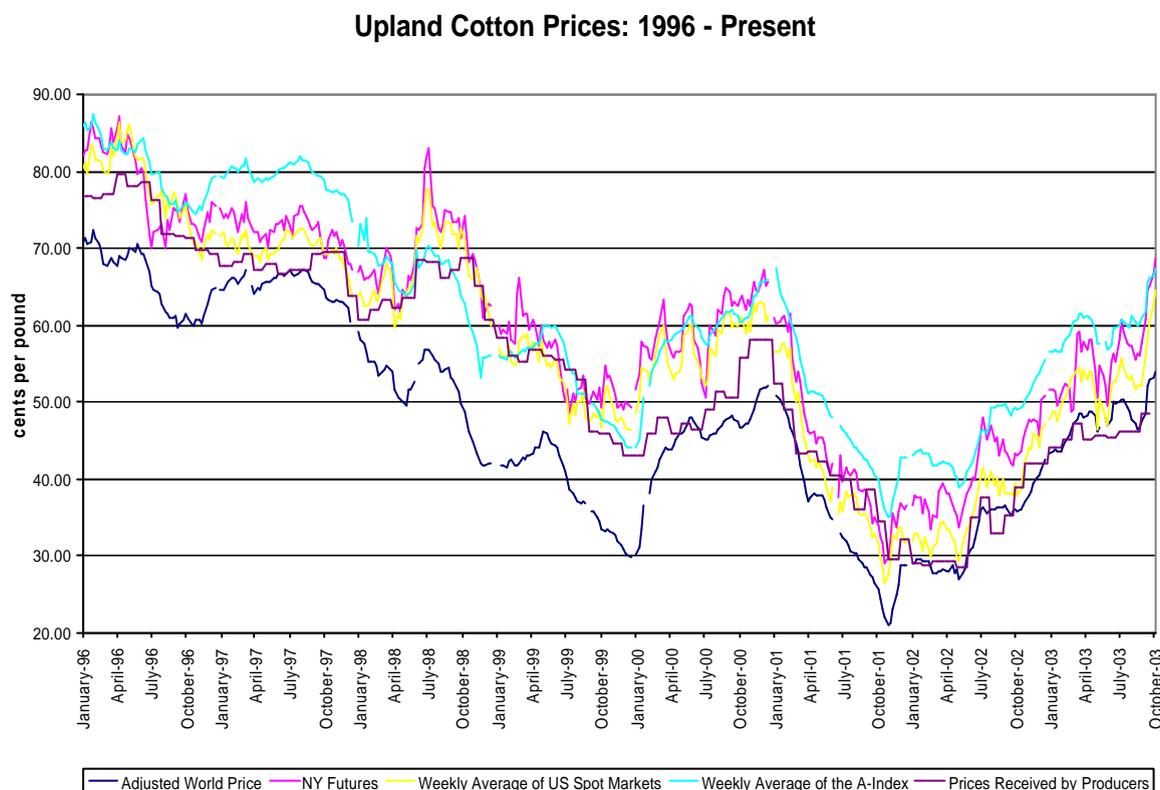
<sup>1392</sup> e.g. United States' oral statement at the resumed session of the first substantive meeting, para. 21.

<sup>1393</sup> United States' further written submission, para. 17.

<sup>1394</sup> Exhibit BRA-311, indicating that the data was obtained from the Cotton Outlook published by Cotlook, Ltd.

<sup>1395</sup> Exhibit US-73.

Chart 1: Various upland cotton "prices" and "indicators"



7.1288 This depicts a broad decline in the overall level of these price trends from 1996 through the beginning of calendar year 2002, with intermittent peaks and valleys. From 2002, there is a general upward trend. This chart also demonstrates that there is a broad similarity in many of the price trends depicted. The fact that prices dropped from 1996 through the beginning of 2002 is relevant. However, it is not, in and of itself, conclusive for a determination of price suppression. Nor is the increase from 2002 conclusive that a determination that any price suppression necessarily ceased at that point. We need to examine whether these prices were suppressed, that is, lower than they would have been without the United States subsidies in respect of upland cotton.

c. nature of the subsidies

7.1289 In this respect, we first recall that the existence of the United States subsidies challenged in this dispute is not in question. We consider that the *nature* of the United States subsidies at issue – in terms of their structure, design and operation – is relevant in assessing whether or not they have price suppressing effects. We see before us two general types of United States subsidies: those that are directly price-contingent, and those that are not. We consider that, in light of the guiding considerations we have already outlined<sup>1396</sup>, this distinction is critical for the purposes of our price suppression analysis in terms of the nexus which the subsidies have to any price suppression and to the subsidized product at issue. We examine each of these two types of subsidies in turn.

<sup>1396</sup> *Supra*, paras. 7.1191-7.1194.

(i) *price-contingent subsidies*

7.1290 We consider it highly relevant that certain of the United States subsidies are directly linked to world market prices. Foremost among these are the marketing loan programme payments and the user marketing (Step 2) payments. MLA payments and CCP payments are also included in this category. We examine each in turn.

7.1291 First, under the marketing loan programme<sup>1397</sup>, benefits to producers result when the United States adjusted world market price falls below the loan rate. The repayment rate for upland cotton is the lower of the two. When the adjusted world market price is lower than the loan rate, the producer repays at less than the loan rate. This difference is referred to as a "marketing loan gain". Alternatively, a producer may forego a marketing loan and receive a "loan deficiency payment" ("LDP") in the amount of the difference between the lower adjusted world market price and the loan rate. Where producers repay at less than the loan rate, there is patently a financial contribution supplementing the income of the producer. We have no doubt that the payments stimulate production and exports and result in lower world market prices than would prevail in their absence. Moreover, the text of the measure indicates that the payments are mandatory, where certain market conditions prevail.<sup>1398</sup>

7.1292 The magnitude of payments under the marketing loan programme was – and continues to be – countercyclical and dependent upon the adjusted world price, which is derived from the A-Index. The greater the difference between the adjusted world price and the marketing loan rate, the greater the subsidy payment.

7.1293 The proposition that the per unit payment under the marketing loan programme increases when the gap between the adjusted world price and the loan rate widens is borne out by the following graph:<sup>1399</sup>

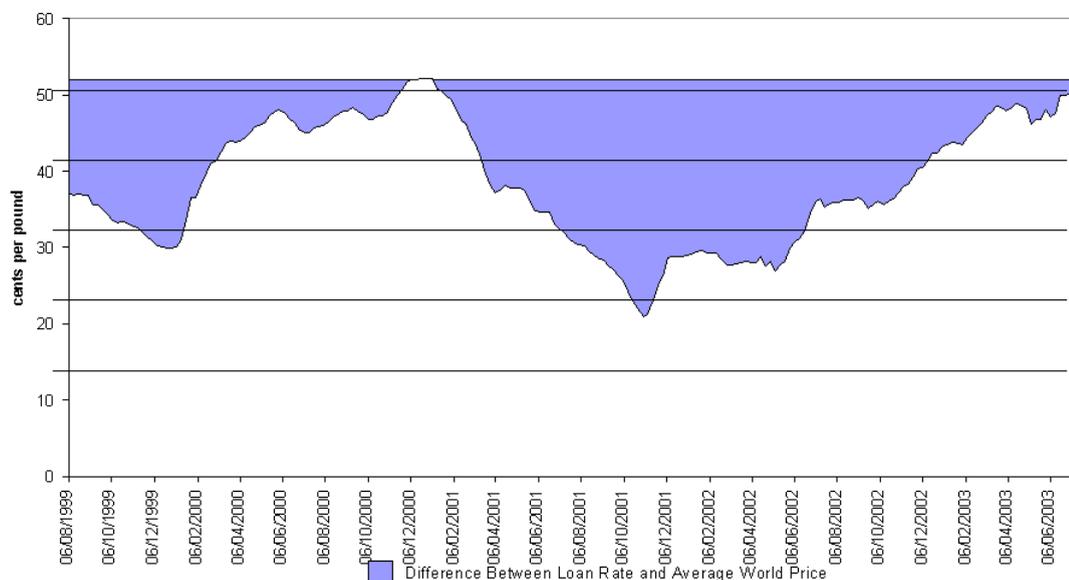
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<sup>1397</sup> See our description of the measure *supra*, Section VII:C.

<sup>1398</sup> Section 1201(a) of the 2002 FSRI Act provides that "... the Secretary shall make available to producers on a farm nonrecourse marketing assistance loans for loan commodities produced on the farm"; and "[t]he producers on a farm shall be eligible for a marketing assistance loan for any quantity of a loan commodity produced on the farm." Section 1202 sets out the loan rate for upland cotton. See Exhibit BRA-29. We refer to and incorporate our general discussion of the mandatory/discretionary distinction in Section VII:C. We also refer to and incorporate *mutatis mutandis* our findings in Sections VII:E and F that section 1601(e) of the FSRI Act of 2002, pertaining to expenditures under subtitles A through E of the FSRI Act of 2002, addresses levels of domestic support for the purpose of a Member's domestic support commitments under the *Agreement on Agriculture*. However, it does not deal with a Member's compliance with the serious prejudice provisions of the *SCM Agreement* and therefore is not legally relevant here.

<sup>1399</sup> Brazil's response to Panel Question No. 167, para. 150.

**Chart 2: Difference between loan rate and adjusted world price**



7.1294 This graph illustrates that except for a short period in MY 2000, the adjusted world price was *below* the marketing loan rate throughout virtually *the whole period* from MY 1999-2002. The shaded portion of the graph corresponds to the difference between the adjusted world price and the marketing loan rate of approximately 52 cents. The graph indicates that the marketing loan subsidy by the United States government, at certain points, was greater than the market value of the product itself. It accounted for *more than half* of the difference between the adjusted world price and the marketing loan rate (and thus of United States upland cotton producer revenue). The further the adjusted world price drops, the greater the extent to which United States upland cotton producers' revenue is insulated from the decline, numbing United States production decisions from world market signals.

7.1295 We concur with Brazil, who cited certain USDA economists<sup>1400</sup> in support, that the structure, design and operation of the marketing loan programme has enhanced production and trade-distorting effects.<sup>1401</sup> The payments stimulate production and exports and result in lower world market prices than would prevail in their absence. The counter-cyclical nature of the programme means that the lower the United States adjusted world price, the greater the magnitude of the subsidy received by United States upland cotton producers over a given time period.

7.1296 Over the period MY 1999-2002 shown in the chart above, when United States prices decreased, due to the marketing loan's impact on United States production of upland cotton, this did not have the effect of decreasing United States production or export. Rather, we see that United States production and exports essentially continued or increased over the period MY 1999-MY 2002, reflecting the enhanced competitiveness of United States producers in world trade.<sup>1402</sup> The structure of the measure, directly linked to the A-Index, affects the world market generally. In particular over the period MY 1999-MY 2002, the United States adjusted world price, that is, the determinative price for the availability and magnitude of the United States marketing loan programme payments and user

<sup>1400</sup> See e.g., Exhibits BRA -222 and -223.

<sup>1401</sup> The fact that the United States notifies the marketing loan programme as "amber box" support under the *Agreement on Agriculture* may not necessarily be determinative for the purpose of our "adverse effects" analysis under Part III of the *SCM Agreement*.

<sup>1402</sup> See e.g., Exhibit BRA-223.

marketing (Step 2) payments was almost always below – and at times well below – this marketing loan rate throughout this period.

7.1297 While we do not believe it is necessary to calculate the precise amount of the subsidies in question, we observe that we have this information readily available on the record.<sup>1403</sup> This is a very large amount.

7.1298 Turning next to user marketing (Step 2) payments<sup>1404</sup>, we see that they contribute to artificially higher prices for United States upland cotton in the way of eliminating any positive difference between United States internal prices and international prices of upland cotton.<sup>1405</sup>

7.1299 *Ceteris paribus*, in the case of user marketing (Step 2) payments to exporters, the relatively lower prices that the foreign purchaser must pay have a positive impact on export demand for United States upland cotton. Similarly, payments to domestic users stimulate the demand for United States upland cotton by domestic users to the same degree that lower prices of United States upland cotton would stimulate such demand. User marketing (Step 2) payments tend to enhance the demand for United States upland cotton and raise the price received by upland cotton producers.<sup>1406</sup> The payments therefore stimulate production and exports and result in lower world market prices than would prevail in their absence.

7.1300 Furthermore, as the triggering, and magnitude, of user marketing (Step 2) payments are also linked to prices – indeed, they are contingent upon the relationship between the A-Index and the United States adjusted world price – the observations that we have made above in the context of the marketing loan programme payments are similarly applicable here.<sup>1407</sup> The structure of the measure, directly linked to the A-Index, affects the world market generally. While we do not believe it is necessary to calculate the precise amount of the subsidies in question, we observe that we have this information readily available on the record.<sup>1408</sup> This is a very large amount.

7.1301 Third, United States upland cotton producers were also receiving MLA payments and CCP payments, which are/were also expressly linked to market prices. The United States has acknowledged that MLA payments were paid in light of low commodity prices. The 1998 MLA payments were intended essentially as a 50 per cent additional PFC payment. The 1998, 1999 and 2001 Act each appropriated a dollar amount to assistance which was divided among PFC payment recipients proportionately to their respective previous PFC payment. The 2000 Act provided for payments at the same contract payment rates as the 1999 Act. CCP payments, established by the FSRI Act of 2002, are provided to producers of a covered commodity for each of the 2002 through

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<sup>1403</sup> *Supra*, Section VII:D.

<sup>1404</sup> We have already addressed the United States statutory and regulatory provisions for the user marketing (Step 2) programme under the FSRI Act of 2002. See Section VII:C for a description of the measures. See also our findings in Section VII:E (concerning payments to exporters) and Section VII:F (payments to domestic users) under the *Agreement on Agriculture* and the *SCM Agreement*. We refer to, and incorporate, our findings concerning the mandatory nature of the measure.

<sup>1405</sup> The United States asserts: "The Step 2 program has been constructed and implemented in a manner to support the price paid to US upland cotton producers by purchasers of their product. [...] Step 2 payments are provided to merchandisers or manufacturers who use upland cotton, as they represent the first step in the marketing chain where these payments could be made and have the greatest impact on producer prices". See United States' oral statement at the first session of the first substantive meeting, para. 24.

<sup>1406</sup> We recall the basic economic proposition that the effect on the producer of a subsidy may be affected by the elasticities of supply and demand.

<sup>1407</sup> *Supra*, paras. 7.1293-7.1296.

<sup>1408</sup> *Supra*, Section VII:D and footnote 895.

2007 crop years whenever the effective price falls below the target price<sup>1409</sup>, which is fixed by the Act at 72.4 cents per pound for upland cotton.

7.1302 We agree with the view of USDA economists that, due to their market-price contingency, CCPs may influence production decisions indirectly by reducing total and per unit revenue risk associated with price variability in some situations. In the price range from the loan rate up to the target price minus the DP payment rate, changes in producer revenues due to changes in market prices are partly offset by the countercyclical payments if the base acreage crop is planted, thereby reducing total revenue risk associated with price variability.<sup>1410</sup> We have confirmed a strong positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production.<sup>1411</sup> Moreover, the payments are mandatory, under certain market conditions.<sup>1412</sup>

7.1303 These three subsidies are provided for in the same legal measure: the FSRI Act of 2002.<sup>1413</sup> They are granted, to varying degrees, in respect of the production and sale and/or export of the subsidized product under examination: upland cotton. They are also price-contingent. In the particular facts and circumstances of this dispute, we consider that these three subsidies therefore have a nexus with the subsidized product and the single effects-related variable - world price - that we are called upon to examine in our price suppression analysis under Article 6.3(c). The effects of these three price-contingent subsidies are, in our view, manifest in the movements in upland cotton prices in the same world market during the reference period. We consider these to be the subsidies whose effects we are required to evaluate for the purposes of our Article 6.3(c) analysis.

7.1304 These subsidies were not, however, the only subsidies in respect of United States upland cotton during this period. Other types of subsidies, not directly tied to world market prices of upland cotton, were also granted. We turn to these subsidies below.

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<sup>1409</sup> The effective price is equal to the sum of (1) the higher of the national average farm price for the MY, or the loan rate for the commodity and (2) the DP rate for the commodity.

<sup>1410</sup> See USDA study in "The 2002 Farm Act, Provisions and Implications for Commodity Markets" (November 2002), reproduced in Exhibit BRA-42: The extent of the offset depends on how much of the acreage base is planted as well as the relationship between the producer's expected selling price and expected season average price. Furthermore, as they increase net producer revenue, they may affect agricultural production through wealth and investment effects. The effect of the additional income stabilization for farmers is to reduce the cost of capital for upland cotton producers and, thereby, to keep land in the production of upland cotton that otherwise would have been removed from producing upland cotton because of low cotton prices. The FSRI Act of 2002 provides, on an on-going basis, for payments under certain market conditions. This contrasts with the *ad hoc* nature of the MLA payments. Under the FSRI Act of 2002, United States producers are currently aware that such payments are available under certain conditions and that there is no need to be uncertain as to whether United States Congress may or may not decide to authorize such payments in a given year. This certain claim on future payments under certain conditions increases United States producers' economic stability. Also, e.g., "Farm Program Payments and the Economic Viability of Production Agriculture", reproduced in Exhibit BRA-130, contains a 2002 USDA ERS report to the United States Congress indicating its view that "such payments can affect production and, thus, market prices and export availability".

<sup>1411</sup> *Supra*, Section VII:D.

<sup>1412</sup> Section 1104(a) of the FSRI Act of 2002, reproduced in Exhibit BRA-29. We refer to and incorporate our general discussion of the mandatory/discretionary distinction in Section VII:C. We also refer to and incorporate *mutatis mutandis* our findings in Sections VII:E and F that section 1601(e) of the FSRI Act of 2002, pertaining to expenditures under subtitles A through E of the FSRI Act of 2002, addresses levels of domestic support for the purpose of a Member's domestic support commitments under the *Agreement on Agriculture*. However, it does not deal with a Member's compliance with the serious prejudice provisions of the *SCM Agreement* and therefore is not legally relevant here.

<sup>1413</sup> As we have noted, MLAs, which we also include in this group, were granted pursuant to legislation to supplement PFCs.

(ii) *subsidies not contingent upon price*

7.1305 First, the PFC and DP payments are/were granted. For PFC payments, the 1996 Act appropriated a budgetary amount to the programme for each fiscal year from 1996 through 2002 and allocated a certain percentage of that amount to each of the seven programme commodities.<sup>1414</sup> DPs, established by the FSRI Act of 2002, provide support to producers based on historical acreage and yields for nine commodities, including upland cotton, for each of the 2002 through 2007 crop years.<sup>1415</sup> We agree with the view of the USDA Economic Research Service<sup>1416</sup> that because DP payments do not expressly depend upon current production of upland cotton and are not directly tied to market prices, their price suppression effects are not as easily discernible as those of certain other subsidy programmes (the marketing loan programme and the user marketing (Step 2) programme and CCP payments). DP payments are tied to base acreage. They enhance producer wealth and investment potential, including lowering of risk aversion.<sup>1417</sup> We have confirmed a strong positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production.<sup>1418</sup> The text of the measure indicates that these payments are mandatory.<sup>1419</sup>

7.1306 Second, we recall the fact that the United States government pays a certain proportion of the insurance premium that would otherwise be payable by the United States upland cotton producer. This means reduced cost and heightened economic security to the United States upland cotton producer.<sup>1420</sup> Moreover, the insurance coverage affects United States upland cotton producers' risk considerations. Each of these will have positive ramifications for producer wealth and investment and economic stability. While we do not believe it is necessary to calculate the precise amount of the

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<sup>1414</sup> The amount appropriated for each fiscal year ranged between \$5.8 billion to \$4.008 billion. The amount of this allocated to upland cotton in each fiscal year was 11.63 per cent. We incorporate our description of the measure, *supra*, Section VII:C.

<sup>1415</sup> We incorporate our description of the measure, *supra*, Section VII:C.

<sup>1416</sup> Exhibit BRA-42.

<sup>1417</sup> The United States acknowledges that these programmes may have some impact on production, albeit the United States says that the research concludes that the impact appears negligible. For the United States, it is "widely accepted" that these programs have whole farm impacts rather than crop-specific impacts. We observe that PFC payments and DP payments mean higher cash flow and higher wealth in terms of net worth for United States upland cotton producers. United States producers that enrol under the PFC and DP payment programmes obtain an entitlement to receive future payments which increases their net wealth. This will have various predictable effects, including enhanced investment prospects due to better access to loans (as the producers are perceived as having a lower risk of default); ability to pay existing loans and other debt; a lowered aversion to risk which may allow a producer to assume riskier planting strategies; and an income-stabilizing effect as a producer may make production decisions taking into account this government revenue stream of income. This is particularly the case when the PFC and DP payments are considered in conjunction with the market loss and its countercyclical component, respectively. We incorporate our description of the measure in Section VII:C, including the requirement to use the land for an agricultural or conserving use. These payments provide an incentive to maintain land in agricultural use. Moreover, while a producer has the ability to vary production among certain crops, the strongly positive relationship between upland cotton (base acre) producers receiving annual payments and upland cotton production shows that they are, to a certain degree, an incentive for continuity. We also refer to and incorporate our findings on these measures in Section VII:D.

<sup>1418</sup> *Supra*, Section VII:D.

<sup>1419</sup> See description of the measure in Section VII:C. We refer to and incorporate our general discussion of the mandatory/discretionary distinction in Section VII:C. We also refer to and incorporate *mutatis mutandis* our findings in Sections VII:E and F that section 1601(e) of the FSRI Act of 2002, pertaining to expenditures under subtitles A through E of the FSRI Act of 2002, addresses levels of domestic support for the purpose of a Member's domestic support commitments under the *Agreement on Agriculture*. However, it does not deal with a Member's compliance with the serious prejudice provisions of the *SCM Agreement* and therefore is not legally relevant here.

<sup>1420</sup> See description *supra*, Section VII:C and Exhibits referenced therein, as well as, for example, Exhibit BRA-229.

subsidies in question, that information is readily available on the record.<sup>1421</sup> The text of the measure indicates that these payments are mandatory.<sup>1422</sup>

7.1307 With respect to this second group of subsidies we have identified, we note that none of them are price-contingent. The PFC and DP payments are provided in the same legal measure as the three price-contingent subsidies we have discussed above - the FAIR Act of 1996 and the FSRI Act of 2002, respectively - whereas crop insurance subsidies have a separate legal basis. PFC and DP payments and crop insurance subsidies, were/are granted, to varying degrees, in respect of the subsidized product under examination: upland cotton. However, in the particular facts and circumstances of this dispute, the combination of these elements indicates to us that these particular subsidies are more directed at income support. This combination attenuates the nexus between these subsidies with the subsidized product and the single effects-related variable - world price - that we are called upon to examine in our price suppression analysis under Article 6.3(c). These subsidies are of a different nature, and thus effect, than the other (price-contingent) subsidies we have examined above.<sup>1423</sup> Because they are of a different nature and effect, we decline to aggregate them and their effects with those of the mandatory price-contingent subsidies in our price suppression analysis here. Rather, we must consider them separately.

d. conclusion as to the existence of price suppression in the same world market

7.1308 As we have just indicated, several of the United States subsidies are directly linked to world prices for upland cotton, thereby numbing the response of United States producers to production adjustment decisions when prices are low. We have readily available information on the record showing us that the price-contingent subsidies in question involve very large amounts of United States government money benefiting United States upland cotton. In our view, the collective operation of these subsidies was akin to a very large, counter cyclical, deficiency payment laced with additional enhancements. We believe that the structure, design and operation, particularly of the price-contingent subsidies, constitutes strong evidence supporting a finding of price suppression.

7.1309 In this respect, we recall that the United States does not disagree with the proposition that increased production and supply which reaches world markets will have an effect on prices. This is the underlying logic for the United States' argument that China's sales of 11.6 million bales between MY 1999-2001 was a significant factor that depressed world prices.<sup>1424</sup> Neither party therefore disputes the proposition that suppressed world prices may follow from an increased supply being infused on the world market, over and above existing available world supply of fungible upland cotton.

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<sup>1421</sup> See *supra*, Section VII:D. Exhibit BRA-57 and Exhibit BRA-374 show the amount of "subsidy" and "premium discount" in recent years. We note the United States' argument that crop insurance subsidies are generally available for most crop producers and hence do not give a specific advantage to one crop or another. Our inquiry into any serious prejudice caused by the United States subsidies in this dispute under the provisions of Part III of the *SCM Agreement* is not limited to an inquiry of the effects of those subsidies on cotton *vis-à-vis* other crops. Rather, our inquiry focuses on the impact of the United States subsidies on upland cotton production and prices.

<sup>1422</sup> Sections 508(b)(1), 508(b)(2)(A) and 508(b)(3) of the Federal Crop Insurance Act, reproduced in Exhibit BRA-30, provide that catastrophic risk protection and alternative risk protection shall be provided. Section 508(c)(1)(A) provides that additional coverage shall be provided. Section 508(e) of the legislation provides that the FCIC shall pay a part of the premium in respect of certain policies. We refer to and incorporate our general discussion of the mandatory/discretionary distinction in Section VII:C. We also refer to and incorporate *mutatis mutandis* our findings in Sections VII:E and F that section 1601(e) of the FSRI Act of 2002, pertaining to expenditures under subtitles A through E of the FSRI Act of 2002, addresses levels of domestic support for the purpose of a Member's domestic support commitments under the *Agreement on Agriculture*. However, it does not deal with a Member's compliance with the serious prejudice provisions of the *SCM Agreement* and therefore is not legally relevant here.

<sup>1423</sup> See, in particular *supra*, para. 7.1303.

<sup>1424</sup> United States' further written submission, paras. 41-43.

7.1310 We believe that this has occurred in the world market for upland cotton. Between MY 1998-2002, the A-Index fell on average approximately 30 per cent below its 1980-1998 average.

7.1311 Moreover, we have before us credible evidence that prices for upland cotton transactions throughout the world are influenced by reference to the New York futures market and largely determined by the A-Index price.<sup>1425</sup> Physical upland cotton is traded on spot markets in each country where upland cotton is produced, or under forward delivery contracts involving domestic or export sales. The levels reflected in the futures market may influence the levels of the prices for spot markets and forward delivery contracts. Moreover, the price movements in the A-Index, the New York futures, spot prices and the United States adjusted world price indicates that United States and world prices for upland cotton are closely linked, and that price movements and trends originating from the United States market are closely tracked by, and would also influence, prices on the world market.<sup>1426</sup> The link between the A-Index and the United States adjusted world price and the parallelism in the price movements confirms the link between prices in the United States and the world market. As we have already indicated, the United States exerts a substantial proportionate influence in this world market.<sup>1427</sup>

7.1312 On the basis of these considerations, we find that price suppression has occurred in the same world market within the meaning of Article 6.3(c) of the *SCM Agreement*.

7.1313 We also find that developments in the world upland cotton price would inevitably affect prices in other markets where Brazil and the United States may compete, due to the nature of the world prices in question and the nature of the world upland cotton market, and the relative proportion of that market enjoyed by the United States and Brazil. All individual sales of upland cotton by Brazil and the United States in any domestic market in which both were present would occur against this backdrop.<sup>1428</sup>

7.1314 We recall the United States' argument that much of the evidence submitted by Brazil in the context of its Article 6.3(c) submissions indicates that it was the prices of Brazil's product that *undercut* the prices of the United States' product in certain markets. The United States argues that a finding of price suppression is not possible under these conditions. In this respect, we note that the text of Article 6.3(c) of the *SCM Agreement* refers to: "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 ... in the same market". We understand this conjunction "*or*", in this context, to indicate alternative independent conditions which may exist. It does *not* indicate any necessity to cumulate the conditions of price undercutting and price suppression in order to find price suppression amounting to serious prejudice. That is, price suppression under Article 6.3(c) exists independent of any finding of price undercutting. Nothing in the context or object and purpose of this provision indicates otherwise to us. We find confirmation for our view in the drafting history

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<sup>1425</sup> Statement of Andrew MacDonald, Annex II to Brazil's further submission. See *supra*, footnotes 1375 and 1323. See the chart in Exhibit BRA-311; Exhibit US-73, cited *supra*, para. 7.1287. While the particular United States price quote for the purposes of the A-Index may not have been consistently among the lowest price quotes taken into account in the calculation of the A-Index, the United States adjusted world price – the determinative price for the marketing loan programme payments as well as user marketing (Step 2) payments – is derived from the A-Index.

<sup>1426</sup> *Supra*, paras. 7.1287-7.1288.

<sup>1427</sup> *Supra*, para. 7.1285.

<sup>1428</sup> We also find support for our view in the statements by Mr. McDonald, Annex II to Brazil's further written submission, in particular, para. 24 (see also *supra* footnote 1375) and Mr. Ward, Exhibit BRA-283, in particular, para. 11. We further note Chad's third party oral statement at the resumed session of the first substantive meeting with the Panel, e.g. para. 3. See also, generally, *supra*, footnote 1323, concerning the participation of experts as part of the parties' and third parties' delegations in these Panel proceedings.

of the provision.<sup>1429</sup> Moreover, the text makes it clear that the conditions set out in Article 6.5 of the *SCM Agreement* pertain to "price undercutting" for the purpose of paragraph 3(c) of Article 6. They do not refer to price suppression under Article 6.3(c) of the *SCM Agreement*.<sup>1430</sup>

7.1315 In light of this finding, we do not believe that it is necessary to proceed to any further examination of the parties' evidence and argumentation relating to alleged price suppression in individual country markets.<sup>1431</sup>

iii Is it "significant" price suppression?

7.1316 It may not simply be *any* price suppression which will necessarily fulfil the conditions of Article 6.3(c) of the *SCM Agreement*. Rather, the text of Article 6.3(c) stipulates that we must examine whether "the effect of the subsidy is a ... *significant* price suppression, price depression or lost sales in the same market." (emphasis added)

7.1317 The current text of the *SCM Agreement* does not define "significant" for the purposes of Article 6.3(c), nor does it expressly specify any elements or criteria that would inform how a panel would go about assessing whether or not any price suppression or depression is "significant" under this provision.<sup>1432</sup>

7.1318 The only prior WTO panel to have examined the meaning of this term in Article 6.3(c) of the *SCM Agreement* in the context of a price undercutting claim observed that:

"Although the term "significant" is not defined, the inclusion of this qualifier in Article 6.3(c) presumably was intended to ensure that margins of undercutting so small that they could not meaningfully affect suppliers of the imported product whose price was being undercut are not considered to give rise to serious prejudice"<sup>1433</sup>

7.1319 That panel did not, therefore, attempt to develop a general definition or interpretation of the term "significant", but rather relied upon its apparent rationale as a mechanism to filter out effects of insignificant degree or magnitude.

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<sup>1429</sup> Articles 31 and 32 of the Vienna Convention. Exhibit BRA-372 indicates that an 18 July 1990 Report by the Chairman on the Negotiating Group on Subsidies and Countervailing Measures (MTN/GNG/NG10/W/38) shows what is now Article 6.3(c) referred to price suppression as a result of price undercutting as opposed to an independent ground ("There is a significant price undercutting by the subsidized products as compared with the price of a like product of another signatory in the same market resulting in price suppression..."). Following various proposals, a subsequent draft Chairman's text (MTN/GNG/NG19/W/38/Rev.2) inserts an "or" between "significant price undercutting by the subsidized products as compared with the price of a like product of another signatory in the same market" [or] "the subsidized imports result in price suppression, price depression or lost sales in the same market...". This "or" remained in the final text, rendering "price undercutting" independent from "significant price suppression".

<sup>1430</sup> We observe, in passing, evidence in Exhibit BRA-383 which indicates that, for MY 1999 - MY 2002, the average price (cents per pound) for exports of United States upland cotton was 45.33, while, for Brazil, it was 44.65. The A-Index was 51.94.

<sup>1431</sup> For this reason, it is also not necessary for us to express any view with respect to the United States assertion that Brazil's statement of findings and recommendations requested is limited to the "Brazilian, United States and world markets", and that Brazil has not specifically requested us, in that portion of its submissions, to request a finding in respect of individual third country export markets.

<sup>1432</sup> Some contextual guidance as to how significance may have, at least originally, be conceived, may be derived from the provisions of the agreement. We recall that Article 6.1(a) of the agreement, which has now lapsed, indicated that serious prejudice "shall be deemed to exist" where the total *ad valorem* rate of subsidization exceeded 5 per cent. Thus, evidence as to the rate of subsidization may be relevant to this issue. We do not, however, consider it necessary to consider this element here.

<sup>1433</sup> Panel Report, *Indonesia – Autos*, para. 14.254.

7.1320 Primarily on the basis of this prior panel report, Brazil suggests that the level of price suppression meaningfully affects non-subsidized suppliers of the like product (i.e., Brazilian, African and other non-United States suppliers) competing with the subsidized product. For Brazil, the notion of "meaningfully affect" and "serious prejudice" are essentially equivalent for the purpose of Article 6.3(c) of the *SCM Agreement*.<sup>1434</sup> Brazil asks us to reject the "two-step approach" suggested by the United States under Article 6.3(c), whereby an affirmative conclusion on "significance" under Article 6.3(c), would be followed by an examination of whether or not such "significant price suppression" constitutes "serious prejudice" within the meaning of Article 5(c).<sup>1435</sup>

7.1321 For its part, the United States asserts that we should not ascribe much weight to the *Indonesia – Autos* panel's view, as that panel conducted no textual examination and also indicated it was making an assumption about the meaning of the term "significant".<sup>1436</sup> For the United States, it is the effect on *prices* (of the Brazilian product) that must be "significant". The existence of any direct effect on Brazilian producers is not relevant to an assessment of the significance of price suppression; rather, significant price suppression may or may not have any effect on producers.

7.1322 We realize that Article 6.3(c) is the only sub-paragraph of Article 6.3 that contains a qualifying adjective – "significant" – that modifies the particular effects-based situation under examination. We believe that the degree of "significance" of any price suppression found to exist in the course of the Article 6.3(c) examination would also ordinarily be a relevant consideration in assessing – under the chapeau of Article 6.3 – whether or not "serious prejudice" "may" exist within the meaning of Article 5(c) of the *SCM Agreement*. Indeed, we agree entirely with the United States that "...it is conceivable that the effect of the subsidy could be price suppression so significant that it alone rises to the level of serious prejudice to the interests of another Member."<sup>1437</sup>

7.1323 We do not, however, believe that this is an issue that can be resolved by an examination of the text of Article 6.3(c) in isolation. In our view, the question whether or not "significant" price suppression within the meaning of Article 6.3(c) will necessarily amount to "serious prejudice" within the meaning of Article 5(c) will also depend on the clarification of the remaining relevant text of the treaty provision in question, i.e. the chapeau of Article 6.3. We must remain cognizant of the terms of both the sub-paragraphs of Article 6.3 and the chapeau of that provision. We are precluded from reducing either one to redundancy.

7.1324 To us, it is therefore essential first to establish whether or not the conditions in Article 6.3(c) exist. If they do, then, due to the particular treaty text and structure of Article 6.3(c) and its chapeau, we would consider the textual terms of the chapeau of Article 6.3(c).

7.1325 As always, we turn first to the treaty text in question: "significant". The ordinary meaning of the term "significant" is "important; notable ... consequential".<sup>1438</sup> The term "significant" therefore connotes something that can be characterized as important, notable or consequential.

7.1326 In the text of Article 6.3(c), the term "significant" modifies the term "price suppression or depression". Therefore, under Article 6.3(c), the "something" that must be important, notable or consequential is the "price suppression or depression".

7.1327 We endorse the shared view of the parties that we can find relevant contextual support (although not direct methodological guidance) for this reading of "significant" "price suppression" in

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<sup>1434</sup> Brazil's 28 January 2004 comments on United States' response to Panel Question No. 234.

<sup>1435</sup> See United States' response to Panel Question No. 234; and Brazil's 28 January 2004 comments on United States' response to Panel Question No. 234.

<sup>1436</sup> United States' further written submission, para. 82.

<sup>1437</sup> United States' response to Panel Question No. 234, para. 135.

<sup>1438</sup> *The New Shorter Oxford English Dictionary*, (1993).

Article 15.2 of the *SCM Agreement*.<sup>1439</sup> That provision reads, in pertinent part: "whether the effect of [the subsidized] imports is otherwise to depress prices to a significant degree or to prevent price increases, which otherwise would have occurred, *to a significant degree...*". (emphasis added)

7.1328 This reading of the text in its context confirms to us that it is the degree of price suppression or depression itself that must be "significant" (i.e. important, notable or consequential) under Article 6.3(c) of the *SCM Agreement*. In determining whether the price suppression is "significant", it may be relevant to look at the degree of the price suppression or depression in the context of the prices that have been affected – that is, at the *degree* of significance of suppression or depression.<sup>1440</sup>

7.1329 Such significance may be manifest in a number of ways. The "significance" of any degree of price suppression may vary from case to case, depending upon the factual circumstances, and may not solely depend upon a given level of numeric significance.<sup>1441</sup> Other considerations, including the nature of the "same market" and the product under consideration may also enter into such an assessment, as appropriate in a given case.

7.1330 We cannot believe that what may be significant in a market for upland cotton would necessarily also be applicable or relevant to a market for a very different product. We consider that, for a basic and widely traded commodity, such as upland cotton, a relatively small decrease or suppression of prices could be significant because, for example, profit margins may ordinarily be narrow, product homogeneity means that sales are price sensitive or because of the sheer size of the market in terms of the amount of revenue involved in large volumes traded on the markets experiencing the price suppression.

7.1331 The *SCM Agreement* contains certain provisions in Article 27 relating to substantive special and differential treatment for developing countries, including relating to certain aspects of actionable subsidies disciplines. However, we do not find any such explicit provision for substantive special and differential treatment for developing countries in Article 6.3(c) of the *SCM Agreement* relating to the assessment of "significance" of any price suppression.

7.1332 During the period under consideration, given the relative magnitude of United States production and exports<sup>1442</sup>, the overall price trends we identified in the world market<sup>1443</sup>, and the nature of the mandatory United States subsidies in question – in particular, the market-price contingent, countercyclical, nature of the marketing loan programme, the user marketing (Step 2) programme, MLA payments and CCP payments<sup>1444</sup> – and the readily available evidence of the order of magnitude of the subsidies<sup>1445</sup>, we are certainly not, by any means, looking at an insignificant or unimportant world price phenomenon.<sup>1446</sup>

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<sup>1439</sup> See e.g., United States' response to Panel Question No. 148 and Brazil's further written submission, para. 88.

<sup>1440</sup> United States' response to Panel Question No. 148.

<sup>1441</sup> In any event, we note that no such numeric standard is provided in Part III of the Agreement. This contrasts, to a certain extent, with the provisions of Part V of the agreement, which contain, for example, indications of "amount" of the subsidy which are *de minimis* (less than 1 per cent *ad valorem*) and volumes of the "subsidized product" which are negligible. See e.g. Article 11.9 of the *SCM Agreement*

<sup>1442</sup> We refer to, and incorporate our examination *supra*, paras. 7.1281-7.1285.

<sup>1443</sup> *Supra*, paras. 7.1287-7.1288.

<sup>1444</sup> We refer to, and incorporate, our examination of the structure, design and operation of these measures, *supra*, paras. 7.1289-7.1303.

<sup>1445</sup> *Supra*, Section VII:D and footnote 895.

<sup>1446</sup> See also our discussion *infra*, para. 7.1395. As we deem this a sufficient basis for our determination of "significance", it is not necessary for us also to consider any impact on Brazilian producers here. We observe, however, that any such examination would only reinforce our finding.

7.1333 We therefore consider that the degree of price suppression we have found to exist in the same world market is "significant" within the meaning of Article 6.3(c) of the *SCM Agreement*.

(k) "The effect of the subsidy"

(i) *Main arguments of the parties*

7.1334 **Brazil** submits that the United States market generated excess supplies of upland cotton through the use of large subsidies which have greatly increased United States exports. In turn, this suppressed prices in the interconnected global commodity markets of upland cotton, a basic fungible commodity. According to Brazil, the evidence it submits, when considered independently, confirms the causal link between United States subsidies and significant price suppression, but, when taken as a whole, overwhelmingly shows the existence of a close and important link in MY 1999-2002.<sup>1447</sup> Brazil also asserts that each of the United States subsidies, individually, have resulted in "serious prejudice" within the meaning of Articles 5(c) and 6.3(c) of the *SCM Agreement*.

7.1335 Brazil does not disagree that the Panel can and should take "other factors" into account, to the extent they are relevant. For Brazil, even though some of these factors may have contributed to lower and suppressed prices during MY 1999-2002, the United States arguments and evidence do not refute Brazil's evidence that the impact of \$12.9 billion in United States subsidies on United States acreage, production, exports and prices was significant.

7.1336 The **United States** submits that Brazil has not demonstrated causation.<sup>1448</sup> It was other factors, and not United States subsidies, that affected world cotton markets during the MY 1999-2002 and caused the dramatic plunge in cotton prices.<sup>1449</sup> The United States also alleges that the use of the years 1998 (due to drought) and 2001 (due to unusually high yields) are misleading. The United States also denies that any of the subsidies, individually, had the effects alleged by Brazil.

(ii) *Main arguments of the third parties*

7.1337 **Argentina** considers that the subsidies granted by the United States to its cotton sector over the MY 1999-2002 period have caused and still cause serious prejudice to the interests of other Members, including Argentina, in that they have a significant suppressing or depressing effect on international cotton prices, within the meaning of Articles 5(c) and 6.3(c) of the *SCM Agreement*.<sup>1450</sup>

7.1338 **Paraguay** submits that "cotton trade is affected by the United States measures" because cotton production has a considerable impact on its economy, and especially on its rural populations which depend on cotton for their livelihood. Thus, the impact on trade in countries like Paraguay is devastating and causes the migration of rural populations to the urban areas, further aggravating the economic situation of a country dependent on its agriculture.<sup>1451</sup>

(iii) *Evaluation by the Panel*

7.1339 Article 5(c) of the *SCM Agreement* provides that: "[n]o Member should *cause*, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.: ...serious prejudice to the interests of another Member". (emphasis added)

7.1340 Article 6.3(c) of the *SCM Agreement* provides that: "Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply: ... (c) *the*

<sup>1447</sup> Brazil's further written submission, paras. 104-105.

<sup>1448</sup> United States' further written submission, para. 17.

<sup>1449</sup> United States' further written submission, paras. 45-70.

<sup>1450</sup> Argentina's written submission to the resumed session of the first substantive meeting, para. 50.

<sup>1451</sup> Paraguay's written submission to the resumed session of the first substantive meeting, paras. 10-11.

*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." (emphasis added)

7.1341 The text of the treaty requires the establishment of a causal link between the subsidy and the significant price suppression.

7.1342 In considering the nature of the causal link that must exist between the subsidy and the price suppression, we recall the general distinction we have drawn between the provisions of Part III and Part V of the *SCM Agreement*, and our general approach to this serious prejudice analysis.<sup>1452</sup>

7.1343 Articles 5 and 6.3 of the *SCM Agreement* do not contain the more elaborate and precise "causation" and non-attribution language which is contained in the trade remedy provisions of the *SCM Agreement*, as well as in the Anti-dumping and Safeguards Agreements.<sup>1453</sup> The absence of such detailed language, which exists elsewhere in the covered agreements, including in the immediate context of the same (SCM) agreement may be taken as a demonstration that the drafters knew how to craft a precise causation standard when they deemed it appropriate. However, they have not done so with as much precision here.<sup>1454</sup>

7.1344 While this may suggest that we need not necessarily separate, distinguish and attribute, to a precise degree, all of the different effects from the various factors, we believe, nevertheless, that the condition of a causal link requires us to ensure that the significant price suppression *is* "the effect of the subsidy" within the meaning of Article 6.3(c). This necessarily calls for an examination of United States subsidies, within the context of other possible causal factors, to ensure an appropriate attribution of causality.

7.1345 We therefore, first, examine whether or not "the effect of the subsidy" is the significant price suppression which we have found to exist in the same world market. As this examination is necessarily a fact-specific examination that will vary from case to case, we will conduct an examination of the arguments and evidence before us as a whole, and come to a conclusion on the basis of the evidence in its entirety.

7.1346 We then consider the role of other alleged causal factors in the record before us which may affect our analysis of the causal link between the United States subsidies and the significant price suppression.

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<sup>1452</sup> *Supra*, paras. 7.1156 ff.

<sup>1453</sup> For example, Article 15.5 of the *SCM Agreement* provides:

"It must be demonstrated that the subsidized imports are, through the effects of subsidies, causing injury within the meaning of this Agreement. The demonstration of a causal relationship between the subsidized imports and the injury to the domestic industry shall be based on an examination of all relevant evidence before the authorities. The authorities shall also examine any known factors other than the subsidized imports which at the same time are injuring the domestic industry, and the injuries caused by these other factors must not be attributed to the subsidized imports. Factors which may be relevant in this respect include, *inter alia*, the volumes and prices of non-subsidized imports of the product in question, contraction in demand or changes in the patterns of consumption, trade restrictive practices of and competition between the foreign and domestic producers, developments in technology and the export performance and productivity of the domestic industry." (footnote omitted)  
See also Article 4.2 of the *Safeguards Agreement* and Article 3.5 of the *Anti-dumping Agreement*.

<sup>1454</sup> Furthermore, Articles 6.4 and 6.5 of the *SCM Agreement* set forth certain detailed considerations to be taken into account when demonstrating the causation of the occurrence of the element in question under paragraphs 3(b) and 3(c) (concerning price undercutting).

i Is there a causal link?

7.1347 There are four main, cumulative, grounds why we believe that a causal link exists between certain of the challenged United States subsidies and the significant price suppression.

7.1348 First, as we have already indicated, we believe that the United States exerts a substantial proportionate influence in the world upland cotton market.<sup>1455</sup> This substantial proportionate influence flows, *inter alia*, from the magnitude of the United States production and export of upland cotton. We recall again that the United States does not disagree with the proposition that a Member's proportionate magnitude in world production and consumption of upland cotton might be a relevant consideration here.<sup>1456</sup> Nor does the United States disagree with the proposition that increased production and supply of upland cotton which reaches the world markets will have an effect on prices.<sup>1457</sup>

7.1349 Second, we recall our examination of the nature of the United States subsidies at issue. In particular, we recall that several of the United States subsidies – marketing loan programme payments, the user marketing (Step 2) payments, MLA payments and CCP payments – are directly linked to world prices for upland cotton, thereby insulating United States producers from low prices.<sup>1458</sup> We believe that the structure, design and operation of these three measures constitutes evidence supporting a causal link with the significant price suppression we have found to exist. Furthermore, while we do not believe that it is strictly necessarily to calculate precisely the amount of the subsidies in question, we observe that we have readily available information on the record showing us that the price-contingent subsidies in question involve very large amounts of United States government money benefiting United States upland cotton production. We agree with the United States that "the question is one of the nature of the subsidy examined and the degree of any predicted effect, which could range from significant to negligible."<sup>1459</sup> These price-contingent subsidies were, in our view, sufficient to cause the significant price suppression that we have found to exist in the same world market.

7.1350 It is true that PFC payments, DP payments and crop insurance payments were/are also granted contemporaneously with these price-contingent subsidies. However, in our view, Brazil has not established that, in light of their structure, design and operation, these measures – which are more concerned with income support than directly with world price effects – had a sufficient nexus with the marketing of the subsidized product and the price suppression effects as to render their inclusion or non-inclusion in our price suppression analysis legally determinative in respect of the significant price suppression that we have found in the same world market. We nevertheless observe that they did not have the effect of diminishing, or cancelling out, the significant price suppression. However, because of the different nature and effect of these subsidies, we decline to aggregate them and their effects with those of the price-contingent subsidies in our serious prejudice analysis. In our view, Brazil has not established that the significant price suppression we have found was "the effect of" these non-price-contingent subsidies within the meaning of Article 6.3(c).<sup>1460</sup>

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<sup>1455</sup> *Supra*, paras. 7.1281-7.1285.

<sup>1456</sup> e.g. United States' further rebuttal submission, para. 37. The United States was the second largest producer of upland cotton, accounting for approximately 20 per cent of the world's cotton production in the relevant years. See our findings, *supra*, para. 7.1282. China, the largest producer, had a slightly higher average share of world production in MY 1999-2002. See "Cotton: World Statistics," ICAC, September 2003, p. 4 reproduced in Exhibit BRA-208.

<sup>1457</sup> This is the underlying logic for the United States' argument that China's sales of 11.6 million bales during MY 1999-2001 was a significant factor that depressed world prices.

<sup>1458</sup> *Supra*, paras. 7.1289-7.1303.

<sup>1459</sup> United States' response to Panel Question No. 164.

<sup>1460</sup> We refer to, and incorporate, the considerations guiding our analysis, *supra*, paras. 7.1191-7.1194 and the citations indicated there.

7.1351 Third, there is a discernable temporal coincidence of suppressed world market prices and the price-contingent United States subsidies. Looking at the period, we see the following:

- United States production of upland cotton increased from MY 1998 to MY 2001 and, while production dropped in MY 2002, there was still an overall increase in MY 2002 compared to MY 1998;
- the United States' share of world upland cotton production increased to and remained at a level of approximately 20 per cent;<sup>1461</sup>
- United States prices received by United States upland cotton producers decreased by 34 per cent between MY 1998 and MY 2001;<sup>1462</sup>
- the A-Index in MY 1999 – MY 2002 was, on average, 29.5 per cent below its 1980-1998 average;<sup>1463</sup>
- United States exports increased by approximately 160 per cent from MY 1998 to MY 2001 and by an even greater percentage from MY 1998-MY 2002;
- United States share of world exports of upland cotton increased;<sup>1464</sup> and
- United States imports of upland cotton remained at comparatively low levels.

7.1352 These data reveal that, over the same period that the subsidies in question were being granted, the United States market generated large supplies of upland cotton. Over this same time period, market revenue of United States upland cotton producers decreased. So did world market prices. There was also a marked increase in United States exports, both absolute and in terms of relative share of world exports. Even taking into account that in 1998, production may have been driven downward by drought and high levels of crop abandonment and that, in 2001, production may have been driven upward by high yields, we see a strong temporal coincidence between the United States subsidies and the drop in United States prices, the drop in – and suppression of – world market prices, the increase in United States exports.

7.1353 Fourth, we find credible evidence on the record concerning the divergence between United States producers' total costs of production<sup>1465</sup> and revenue from sales of upland cotton since

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<sup>1461</sup> See our findings *supra*, para. 7.1282.

<sup>1462</sup> USDA Fact Sheet: Upland Cotton (January 2003), p. 4-5, reproduced in Exhibit BRA-4.

<sup>1463</sup> The A-Index averaged 73.54 and 51.88 US-cents/lb in the periods of MY 1980-1998 and MY 1999-2002, respectively. Exhibit BRA-209.

<sup>1464</sup> See *supra*, para. 7.1283, pertaining to export data on the Panel record.

<sup>1465</sup> We believe that not only coverage of variable costs, but also of fixed costs, would be necessary, at least over the medium to longer term, in order for United States upland cotton producers rationally to opt to remain United States upland cotton producers. We find support for this proposition in Appellate Body Report, *Canada – Dairy (Article 21.5 – New Zealand and US)*, paras. 87, 88. Only an analysis of the total cost of production takes account of the economic resources the producer invests in the product. Fixed and variable costs are the total amount which the producer incurs in order to produce the product and the total amount it must recoup, in the long-term, to avoid making losses. To the extent that the producer charges prices that do not recoup the total cost of production, over time, it sustains a loss which must be financed from some other source, or else the producer simply has to close down his business. We recall, for example, the statement of Mr. Christopher Ward, reproduced in Exhibit BRA-283. Mr. Christopher Ward, who is a Brazilian producer and exporter of upland cotton, also made a statement regarding the conditions of producing upland cotton in Brazil at the resumed session of the first substantive meeting with the Panel as a member of Brazil's delegation. See *supra*, footnote 1323, relating to the involvement of experts as members of party and third party delegations in these Panel proceedings.

1997.<sup>1466</sup> This supports the proposition that United States upland cotton producers would not have been economically capable of remaining in the production of upland cotton had it not been for the United States subsidies at issue<sup>1467</sup> and that the effect of the subsidies was to allow United States producers to sell upland cotton at a price lower than would otherwise have been necessary to cover their total costs.

7.1354 If market revenue alone is compared to United States upland cotton producers' total costs of production, the information before us reveals that United States upland cotton producers would on average have lost money for each planted acre in every year since MY 1998, and made a small profit in MY 1997.<sup>1468</sup> We do not believe the utility of the record data is fundamentally undermined by any of the criticisms levied by the United States for the purposes of this dispute, particularly as the data are calculated in accordance with a methodology which the USDA itself has deemed to be a sufficiently reliable reflection of United States upland cotton producers' costs and revenues.<sup>1469</sup> That the figures before us are cumulated to show a result over the six-year period from 1997-2002 also lends itself to an assessment of the medium- to longer- term examination of developments in the United States upland cotton industry.<sup>1470</sup> We believe that the existence of this gap between upland

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<sup>1466</sup> See USDA "Characteristics and Production Costs of United States Cotton Farms" (October 2001), reproduced in Exhibit BRA-16, in which the USDA ERS indicates that, for 1997, producing a pound of upland cotton cost United States farmers 38 cents in operating costs and another 35 cents in overhead-costs (average total cost of production: 73 cents per pound). Brazil's arguments address the marketing years since 1997.

<sup>1467</sup> We note that the USDA has acknowledged that "Potential net revenue is the bottom line in a producer's decision to participate in government programs...". See Exhibit BRA-12, p. 20.

<sup>1468</sup> See e.g., Brazil's response to Panel Question No. 163, para. 136. See also "Costs and Returns of United States Upland Cotton Farmers MY 1997-2002", reproduced in Exhibit BRA-323. Exhibit BRA-206 shows the revenue gap for United States production of upland cotton lint. Exhibit BRA-353 depicts producers' cumulative loss without contract payments. See also United States' response to Panel Question No. 163, para. 100 and accompanying chart. See also Brazil's response to Panel Question No. 163, paras. 131-136. Depending upon which figures before us are taken into account, we see that United States upland cotton producers would have suffered cumulative losses during MY 1997-2002 of approximately \$872 (or \$748) per acre of upland cotton. As either of these indicates a gap, we need not select between them for the purposes of resolving this dispute. We also note that "operating costs" include the costs of "ginning". They also break down data pertaining to upland cotton and cottonseed. Due to the small relative magnitude of cottonseed returns data in relation to cotton lint returns, we do not consider that its inclusion in some of the data considered materially affects our findings here.

<sup>1469</sup> Brazil's further rebuttal submission, para. 72. The United States, in this dispute, takes issue with the methodology applied to calculate these figures, and the reliability of the figures as a reflection of the choices and expectations of United States upland cotton producers. However, the cost projections by the USDA cited by Brazil are updates of a 1997 USDA cost survey. As the United States has indicated, in every year subsequent to 1997, the USDA takes the results of the 1997 cost survey and updates it to reflect the general increase in prices according to the producer price index. We observe that, according to the USDA, the reliability of the USDA estimate may differ depending upon the amount of time that has elapsed since the USDA survey year. See USDA's website: [www.ers.usda.gov/costs and returns/...](http://www.ers.usda.gov/costs_and_returns/)

This approach may not fully reflect all of the technological and structural change since 1997 in United States upland cotton production. We nevertheless also understand that certain developments affecting costs and returns may be reflected to a certain extent through the USDA's updated estimation process (e.g., pest eradication bringing new (low cost) areas of the United States into production or the adoption of biotech cotton which requires fewer pesticide applications: the cost of production demonstrates that the cost for seed increased from \$17.63 in MY 1997 to \$47.99 in MY 2002). This increase may reflect developments such as the introduction of more expensive biotech cotton seed varieties. At the same time, costs for fertilizer and chemicals remained constant or fell. This is also consistent with the use of biotech crops.

We note that Exhibits BRA-14 and BRA-251 contain surveys of comparative costs of production of raw cotton in various countries. We are aware that such cross-country comparisons are affected by numerous considerations. We observe that this evidence reflects that the United States cost of production is higher than the cost of production in many other countries.

<sup>1470</sup> We disagree with the United States that an examination of United States upland cotton producers' "off farm income" may be a legally relevant consideration in the examination before us. We are considering

cotton producers' total production costs and market revenue, on the one hand, and the effect of the subsidies, on the other hand, was to sustain a higher level of output than would have occurred in the absence of the United States subsidies at issue.<sup>1471</sup>

7.1355 While there may well have been other factors affecting prices in the world market over this time period, on the basis of the above examination of these four factors, taken together, we find that a causal link exists between the mandatory United States price-contingent subsidies at issue – marketing loan programme payments, user marketing (Step 2) payments, MLA payments and CCP payments – and the significant price suppression that we have found to exist. However, no such causal link has been established in respect of the non-price contingent subsidies before us, that is, PFC and DP payments and crop insurance subsidies.

7.1356 We proceed to an examination of other causal factors in order to see whether any of these would have the effect of attenuating this causal link, or of rendering not "significant" the effect of the subsidy.

ii Other alleged causal factors

7.1357 We address each of the other causal factors alleged by the United States in turn.

7.1358 First, the United States asserts that prices have been historically low because of the weakness in world demand for cotton due to competing, low-priced synthetic fibres, and weak world economic growth. Brazil argues that data on world consumption do not support the United States claim of weak world demand. It seems to us that if the low prices acknowledged by both parties were caused by persistent weakness in the world demand for upland cotton, one would reasonably expect a reduction in production of upland cotton. However, United States upland cotton production increased over the period.<sup>1472</sup> Although we see an increase in world polyester production, we also see an increase in world cotton production up until 2001 and we do not see pronounced declines in world consumption of upland cotton.<sup>1473</sup> We do not find this United States argument compelling.

7.1359 Second, the United States argues that burgeoning United States textile imports, reflecting the strong United States dollar since the mid-1990's and declining United States competitiveness in textile and apparel production, have fundamentally shifted the disposition of United States cotton production from domestic mills to export markets. The United States asserts that the growing United States

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costs and market revenues in respect of upland cotton. Our examination is one of the upland cotton industry. We find support for this proposition in the references to "subsidized product" and "like product" in Article 6.3(c) of the *SCM Agreement*, and contextual support in such references in Article 15 of the *SCM Agreement*. We are inquiring into whether, in respect of upland cotton production, United States producers' revenues in respect of upland cotton were insufficient to sustain their total costs incurred. We are not looking into the possibility of cross-subsidization or cross-financing of insufficient market revenues for upland cotton that may have come from other United States industries. Indeed, the very fact that the United States relies on such cross-subsidization as a possible source of revenue would tend to support the proposition that upland cotton producers would have lost money over the longer term if they were involved in upland cotton production alone. If the infrastructure of United States upland cotton production supports the "off farm income" then the subsidies are supportive of that income as well. If the infrastructure of United States upland cotton production does not support "off farm income", the producer need not produce upland cotton. However, we have seen, as a factual matter, that United States producers continue to produce upland cotton, and still receive subsidies in relation to production.

<sup>1471</sup> Exhibit BRA-109, containing 2001 testimony of the then-Chairman of the National Cotton Council before the United States House Agriculture Committee would support this proposition: "during the past three years, many cotton farmers have avoided bankruptcy only because Congress has authorized emergency relief to supplement the FAIR Act's inadequate fixed payments". This tells us that United States upland cotton producers rely on United States government subsidies to cover their production costs.

<sup>1472</sup> USDA Fact Sheet: Upland Cotton (January 2003), p. 4, reproduced in Exhibit BRA-4.

<sup>1473</sup> "Cotton: World Statistics," ICAC, September 2003, p. 3-4, reproduced in Exhibit BRA-208.

cotton-equivalent trade deficit and growth in United States retail purchases of cotton fibres has supported world cotton prices. We see that exchange rate adjustments affect textile trade flows.<sup>1474</sup> We do not see how this United States assertion concerning support, rather than suppression, of world upland cotton prices is germane to our examination of other possible causal factors that might have suppressed world upland cotton prices.

7.1360 Third, the United States asserts that the strong United States dollar since the mid-1990's has had an inverse effect on the world price of cotton, as cotton is traded internationally in dollars.<sup>1475</sup> Brazil disagrees. We observe that the United States' share of world upland cotton production did not decline materially and its share of world upland cotton exports increased markedly at the same time the United States dollar appreciated during MY 1999-2001.<sup>1476</sup> While we acknowledge that exchange rates are indeed important for United States upland cotton production and exportation, and would affect market prices, such market prices are not guiding United States producer decisions (except to the extent that, when they are lower than the marketing loan rate, they dictate the magnitude of United States government subsidies to producers). United States producers' market revenue was effectively sheltered from such currency/price developments by virtue of the United States subsidies (mainly the marketing loan programme and the user marketing (Step 2) programme).<sup>1477</sup> We do not find this United States argument compelling.

7.1361 Fourth, the United States asserts that China subsidized the release of millions of bales of government stocks between 1999 and 2001, which was instrumental in pushing down upland cotton prices to very low levels. Brazil concurs that suppressed world prices would inevitably follow from millions of additional million bales being added to available world supply of upland cotton where demand is relatively inelastic. We endorse the shared view of the parties that an infusion of a large amount of supply onto the market would exert a downward pressure on prices. The fact that such additional supplies became available on the world market may well have affected world prices. However, it was smaller in magnitude than the United States exports over this period. In addition, it did not have a dampening effect upon United States production or exports, which both continued and/or increased over this period.

7.1362 Finally, the United States asserts that upland cotton planting decisions that are not limited only to benefits derived from United States subsidies, but rather are driven by other factors such as (1) the effect of technological factors of upland cotton production, which includes boll weevil eradication and genetically modified upland cotton (2) the relative movement of upland cotton prices *vis-à-vis* prices of competing crops, which affect upland cotton producers' planting decisions and (3) the expected prices for the upcoming crop year.<sup>1478</sup> Even assuming that the effect of the two cited technological factors reduced the cost of production for some United States upland cotton farmers, which may not be fully reflected in USDA cost-revenue estimate updates, the record still shows that the total cost of production for United States producers increased over the period in question, while world market prices were suppressed. Furthermore, during MY 1999-2002, we have found a strongly positive relationship between upland cotton base acres and continued production of upland cotton.<sup>1479</sup>

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<sup>1474</sup> See for example, Exhibit BRA-100.

<sup>1475</sup> United States' further written submission, paras. 35-36.

<sup>1476</sup> See, e.g. our findings *supra*, paragraphs 7.1281-7.1285.

<sup>1477</sup> See *supra*, Chart 2, para. 7.1293. The USDA effectively recognizes this, at least with respect to the marketing loan programme. Exhibit BRA-100 contains a USDA ERS discussion of "US Cotton and the Appreciation of the Dollar". Addressing the maintenance of "relatively steady" US cotton production despite the fall in the dollar-denominated world price for cotton, it states: "Finally, cotton producers benefit from the marketing loan programme, which helps producers maintain revenues while permitting large adjustments in market prices." Also see, for example, Exhibit BRA-214. In Exhibit BRA-213, the National Cotton Council indicated, in 2001 that "without the presence of US cotton's Step 2 program to offset some of the impact of a strong dollar, US raw cotton exports would likely have experienced a far larger decline" (since 1996).

<sup>1478</sup> United States' further written submission, paras. 45-70.

<sup>1479</sup> *Supra*, Section VII:D.

Thus, it is reasonable to conclude that United States producers continued to grow upland cotton due to United States subsidies rather than market prices or expected market revenue.

7.1363 Although some of these factors may have contributed to lower, and even suppressed, world upland cotton prices during MY 1999-2002, they do not attenuate the genuine and substantial causal link that we have found between the United States mandatory price-contingent subsidies at issue and the significant price suppression. Nor do they reduce the effect of the mandatory price-contingent subsidies to a level which cannot be considered "significant".

(l) The chapeau of Article 6.3 of the *SCM Agreement* and "serious prejudice"

(i) *Main arguments of the parties*

7.1364 **Brazil** contends that an examination under Article 6.3(c) of the *SCM Agreement* is determinative of "serious prejudice" for the purposes of Article 5(c) of the *SCM Agreement*, and that no further showing is necessary.<sup>1480</sup> However, even if it were, Brazil submits that it has discharged this burden as well.

7.1365 The **United States** is of the view that the use of "may" in the introductory sentence of Article 6.3 of the *SCM Agreement* indicates that serious prejudice need not arise even if one or more of the circumstances listed in Article 6.3 are found. If Brazil demonstrates one or more of the criteria in Article 6.3 is met, Brazil must then demonstrate "serious prejudice" – that is, that the "prejudice" caused by the effects of the subsidy were "serious."<sup>1481</sup>

(ii) *Main arguments of the third parties*

7.1366 **India** is of the view that nothing more than the demonstration that one of the effects enumerated in Article 6.3 exists is necessary to arrive at a finding of "serious prejudice". The effects listed in Article 6.3 themselves equate to serious prejudice. Subsidies listed under Article 6.1 are *deemed* to cause serious prejudice, hence such a presumption is rebuttable under Article 6.2 if the subsidy does not result in any of the effects enumerated in Article 6.3. No such rebuttal is envisaged under Article 6.3.<sup>1482</sup>

7.1367 **New Zealand** submits that there is no basis for drawing from a comparison of language used in Articles 6.1 and 6.3 the conclusion that there is some other standard, independent of Article 6, that must be demonstrated in order to show "serious prejudice". New Zealand states that a comparison of both the language *and substance* of Articles 6.1 and 6.3, in the context of Articles 5 and 6 of the *SCM Agreement*, supports the contrary conclusion – that if a complainant has demonstrated the existence of one or more of the effects enumerated in Article 6.3 there is "serious prejudice" that is an adverse effect of the subsidy within the meaning of Article 5. Both must be seen in the context of concern in this part of the *SCM Agreement* with the effects of subsidies on other Members.<sup>1483</sup>

(iii) *Evaluation by the Panel*

i "Serious" prejudice

7.1368 Article 5(c) of the *SCM Agreement* sets out the concept of "serious prejudice" to the interests of another Member as one of three forms of "adverse effects" in Article 5 of the *SCM Agreement*. The chapeau of Article 6.3 states that "[s]erious prejudice in the sense of paragraph (c) of Article 5 *may*

<sup>1480</sup> Brazil's response to Panel Question No. 229.

<sup>1481</sup> United States' further written submission, paras. 77-79.

<sup>1482</sup> India's oral statement at the resumed session of the first substantive meeting, p. 2.

<sup>1483</sup> New Zealand's written submission to the resumed session of the first substantive meeting, para. 211.

arise in any case where one or several of the following apply."(emphasis added) Article 6.3(c) defines one circumstance in which such "serious prejudice" "may" arise.

7.1369 The parties disagree as to whether the establishment of all of the requisite elements in Article 6.3(c) is *sufficient*, in and of itself, to also establish the existence of serious prejudice within the meaning of Article 5(c). Brazil believes that it is, but, even if not, it submits evidence to substantiate that "serious prejudice" exists.<sup>1484</sup> The United States, however, argues that even if Brazil establishes that the conditions in Article 6.3(c) are met, the use of the term "may" in the chapeau of Article 6.3 signifies that Brazil must still demonstrate that the "prejudice" caused by the effects of the subsidy is "serious" within the meaning of Article 5(c) of the *SCM Agreement*.

7.1370 The ordinary meaning of the word "may" in the chapeau of Article 6.3 of the *SCM Agreement* may express "possibility" or "permission".<sup>1485</sup> We agree with the United States that the use of the word "may" in the chapeau of Article 6.3(c) may, at least, play such a permissive role. In this sense, the ordinary meaning of the chapeau of Article 6.3 would be that there is a "possibility" or "opportunity" for serious prejudice in the sense of Article 5(c) to arise where one or more of the effects-based situations listed in Article 6.3 is found. A panel would be permitted to find serious prejudice upon finding that one of these listed effects-based situations exists.

7.1371 There is an explicit and bald textual linkage between Article 6.3(c) and Article 5(c) through the cross-reference in the chapeau of Article 6.3 of the *SCM Agreement*. This textual linkage contains no additional express criteria to establish serious prejudice within the meaning of Article 5(c).

7.1372 Moreover, nowhere else in Articles 5 and 6 of the *SCM Agreement* are any additional criteria explicitly or specifically identified that would inform a panel's examination as to when serious prejudice would or would not arise within the meaning of Article 5(c) once the conditions in one or more of the paragraphs of Article 6.3 are fulfilled.

7.1373 The absence of any reference in Articles 5 and 6 of the *SCM Agreement* to any such additional criteria that would inform a panel's examination as to when serious prejudice would or would not arise within the meaning of Article 5(c) once the conditions in one or more of the paragraphs of Article 6.3 are fulfilled differs from the level of detailed affirmative guidance provided in respect of the price and volume effects, in Article 6.4, that would go to the establishment of displacement or impediment of exports for the purpose of Article 6.3(b); and, in Article 6.5, with respect to the establishment of price undercutting for the purposes of Article 6.3(c) of the *SCM Agreement*.

7.1374 In contrast, the text of the chapeau of Article 6.3 of the *SCM Agreement* is silent as to any factors which would guide an examination under its term "may". We do not believe that, in light of this relatively detailed express guidance that is available on certain aspects relevant to the Article 6.3 examination, there is *another* set of entirely *undefined* requirements or conditions that must also guide our examination and that must also be demonstrated in order to find serious prejudice within the meaning of Article 5(c). Indeed, we believe that the use of "may" in the chapeau of Article 6.3 could be seen as an implicit cross-reference to these other, more specific, requirements spelled out in the other paragraphs of Article 6 relating to price and volume effects of subsidies that are generally referred to in Article 6.3.<sup>1486</sup>

7.1375 The indication in the chapeau of Article 6.3 that serious prejudice may arise when "one or several" of the effects-based situations in the sub-paragraphs exist(s) does not change our view. In

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<sup>1484</sup> Brazil's further written submission, paras. 437 ff.

<sup>1485</sup> *Concise Oxford English Dictionary* (Oxford, Clarendon Press, 1995).

<sup>1486</sup> We note, however, that no such detailed guidance is available, e.g. in respect of price suppression under Article 6.3(c).

using this phrase, the drafters indicated their awareness that at least one of the effects-based phenomena in the various sub-paragraphs of Article 6.3 must exist, but that it was conceptually possible that several might co-exist or overlap in a serious prejudice analysis. The simultaneous co-existence of situations identified in several of the sub-paragraphs would bolster, rather than negate, a finding of serious prejudice. We thus do not understand their reference to "one or several" to require any sort of cumulative application of the sub-paragraphs of Article 6.3, so as to obliterate the possibility that the establishment of one of the effects-based situations identified in a single sub-paragraph would be sufficient to ground a finding of serious prejudice in the sense of Article 5(c).

7.1376 This interpretation – that a demonstration of the existence of one or more of the effects-based situations enumerated in Article 6.3 is sufficient to ground a finding of "serious prejudice" within the meaning of Article 5(c) – finds support in the context of the provision.

7.1377 The language in Article 6.3 ("may") contrasts with the contextual language in Article 6.1 ("shall").<sup>1487</sup> At first blush, it could be concluded that the "may" in Article 6.3 could then only be permissive and *conditional*, rather than permissive in all circumstances. Following this reasoning, had the drafters intended Article 6.3 to be determinative in all circumstances for "serious prejudice" under Article 5(c), they presumably could and would have used "shall".

7.1378 This contrast is not, in itself, dispositive, because of the different substantive focuses of the two provisions. Under Article 6.1, "serious prejudice" was given meaning by reference to qualitative and quantitative criteria pertaining to the particular types and characteristics of the subsidies themselves. Serious prejudice was "deemed" to exist upon identification of subsidies with such characteristics or qualities. As the titles of Articles 5 ("Adverse Effects") and 6 ("Serious Prejudice") of the *SCM Agreement* indicate, the underlying rationale for these provisions is to focus upon subsidies with adverse effects. Thus, the subsidies of the nature enumerated in the sub-paragraphs of Article 6.1 were deemed to have such *effects*.

7.1379 However, it is critical to also take note of the text of Article 6.2, which states:

"Notwithstanding the provisions of paragraph 1, serious prejudice shall not be found if the subsidizing Member demonstrates that the subsidy in question has not resulted in any of the effects enumerated in paragraph 3."

7.1380 Thus, under Article 6.2, it was open to a subsidizing Member to rebut the presumption of serious prejudice by showing that, despite its nature, in fact, the subsidy did not actually cause any *effect* tantamount to serious prejudice. That is, that the subsidy had not caused any of the *effects* enumerated in Article 6.3. In our view, Article 6.2 serves to clarify that a prerequisite for a finding of serious prejudice is that at least one of the four effects-based situations in Article 6.3 must be demonstrated. It indicates to us that demonstration that at least one of the four effects-based situations in Article 6.3 exists is a necessary basis to conclude that serious prejudice exists.

7.1381 A symmetrical reading of the text of Article 6.2 could be that it identifies, by implication, the situations listed in Article 6.3 as, in and of themselves, constituting or giving rise to, serious prejudice. That is, the elements in Article 6.3 may be not only necessary, but also sufficient, conditions, to support a serious prejudice finding under Article 5(c) of the *SCM Agreement*.

7.1382 Another reading of the text could result in an asymmetry, whereby demonstration that none of the effects-based situations enumerated in Article 6.3 existed would mean that serious prejudice did not exist, but demonstration that one or more of the effects enumerated in Article 6.3 existed would

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<sup>1487</sup> We are aware that this provision has lapsed, through the operation of Article 31. Nevertheless, we find it may provide relevant guidance as to the original architecture of the *SCM Agreement*. See *supra*, footnote 1292.

not be sufficient to find serious prejudice. If there were other elements above and beyond those in Article 6.3 that had to be demonstrated to show serious prejudice, we might wonder why Article 6.2 would not also require a subsidizing Member to show that those elements were not present in order to avoid the presumption of serious prejudice in Article 6.1 of the *SCM Agreement*?

7.1383 The qualitative and quantitative focus upon the types and characteristics of certain subsidies in Article 6.1 contrasts with the effects-based focus of Article 6.3. For the purposes of an Article 6.3 examination, there is thus no need to "deem" certain effects to arise from subsidies of a certain nature, as there was in Article 6.1. Rather, Article 6.3 does not attempt to define any qualitative or quantitative aspects of the subsidy: its effects-based focus embraces a subsidy of any nature that has the adverse effects enumerated and is therefore "actionable".

7.1384 Moreover, we find further contextual guidance in other provisions of the *SCM Agreement*. Article 27.8 of the *SCM Agreement* stipulates:

"There shall be no presumption in terms of paragraph 1 of Article 6 that a subsidy granted by a developing country Member results in serious prejudice, as defined in this Agreement. Such serious prejudice, where applicable under the terms of paragraph 9, shall be demonstrated by positive evidence, in accordance with the provisions of paragraphs 3 through 8 of Article 6."

7.1385 This provision makes it clear that "serious prejudice" "shall be demonstrated by positive evidence, in accordance with the provisions of paragraphs 3 through 8 of Article 6". Thus, the considerations spelled out in Articles 6.3-6.8 are considered to be *determinative* in terms of establishing serious prejudice. This provision makes no reference to any other, super-added requirements to establish "serious prejudice" after having established that the effects-based situations in one of the paragraphs of Article 6.3 exist. We consider that the rationale underlying this explicit, contextual guidance informs the meaning of the references in Article 6.4 of the *SCM Agreement* to "for the purpose of paragraph 3(b)", and in Article 6.5 to "for the purpose of Article 3(c)".

7.1386 The United States argues that these references serve to establish displacement or impediment or price undercutting for the purposes of Article 6.3 of the *SCM Agreement*, but do not explicitly indicate that such phenomena necessarily constitute, or result in, serious prejudice for the purposes of Article 5(c). According to the United States, had Members intended that a finding under Article 6.3 would necessarily suffice to demonstrate serious prejudice, one also would have expected Articles 6.4 and 6.5 to mandate a finding of serious prejudice where a finding of one of the effects under Article 6.3 is mandated.<sup>1488</sup>

7.1387 We disagree with this argument of the United States, particularly in light of the references in Article 6.7 ("Displacement or impediment *resulting in serious prejudice* shall not arise under paragraph 3..."), and in Article 6.8 ("In the absence of circumstances referred to in paragraph 7, the existence of *serious prejudice* should be determined ...). These references indicate that the examination called for under Article 6.3 of the *SCM Agreement*, as informed by the more detailed guidance in Articles 6.4-6.8, could equally serve to establish whether or not serious prejudice exists, for the purposes of Article 5(c) of the *SCM Agreement*.

7.1388 An interpretation that the term "may" in the chapeau of Article 6.3 does not require the establishment of any additional elements to those established under one of the paragraphs of Article 6.3 would also be consistent with the object and purpose of the agreement. It would also find

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<sup>1488</sup> United States' response to Panel Question No. 149.

support in the drafting history of the provision.<sup>1489</sup> In this respect, we understand that the term "may" was, at least originally, intended to demonstrate that the list in Article 6.3 is illustrative and not exhaustive. Pursuant to the footnote 13 attached to Article 5(c), the concept of "serious prejudice" is used in the same sense as in Article XVI.1, which includes *inter alia* the threat of serious prejudice. Therefore, it was appropriate to state that serious prejudice in the sense of paragraph (c) of Article 5 *may* arise where any of the listed effects exists because there may be other circumstances in which serious prejudice could be demonstrated, including, for example, where there is a threat of serious prejudice. The use of the word "shall" could have been taken to mean that Article 6.3 provides the exhaustive enumeration of situations in which serious prejudice can ever arise. As we are dealing with one of the listed items in Article 6.3, it is not necessary for us, here, to decide on whether or not there may exist situations – other than those enumerated in Article 6.3 – in which serious prejudice could be established.

7.1389 We would therefore be permitted to find that serious prejudice has arisen upon fulfilment of the elements in one or more of the paragraphs of Article 6.3(c). In this connection, we note the presence of the qualifying term "significant", which modifies the term "price suppression" in Article 6.3(c). The presence of this qualifying term, which permits consideration of the *degree* or *intensity* of the effects caused, stands in sharp contrast to the absence of any such (or analogous) term in the other paragraphs of Article 6.3.<sup>1490</sup> Nevertheless, we fail to see how the absence of any element of degree in paragraphs 3(a), 3(b) and 3(d) of Article 6 would result in the complaining Member being separately required to prove that any prejudice is indeed "serious" even after having established that one of the listed effects-based situations exists. If the drafters had intended that the complaining

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<sup>1489</sup> The *Tokyo Round Subsidies Code*, where the word "may" appeared in this context for the first time, contained a basic rule on serious prejudice (Article 8.3), which was conceptually similar to Article 5 of the current *SCM Agreement*. It provided:

- "2. Signatories [...] agree that they shall seek to avoid causing, through the use of any subsidy:
- (a) injury to the domestic industry of another signatory, [footnote omitted]
  - (b) nullification or impairment of benefits accruing directly or indirectly to another signatory under the General Agreement, [footnote omitted] or
  - (c) serious prejudice to the interests of another signatory.<sup>25</sup>

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<sup>25</sup> Serious prejudice to the interests of another signatory is used in this Agreement in the same sense as it is used in Article XVI:1 of the General Agreement and includes threat of serious prejudice."

Article 8.4 of the Code stated:

- "4. The adverse effects to the interests of another signatory required to demonstrate nullification or impairment or serious prejudice *may arise* through
- (a) the effects of the subsidized imports in the domestic market of the importing signatory,
  - (b) the effects of the subsidy in displacing or impeding the imports of like products into the market of the subsidizing country, or
  - (c) the effects of the subsidized exports in displacing the exports of like products of another signatory from a third country market." (emphasis added, footnotes omitted)

The term "may arise" in the chapeau of Article 8.4 seems to suggest that the items enumerated in (a) through (c) are simply intended to be examples of possible ways in which serious prejudice (and/or nullification or impairment) could show itself. That is, this list in the *Tokyo Round Subsidies Code* seems to be an illustrative, non-exhaustive list of situations constituting serious prejudice, with the "may" leaving open the possibility that other situations as well might lead to or constitute serious prejudice. It appears that the drafting of the terms "serious prejudice may arise" was directly carried over from the *Tokyo Round Subsidies Code* into Article 6.3 of the *SCM Agreement*. This phrase appears unchanged in the chapeau of versions of the negotiating text of what is now Article 6.3 of the *SCM Agreement* (i.e., MTN/GNG/NG10/W/38 and Revisions).

<sup>1490</sup> We discuss this term in more detail below.

Member should separately establish that the prejudice caused by the effects of the subsidy was "serious", they would have defined the requirements for this purpose.<sup>1491</sup>

7.1390 We therefore do not believe that, once we have concluded that the conditions in Article 6.3(c) are fulfilled, and thus that serious prejudice "in the sense of paragraph (c) of Article 5" may arise, a separate examination of the existence of "serious prejudice" under the chapeau of Article 6.3 or Article 5(c) is necessary.<sup>1492</sup> Our examination of the text, in its context, indicates to us that the Article 6.3(c) examination is determinative also for a finding of serious prejudice under Article 5(c). That is, an affirmative conclusion that the effects-based situation in Article 6.3(c) exists is a sufficient basis for an affirmative conclusion that "serious prejudice" exists for the purposes of Article 5(c) of the *SCM Agreement*.

7.1391 In any event, even assuming *arguendo* that any sort of additional demonstration is necessary to establish that the "significant price suppression" we have found to exist in the same world market constitutes prejudice amounting to "serious prejudice" within the meaning of Article 5(c), we believe that Brazil has also fulfilled that burden.

7.1392 For the purposes of this dispute, we do not believe that it is necessary to develop a fixed interpretation of the outer parameters of what may constitute "serious prejudice" to the interests of another Member within the meaning of Article 5(c) of the *SCM Agreement*. At the very least, given the subject matter covered by the *SCM Agreement* – government subsidies in respect of goods – the effects-based situations identified in the sub-paragraphs of Article 6.3, and the reference in the chapeau of Article 6.3 to serious prejudice "in the sense of" Article 5(c), we believe that such "serious prejudice" may involve the effects of subsidies on the complaining Member's trade in a given product. That is, it addresses the volumes and prices and flows of such trade, which may, by logical extension, affect a producing Member's domestic production of that product. We therefore consider that a

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<sup>1491</sup> While we can conceive of a theoretical situation where a panel would not be compelled to deem even the most *de minimis* effects of a subsidy inevitably to give rise to, or constitute, serious prejudice, the facts of the case before us do not envisage such a situation.

<sup>1492</sup> We find support for this proposition in previous WTO and GATT panel reports. The only other WTO panel to have examined these provisions (including "may"), the *Indonesia-Autos* panel, did not conduct such an additional examination, but apparently considered that it was sufficient to establish serious prejudice through the fulfilment of the conditions in Articles 6.3(a) through (d).

This approach was essentially consistent with the approach of three GATT 1947 panels. Two of these disputes were based exclusively on Article XVI of GATT 1947, as they occurred prior to the entry into force of the Tokyo Round *Agreement on Interpretation and Application of Articles VI, XVI and XXIII of the General Agreement on Tariffs and Trade*. At that time, the term "serious prejudice" in Article XVI:1 – without any further textual elaboration – was the only reference to this concept in the GATT rules governing subsidies. In *EC – Sugar Exports (Australia)*, the panel noted that the European Communities scheme in question and its application "had contributed to depress world sugar prices in recent years and that thereby serious prejudice had been caused indirectly to Australia, although it was not possible to quantify the prejudice in exact terms" (i.e. effectively, that price depression constituted serious prejudice). See Panel Report, *EC – Sugar Exports (Australia)*, Section V, conclusion (g). In *EC – Sugar Exports (Brazil)* the panel similarly found that the European Communities scheme in question "[...] had been applied in a manner which in the particular market situation prevailing in 1978 and 1979, contributed to depress sugar prices, and that this constitutes a serious prejudice to Brazilian interests in terms of Article XVI:1". See Panel Report, *EC – Sugar Exports (Brazil)*, Section V, conclusion (f).

The panel in *EEC – Wheat Flour Subsidies*, which occurred after the entry into force of the Tokyo Round *Subsidies Code*, framed its examination in terms of whether the subsidies in question had led to market displacement or price undercutting, and conducted no further, separate, inquiry concerning serious prejudice.

These dispute settlement reports indicate that serious prejudice involved the effects of subsidies on a Member's trade in a given product as such, i.e., the volumes and prices and flows of such trade, rather any further effects on a Member's domestic industry, or other issues such as the significance of the particular industry producing the product in question to the overall "interests" of the complaining Member.

detrimental impact on a complaining Member's production of, and/or trade in, the product concerned may fall within the concept of "prejudice" in Article 5(c) of the *SCM Agreement*.<sup>1493</sup>

7.1393 Moreover, the prejudice involved must be "serious". In one of its ordinary meanings, "serious" means "important" and "not slight or negligible".<sup>1494</sup> Thus, the prejudice in terms of the effect on Brazil's production of, and/or trade in, upland cotton must be such as to affect Brazil's production of upland cotton, to a degree that is "important", "not slight or negligible", or meaningful.

7.1394 We recall our conclusion that the price suppression is "significant".<sup>1495</sup> We note, moreover, Brazil has submitted evidence to substantiate its assertions that there is a close relationship between movements of Brazilian prices and movements in the A-Index and that Brazilian producers have suffered from the suppressed price trends in the Brazilian market and in Brazilian export markets, including in terms of Brazilian producers having reduced production and investment.<sup>1496</sup>

7.1395 In the particular facts and circumstances of this case, whether or not we consider the impact and magnitude of the price suppression or the materiality of effect upon Brazilian producers of upland cotton in terms of the "significance" of the price suppression or in terms of the question as to whether or not such "significant" price suppression amounts to "serious prejudice" under the chapeau of Article 6.3, we arrive at the same conclusion: such "significant price suppression" amounts to "serious prejudice" within the meaning of Article 5(c) of the *SCM Agreement*.

ii Serious prejudice to the interests of "another Member"

7.1396 **Brazil** also asserts that other WTO Members, in particular African cotton-producing Members, have suffered serious prejudice as a result of the United States subsidies. The **United States** asserts that the only Member's interests at issue under Article 5(c)/Article 6.3(c) examination are those of Brazil, as the complaining party in this dispute.

7.1397 In terms of third parties, whereas the **European Communities** agrees with the United States that, for the purposes of Article 6.3(c), only the price effects on the "products" of Brazil are relevant<sup>1497</sup>, **New Zealand** asserts that just because Brazil is the "other party" in the context of

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<sup>1493</sup> In contrast to a trade remedy investigation, in the context of a serious prejudice analysis under Article 5(c), we are not considering a "domestic industry" test where there may be a need to show that a domestic industry is being materially or seriously injured.

<sup>1494</sup> *Concise Oxford English Dictionary* (Oxford, Clarendon Press, 1995).

<sup>1495</sup> *Supra*, para. 7.1333.

<sup>1496</sup> Annex III to Brazil's further submission contains notarized statements by 27 Brazilian "cotton" producers – some in English, some in Portuguese – generally attesting to the nature of cotton production in Brazil, lower cotton price trends in recent years and/or the effects of these price trends on their production and investment decisions. For example, Mr. Christopher Ward (see *supra*, footnote 1465) states that, "[o]ver the past three years I have experienced lower prices for both my domestic Brazilian and export sales". Another producer states that "I initiated my cotton planting in the 1998/99 crop year" and "was very encouraged with the prospect of getting a good profit margin", doubling his acreage in crop year 1999/2000. This producer was "forced to sell" at low prices, subsequently reduced his planted area in crop year 2000/2001 by more than half and then "decided to abandon cotton planting". A further producer indicates that he decided to reduce, as of the 2003/2004 crop year, his planted area by 50 per cent, and would only change his decision if "there is a further substantial rise in current prices". A different producer indicates that he is no longer planting cotton and the last time he planted was in 2000/2001, with an area of 100 hectares. According to him, "[t]he lack of adequate price and elevated costs when compared to other cultures led me to stop producing cotton." Yet another producer indicates that he reduced his cotton planted area "during this last crop-year due to last crop's prices, which left us quite dispirited".

<sup>1497</sup> European Communities' response to Panel third party Question No. 55.

Article 5(c), this does not mean that other Members too cannot be suffering the serious prejudice through the use of the subsidies at issue by the United States.<sup>1498</sup>

7.1398 Certain third parties have also argued that the concept of "another Member" in Article 6.3(c) would include Members other than the complaining Member in a particular dispute.<sup>1499</sup>

7.1399 For example, **Argentina** submits that, despite the fact that Brazil is the complainant, the concept of "another Member" within the meaning of Article 6.3(c) includes Argentina, which submitted allegations relating to the price effect of United States subsidies and has also suffered serious prejudice.<sup>1500</sup>

7.1400 **Benin** and **Chad** also submit that the Panel is required to take account of the effects of the United States subsidies on the interests of Members other than the complaining Member in assessing the WTO-consistency of the United States subsidies<sup>1501</sup>, for the following reasons: (1) the drafters of Article 5 of the *SCM Agreement* referred to "Members" in the plural, connoting an obligation on behalf of the subsidizing Member not to cause adverse effects to the interests of all WTO Members – not just the complaining Member; (2) when the drafters of the *SCM Agreement* intended to refer only to the "complaining Member", they used this term specifically, such as in Article 6.7, or in paragraph 2 of Annex V; (3) it is consistent with Article 3.8 of the *DSU*, which refers to the "adverse impact" on "other Members" in the plural, referring to all WTO Members despite the fact that the *SCM Agreement* provides special and additional rules for dispute settlement; (4) by contrast to Article 10.2 of the *DSU*, Article 10.1 is not limited to providing third parties with the right to present views, as it mandates that the "interests" of the third parties shall be "fully taken into account"; (5) if Article 24.1 of the *DSU* has any meaning, this "special situation" of Benin and Chad must be given full, substantive consideration by the Panel; and (6) the fact that Brazil has specifically addressed the serious prejudice caused to Benin and Chad's economies provides additional support for the position that the serious prejudice to Benin and Chad needs to be examined by the Panel.

7.1401 **China** asserts that "another Member" under Article 6.3 of the *SCM Agreement* includes any Member, the prices of whose like product, as supplied in the same market, at the same level of trade and at comparable times, is capable of being compared to the prices of the subsidized product for the purpose of determining whether "significant price undercutting" exists under Article 6.3(c).<sup>1502</sup>

7.1402 The **Panel** recalls that, Article 7 of the *SCM Agreement*, entitled "Remedies", sets forth the steps to be taken by a Member that believes that it has suffered adverse effects within the meaning of Part III of the *SCM Agreement*. Article 7.2 of the *SCM Agreement*, a special and additional rule or procedure identified in Appendix 2 to the *DSU*, provides that:

"A request for consultations under paragraph 1 shall include a statement of available evidence with regard to (a) the existence and nature of the subsidy in question, and (b) the injury caused to the domestic industry, or the nullification or impairment, or serious prejudice [footnote omitted] *caused to the interests of the Member requesting consultations.*" (emphasis added)

7.1403 The text of Article 7.2 of the *SCM Agreement* makes it clear that the dispute settlement procedures set forth in Article 7 of the *SCM Agreement* may only be invoked by a Member where that

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<sup>1498</sup> New Zealand's response to Panel third party Question No. 55.

<sup>1499</sup> Chinese Taipei does not claim that it is an "another Member" in the sense of Article 6.3(c) of the *SCM Agreement*. See Chinese Taipei's response to Panel third party Question No. 55.

<sup>1500</sup> Argentina's response to Panel third party Question No. 55.

<sup>1501</sup> Benin and Chad's response to Panel third party Question Nos. 44 and 55. We also recall that the delegation of Benin at the resumed session of the first substantive meeting included Mr. Nicholas Minot. See *supra*, Section VII:A, para. 7.54 and footnote 118.

<sup>1502</sup> China's response to Panel third party Question No. 55.

Member believes that it has itself suffered serious prejudice as a result of subsidization. From this, the only logical inference is that the serious prejudice under examination by a WTO panel is the serious prejudice experienced by the complaining Member.

7.1404 Our view of the nature of the dispute settlement process under Article 7 of the *SCM Agreement* is bolstered by the substantive provisions of Articles 5 and 6 of the *SCM Agreement*. The chapeau of Article 5 of the *SCM Agreement* reads:

"No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e. ..."

7.1405 This general introductory statement refers to "other Members" in the plural, and could be taken to refer to Members other than exclusively the complaining Member. However, the more precise text of Article 5(c) refers to "serious prejudice to the interests of *another Member*" (emphasis added). The related footnote 13 of the *SCM Agreement* specifies: "The term "serious prejudice to the interests of another Member" is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice."<sup>1503</sup>

7.1406 The entirety of Articles 7.2-7.10 of the *SCM Agreement* are special and additional rules or procedures identified in Appendix 2 to the *DSU*. However, none of these provisions contains any special rules or procedures pertaining to other WTO Members or to third parties to a dispute governed by these provisions (in conjunction with the provisions of the *DSU*). As Article 7 of the *SCM Agreement* makes no mention of third parties, the customary rights and obligations governing third party participation in panel proceedings in Article 10 of the *DSU* pertain.

7.1407 Pursuant to Article 10.1 of the *DSU*,

"The interests of the parties to a dispute and those of other Members under a covered agreement at issue in the dispute shall be fully taken into account during the panel process."

7.1408 We are bound to take the interests of the parties and those of other Members under the *SCM Agreement* into account during the Panel process.<sup>1504</sup>

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<sup>1503</sup> The focus on the trade effects of subsidization in Article XVI:1 of the *GATT 1994* on any other Member is carried over into Part III of the *SCM Agreement*. As we have already seen, Article 6.3 of the *SCM Agreement* provides that serious prejudice may arise where one or several of four listed situations exist, and Article 6.3(c) addresses price suppression. Article 6.7 allows a subsidizing Member to raise a defence to a displacement/impedance claim where "imports from the complaining Member" or "exports from the complaining Member" are affected by such factors as export prohibitions or restrictions, natural disasters, and arrangements limiting exports. These provisions of Article 6.7 assume that the products subject to a claim of serious prejudice arising from displacement or impedance originate in the complaining Member.

<sup>1504</sup> We further note the provisions of Article 3.8 of the *DSU*:

"In cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered *prima facie* to constitute a case of nullification or impairment. This means that there is normally a presumption that a breach of the rules *has an adverse impact on other Members parties to that covered agreement*, and in such cases, it shall be up to the Member against whom the complaint has been brought to rebut the charge." (emphasis added)

This phrase also recognizes the particular nature of the rights and obligations of the covered agreements.

7.1409 We recall that two least-developed country WTO Members – Benin and Chad – have reserved third party rights in these Panel proceedings. We take note of the provisions of Article 24 of the *DSU*, entitled "Special Procedures Involving Least-Developed Country Members". Article 24.1 states:

"1. At all stages of the determination of the causes of a dispute and of dispute settlement procedures involving a least-developed country Member, particular consideration shall be given to the special situation of least-developed country Members. In this regard, Members shall exercise due restraint in raising matters under these procedures involving a least-developed country Member. If nullification or impairment is found to result from a measure taken by a least-developed country Member, complaining parties shall exercise due restraint in asking for compensation or seeking authorization to suspend the application of concessions or other obligations pursuant to these procedures."

7.1410 While this provision seems to us primarily to address a situation where a least-developed country Member would be the Member complained against in a particular WTO dispute settlement proceeding, the first sentence of the provision is sufficiently generally worded to encompass the situation where least-developed country Members are involved as third parties in a Panel proceeding. This requires that at all stages of the dispute settlement procedures, which includes this Panel process, particular consideration shall be given to the situation of least-developed countries.<sup>1505</sup> We understand this direction, contained in the *DSU*, to address the procedural aspects of the dispute settlement process, rather than our substantive examination under the covered agreements. We recall our references, in Section VII:A, *supra*.

7.1411 As we have already observed, by the terms of Article 10.1 of the *DSU*, we are already bound to take the interest of *all* WTO Members – naturally including least-developed country Members – *fully* into account in our substantive examination under Part III of the *SCM Agreement*. In taking such full account of all Members' interests, we do not view it as conceptually or practically possible to take certain Members' interests *more fully* into account than those of other Members.

7.1412 Nor, in the course of our substantive examination of the merits of Brazil's claims in this dispute, do we believe that this full "taking into account" of *all* Members' interests would entitle us to alter the terms of the treaty text which determines the substantive rights and obligations of Members. In this respect, we note that the substantive subsidy disciplines in the *SCM Agreement* envisage, in Article 27, certain *substantive* special and differential treatment for developing and least-developed countries. Of certain relevance to this dispute are the substantive special and differential treatment provisions relating to the obligations of developing countries in terms of Part III of the *SCM Agreement*.<sup>1506</sup>

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<sup>1505</sup> See *supra*, Section VII:A, where we identify elements germane to the participation of Benin and Chad, as least-developed country Members in these Panel proceedings.

<sup>1506</sup> Articles 27.8 and 27.9 of the *SCM Agreement* provide:

"27.8 There shall be no presumption in terms of paragraph 1 of Article 6 that a subsidy granted by a developing country Member results in serious prejudice, as defined in this Agreement. Such serious prejudice, where applicable under the terms of paragraph 9, shall be demonstrated by positive evidence, in accordance with the provisions of paragraphs 3 through 8 of Article 6.

27.9 Regarding actionable subsidies granted or maintained by a developing country Member other than those referred to in paragraph 1 of Article 6, action may not be authorized or taken under Article 7 unless nullification or impairment of tariff concessions or other obligations under GATT 1994 is found to exist as a result of such a subsidy, in such a way as to displace or impede imports of a like product of another Member into the market of the

7.1413 However, we do not see, in the text of Article 6.3(c) of the *SCM Agreement*, any specific provision concerning *substantive* special or differential treatment in the situation dealt with under these particular Panel proceedings.

7.1414 For these reasons, in examining Brazil's allegations under Part III of the *SCM Agreement* that it has suffered serious prejudice to its interests within the meaning of Article 5(c), we take full account of the interest of *all* Members – including those of least-developed Members – in these dispute settlement proceedings in accordance with the rights and obligations provided for in Part III of the *SCM Agreement*. Pursuant to Article 3.2 of the *DSU*, we are called upon to clarify the rights and obligations in this covered agreement through application of customary principles of interpretation of public international law.

7.1415 Therefore, we have taken into account serious prejudice allegations of other Members to the extent these constitute evidentiary support of the effect of the subsidy borne by Brazil as a Member whose producers are involved in the production and trade in upland cotton in the world market. However, we have not based our decision on any alleged serious prejudice caused to them.

7.1416 In 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*.

#### **4. Claims under Articles 6.3(d) and 5(c) of the *SCM Agreement***

##### **(a) Introduction**

7.1417 As we have already mentioned, Part III of the *SCM Agreement* is entitled "Actionable Subsidies". Article 5 of the *SCM Agreement* is entitled "Adverse Effects". According to its chapeau: "No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e. ...". Article 5(c) identifies "serious prejudice to the interests of another Member" as one such adverse effect. Article 6.3(d) of the *SCM Agreement* provides:

"Serious prejudice in the sense of paragraph (c) of Article 5 may arise in any case where one or several of the following apply ...

(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<sup>17</sup> 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."

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<sup>17</sup>Unless other multilaterally agreed specific rules apply to the trade in the product or commodity in question.

7.1418 We recall that, pursuant to the chapeau of Article 5 of the *SCM Agreement*, to be an "actionable subsidy" for the purposes of Part III of the *SCM Agreement*, there must first be a specific

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subsidizing developing country Member or unless injury to a domestic industry in the market of an importing Member occurs."

subsidy within the meaning of Articles 1.1 and 1.2 of the *SCM Agreement*. We refer to, and incorporate, our earlier findings that the subsidies at issue – user marketing (Step 2) payments to domestic users and exporters<sup>1507</sup>; marketing loan programme payments; PFC payments; MLA payments; DP payments; CCP payments; crop insurance payments; and cottonseed payments constitute "subsidies" within the meaning of Articles 1.1(a) and (b) of the *SCM Agreement* that are "specific" within the meaning of Articles 1.2 and 2 of the *SCM Agreement*.

7.1419 Having established that these subsidies may be actionable for the purposes of Article 5, we observe that there is no disagreement between the parties that an examination under Article 6.3(d) may precede any examination under Article 5(c) of the *SCM Agreement*. There is also no disagreement, in this part of this dispute, that an affirmative conclusion under Article 6.3(d) is a necessary element for an affirmative serious prejudice finding under Article 5(c). We therefore first examine the elements of Brazil's claim under Article 6.3(d) of the *SCM Agreement*.

7.1420 The text of Article 6.3(d) of the *SCM Agreement* consists of at least the following six definitional elements: (i) the effect of the subsidy; (ii) is an increase in the world market share; (iii) of the subsidizing Member; (iv) in a particular subsidized primary product or commodity; (v) as compared to the average over the preceding period of three years; and (vi) this increase "follows a consistent trend over a period when subsidies have been granted."

7.1421 There is no disagreement between the parties that the United States is the [alleged] "subsidizing Member", nor that upland cotton is the "particular subsidized primary product or commodity" in question.<sup>1508</sup>

7.1422 However, the parties disagree on the meaning of "world market share". Due to the evidence each party marshals in line with its own understanding of these terms, the answer to the question of whether or not an "increase" exists following a period manifesting a consistent trend within the meaning of Article 6.3(d) would differ.

7.1423 We thus now examine the meaning of "world market share" in the text of this treaty provision.

(b) "World market share"

7.1424 **Brazil** argues that the phrase "world market share" as used in Article 6.3(d) of the *SCM Agreement* means a Member's share of the world market for exports.<sup>1509</sup>

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<sup>1507</sup> We again recall that we have already found *supra* that user marketing (Step 2) payments to domestic users and exporters are "subsidies" within the meaning of Article 1 of the *SCM Agreement*. *Supra*, Sections VII:E and F.

<sup>1508</sup> United States' response to Panel Question No. 154; Brazil's further written submission, para. 262. Footnote 17 of the *SCM Agreement*, linked to Article 6.3(d), states that the provision applies to a particular subsidized primary product or commodity "[u]nless other multilaterally agreed specific rules apply to the trade in the product or commodity in question." In this dispute, the parties are in agreement that footnote 17 does not affect a claim under this provision concerning upland cotton. See, e.g. Brazil's further written submission, para. 275; United States' response to Panel Question No. 156: (Brazil notes that footnote 17 does not carve out upland cotton from the scope of Article 6.3(d), as there are no multilateral agreed "specific" rules that apply to the trade of upland cotton. Brazil further submits examples of what it conceives would be covered by footnote 17, in the form of: *The International Agreement on Olive Oil and Table Olives*, EC OJ L214, 4 August 1987, reproduced in Exhibit BRA-246; *The International Sugar Agreement of 1977*, 9 *Australian Treaty Series* (1978), reproduced in Exhibit BRA-248; and a list of further "International Commodity Agreements" from the website: [europa.eu.int/eur-lex/en/...](http://europa.eu.int/eur-lex/en/...), reproduced in Exhibit BRA-247. The United States asserts that it is not aware of any other multilaterally agreed specific rules that apply to upland cotton within the meaning of footnote 17.) Given this agreed view of the parties, we wish to emphasize that our reasoning is without prejudice to the interpretation of footnote 17.

7.1425 The **United States** is of the view that the reference to "world market share" in Article 6.3(d) of the *SCM Agreement* "encompasses all consumption of upland cotton, including consumption by a country of its own cotton production" and that "US cotton's share of total world consumption" is "US exports plus domestic US consumption divided by total world consumption".<sup>1510</sup> In response to a Panel question, the United States asserted: "The United States has proposed that the US share of the world market for upland cotton must be measured by that portion of world consumption of upland cotton satisfied by United States upland cotton."<sup>1511</sup>

7.1426 As third parties, **Argentina** and **New Zealand** argue that the United States errs in its interpretation of the expression "world market share" in Article 6.3(d) by trying to identify it with "share in world consumption". However, the **European Communities** supports the United States' arguments: the ordinary meaning of "world market" is the sum of all the geographical markets for the product concerned, including the domestic market of the subsidizing Member.<sup>1512</sup> **Paraguay** generally requests the Panel to find that the measures applied by the United States are inconsistent with the obligations laid down in various provisions of the GATT 1994 and the *SCM Agreement*, and to take account of the arguments put forward by **Brazil**.<sup>1513</sup>

7.1427 **We** must therefore interpret the phrase "world market share" in order to decide whether it refers to the world *export* market (as **Brazil** argues), or whether it encompasses all consumption of upland cotton, including consumption by a country of its own cotton production (as the United States argues), or whether it refers to something else.

7.1428 We recall our examination of the term "market" in the context of our Article 6.3(c) analysis.<sup>1514</sup> We see no reason, and none has been pointed out to us, why a similar approach to this terms cannot be taken here in the circumstances of this dispute.

7.1429 As we have already observed, the term "market" can be defined as: "a place ... with a demand for a commodity or service"<sup>1515</sup>; "a geographical area of demand for commodities or services"; "the area of economic activity in which buyers and sellers come together and the forces of supply and demand affect prices".<sup>1516</sup> In one of its ordinary meanings, therefore, "market" may refer to a geographical area of economic activity in which buyers and sellers come together and the forces of supply and demand affect prices, that is, a locus of competition for sales of a particular commodity.

7.1430 As we have already noted<sup>1517</sup>, the meaning of a the term "market" may vary depending upon the geographical context in which the term is used. That is, if the frame of reference is a market within a sub-federal unit within a Member, a Member's domestic market, or a continental or regional market, the meaning would be different than, for example, a "world market" in the context in which the term is used in Article 6.3(d) of the *WTO Agreement*.

7.1431 The ordinary meaning of "world market" is the global geographical area of economic activity in which buyers and sellers come together and the forces of supply and demand affect prices.

7.1432 We see no foundation in the plain meaning of these terms to find that "world market" as used in Article 6.3(d) would necessarily *not* include the domestic market of the subsidizing Member.

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<sup>1509</sup> Brazil's further written submission, para. 265.

<sup>1510</sup> United States' further written submission, paras. 97 and 99 and footnote 52.

<sup>1511</sup> United States response to Panel question No. 239(b), para. 148.

<sup>1512</sup> European Communities' written submission to the resumed session of the first substantive meeting paras. 14-16.

<sup>1513</sup> Paraguay's written submission to the resumed session of the first substantive meeting, para. 15.

<sup>1514</sup> *Supra*, paras. 7.1235-7.1252

<sup>1515</sup> *The New Shorter Oxford English Dictionary*, (1993).

<sup>1516</sup> *Merriam-Webster Dictionary Online*.

<sup>1517</sup> See *supra*, paras. 7.1246-7.1247.

Rather, we see that this may be a geographic term inclusive of all national "markets", to the extent that such inclusion would be germane to the inquiry envisaged by the provision.

7.1433 The text of Article 6.3(d) also refers to a particular "share" of this world market. The ordinary meaning of the word "share" is "a: a portion belonging to, due to, or contributed by an individual or group; b: one's full or fair portion".<sup>1518</sup>

7.1434 According to Article 6.3(d), it is the "share of the subsidizing Member" that must be examined. Thus, we need to examine the portion of the world market that is satisfied by the subsidizing Member's producers. We are of the view that a plain reading of the combined terms "share of the subsidizing Member" and "world market" in Article 6.3(d) calls for an examination of the portion of the world's supply that is satisfied by the subsidizing Member's producers.

7.1435 Therefore, we disagree with Brazil's argument that a Member's share of the world market would necessarily consist solely of the Member's exports as a proportion of the world export market, and would not embrace relevant developments within the domestic market of the Member. Like Brazil, we believe that a Member's exports are relevant to an examination under this provision. However, unlike Brazil, we also believe that a Member's supply (which may not ultimately be exported) is also a relevant consideration for the purposes of this provision.

7.1436 Furthermore, we agree with the United States that certain developments within the subsidizing Member's domestic market may be relevant. However, we disagree with the United States argument that a Member's share of the world market within the meaning of Article 6.3(d) would necessarily include a Member's own *consumption*.<sup>1519</sup>

7.1437 We derive support for this interpretation of the text of Article 6.3(d) from the immediate context of Article 6.3(d), that is, other paragraphs in the same Article: Article 6.3(a) refers to "imports" and Article 6.3(b) refers to "exports". Both of these provisions contain market-specific references. Article 6.3(a) indicates that a Member's domestic market (as a potential destination for the exports of other Members) may indeed be relevant to a serious prejudice analysis. Article 6.3(b) indicates that the market of a third country Member to which the subsidizing and complaining Member exports may also be relevant. Article 6.3(c) does not refer specifically to the domestic market of any Member. It refers to "the same market", which we have found may refer to a geographical area, including the world.<sup>1520</sup>

7.1438 Other provisions of the covered agreements provide additional contextual guidance. Article XVI:3 of the *GATT 1994* explicitly refers to "world export trade". Article 27.6 of the *SCM Agreement*, dealing with achievement by developing country Members of export competitiveness explicitly refers to the situation where "a developing country Member's exports of [a] product have reached a share of at least 3.25 per cent in world trade of that product".

7.1439 Brazil would have us read the terms "world market share" in Article 6.3(d) to be synonymous with the phrases "world export trade" or the share of a Member's exports in world trade in these other contextual provisions. The United States asserts that, had Members intended that "world export trade" be the relevant concept to apply in Article 6.3(d), one would have expected use of that phrase.

7.1440 We agree entirely with the United States on this point. The use of the phrase "world export trade" in Article XVI:3 of the *GATT 1994* demonstrates to us that the drafters were well aware of how

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<sup>1518</sup> *Merriam-Webster Dictionary Online*.

<sup>1519</sup> We note that the United States at times refers to an approach which seems to resemble the one we adopt (see, for example, United States response to Panel Question No. 239(b), para. 148, cited *supra*, at para. 7.1425). However, the United States' arguments focus on the term "consumption" and, as we have noted, *infra*, at footnote 1527, the United States' data includes imports, which is not reflective of our approach.

<sup>1520</sup> *Supra*, 7.1235-7.1252.

to insert this concept when they so intended. Indeed, the fact that this particular phraseology had existed since the inception of the *GATT 1947* means that the Uruguay Round negotiators could very well have simply transposed those terms from the text of Article XVI:3 of the *GATT 1947* into Article 6.3(d) of the *SCM Agreement*.<sup>1521</sup> However, they did not do so.

7.1441 Similarly, the use of the terms "a developing country Member's exports of [a] product have reached a share of at least 3.25 per cent in world trade of that product" in Article 27.6 of the *SCM Agreement* demonstrates to us that negotiators were well aware of how to include a reference to a Member's share of world export trade in the product concerned in the same *SCM Agreement*. However, again, they did not do so.

7.1442 Rather, the Uruguay Round negotiators used different words in Article 6.3(d) of the *SCM Agreement*. We attribute meaning to the fact that the negotiators used such different words. It is not our task to read into the text obligations which do not exist or concepts which are not there. We therefore cannot read the terms "world market share" in Article 6.3(d) as referring to a Member's share of "world export trade".

7.1443 Brazil has submitted evidence to us that the interpretation of the phrase "world market share" as referring to the share of a member's exports in world export trade in Article 6.3(d) is consistent with the USDA's<sup>1522</sup> own use of the term "world market share", as well as with the use of that term by other Members – e.g. and the European Communities<sup>1523</sup> and Canada.<sup>1524</sup>

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<sup>1521</sup> The Tokyo Round negotiators had done just this, maintaining the Article XVI:3 reference to "more than an equitable share of world export trade" in Articles 10.1 and 10.2 of the *Tokyo Round Subsidies Code*.

<sup>1522</sup> Exhibit BRA-277 (USDA, *Cotton: World Markets and Trade*, January 2000, "Francophone West African Cotton Exports Reach 14 Percent of World Market Share", also stating such "exports are 14 per cent of world trade"); Exhibit BRA-277 (USDA, *Oilseeds: World Markets and Trade*, Circular Series FOP 11-01, November 2001, p. 1, "Growth in World Soybean Trade Benefits Brazil", states: "As the demand for soybeans has surged in recent years, Brazil has been able to increase exports both relative to their competitors, as well as in absolute terms. Brazil's exports have grown from 8.9 million tons three years ago to an estimated 17.5 million tons in the coming October-September year. This growth represents a rise in Brazil's *world market share* from 23.1 per cent three years ago, to 30.5 per cent expected this coming year.") (emphasis added); Exhibit BRA-277 (Paul C. Westcott and Linwood A. Hoffman, Market and Trade Economics Division, Economic Research Service, USDA, "Price Determination for Corn and Wheat: The Role of Market Factors and Government Programs," Technical Bulletin N° 1878, July 1999, p. 7, under the sub-heading "Exports" states: "Although the United States is the world's largest exporter of wheat, it has a smaller *world market share* than for corn, averaging slightly over 30 per cent of global wheat trade in 1990-96."); Exhibit BRA-277 ("World Coarse Grains Situation and Outlook," FASOnline, p. 1, states: "Global corn trade is forecast up marginally to a five year high. Increased exports from China and Argentina are expected to encroach into US *world market share*, reducing expected exports 2.9 million tons from 1998/99.") (emphasis added); Exhibit BRA-277 (USDA, "World Beef, Pork, and Broiler Trade Forecast to Reach Record High in 2002; Competition for Market Share Stiffens," Livestock and Poultry: World Markets and Trade, Circular Series DL&P 1-02, March 2002 states: "World beef, pork, and poultry exports for 2002 are forecast to rise to new records. For beef and pork, the United States will be facing stiff competition in key markets, especially Japan. For poultry, US exports are projected to continue growing, although Brazil is making gains in their *world market share*.")) (emphasis added); Exhibit BRA-277 ("U.S. Agricultural Market Share Holds Its Own," FASOnline, October 1998, p. 1, states: "Exports fell ... and are projected to fall ... Despite the decline, it's important to remember that the United States has managed to retain its share of the global agricultural trade pie: the U.S. *world market share* is forecast to remain at 19.5 per cent in 1999.") (emphasis added).

<sup>1523</sup> EUROPA, Trade Issues, Sectoral Issues, "Trade in Agricultural Goods and Fishery Products," Press Release, Brussels, 11 July 2002, p. 3, reproduced in Exhibit BRA-277 states: "The same factors also help to explain why an obverse picture is seen in *exports*. The EU exports far less to developing countries than the U.S., and is in fact losing *world market share* in farm commodity products (due to restraint in use of export measures and supply-side limiting measures.)" (emphasis added).

<sup>1524</sup> Agriculture and Agri-Food Canada, "Challenges and Implications Arising from the Achievement of CAMC's 2005 Agri-food Export Target," June 1998, p. 9, reproduced in Exhibit BRA-277 states: "For most

7.1444 This evidence indicates that some WTO Members, including the United States itself, sometimes utilize the phrase "world market share" when referring, in the context of world agricultural trade, including world trade of upland cotton, to the proportional share of a Member's exports in relation to world exports.

7.1445 However, we do not view this evidence as determinative for the interpretation of the phrase "world market share" in Article 6.3(d) of the *SCM Agreement*. It is not a formal interpretative tool within the meaning of Articles 31 or 32 of the *Vienna Convention*, much less a universally agreed interpretation among WTO Members within the meaning of the *WTO Agreement*.

7.1446 Our interpretation of the text, in its context, also finds support in the object and purpose of the subsidy disciplines in the *SCM Agreement*. As we have already mentioned, Part III of the *SCM Agreement*, containing Articles 5-7, is entitled "Actionable Subsidies". Article 5 of the *SCM Agreement* is entitled "Adverse Effects"; Article 6 is entitled "Serious Prejudice".

7.1447 From even this rudimentary outline, it is evident to us that Part III of the *SCM Agreement* focuses on the effects of subsidies in respect of products produced by a Member's producers, in order to discern, for example, whether and to what extent such subsidies increase their production (and export) of the product concerned in a manner that causes adverse effects. Why is this so? Because such increase in the production and export of the product concerned from the subsidizing Member – which does not flow from the operation of market forces but rather reflects governmental interference through the bestowal of subsidies – may adversely affect other Members' production and export of the product concerned.

7.1448 If we held the view that the actionable subsidies provisions in Part III of the *SCM Agreement* were limited to export subsidies<sup>1525</sup> – which we most definitely do not – then we would perhaps be more sympathetic to the view that "world market share" in Article 6.3(d) referred to "world export trade". This would dovetail with the hypothetical scope of application of that provision in such a scenario.

7.1449 However, we hasten to underline that actionable subsidies governed by the provisions of Part III of the *SCM Agreement* are *not* limited to export subsidies, or even to subsidies which may necessarily affect a subsidizing Member's exportation. Rather, Part III of the *SCM Agreement* relates generally to adverse effects, including those that may be the effect of subsidies that affect production. This includes not only those subsidies that, while not contingent upon export performance within the meaning of Article 3.1(a), may still incidentally facilitate or promote exportation. It also embraces subsidies that promote production itself, whether or not exportation of such production necessarily results.<sup>1526</sup>

7.1450 In order to dovetail with the actual scope of application of Article 6.3(d), and with the overall architecture of the subsidies disciplines in the agreement, we believe that it is not only entirely reasonable, but also necessary, to read the phrase "world market share" in a manner which takes into account both production and exports. This supports our interpretation of that provision as referring to the share of the world market supplied by the subsidizing Member.

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bulk commodities, Canada may significantly increase export volume but have relatively little impact on world prices because of its small *share of the world market*." (emphasis added).

<sup>1525</sup> Article 3.1(a) in Part II of the *SCM Agreement* addresses, and indeed prohibits, subsidies contingent upon exportation. An interpretation that actionable subsidies included only export subsidies would render the distinction between the prohibited subsidy disciplines in Part II of the *SCM Agreement* and the actionable subsidies disciplines in Part III of the *SCM Agreement* a nullity. We, as a treaty interpreter, are not permitted to do so.

<sup>1526</sup> For example, Article 6.3(a) focuses on effects within the domestic market of the subsidizing Member.

7.1451 By contrast, a focus on a Member's consumption share, plus exports, in world consumption in Article 6.3(d) would run counter to the underlying object and purpose of the subsidy disciplines in the agreement. We do not find tenable the proposition that the expression "world market share" in Article 6.3(d) includes the increase in consumption of the Member granting the subsidy.<sup>1527</sup> It is simply unfathomable to us why an agreement that focuses on subsidies in respect of products would contain a provision effectively limiting an increase in a Member's *consumption* of a product, including of their own product.

7.1452 Indeed, increased consumption of a product would potentially lead to enhanced demand, which might then be satisfied either by the subsidizing Member's own production, or from imports. To the extent imports increased due to enhanced consumption, this would be more likely to benefit, rather than adversely effect, the interests of other WTO Members. Such a situation would most definitely not fall within the "adverse effects" paradigm envisaged in Part III of the *SCM Agreement*.

7.1453 The aim of Articles 5 and 6 is to address the adverse effects of subsidies on the interests of other Members. Specifically, it is concerned with adverse effects to other Members caused when one Member uses subsidies in order to increase its share of the world market for a particular product. To construe "world market share" as including a reference to the consumption of a Member as a share of world consumption of a product would subvert the underlying rationale of Article 6.3(d).

7.1454 We thus understand the terms "world market share" in the text of Article 6.3(d) to refer to the share of the world market supplied by the subsidizing Member.

7.1455 We consider that this interpretation of the text, in its context, and in light of the object and purpose of the subsidy disciplines in the *SCM Agreement* is clear and unambiguous. We would therefore be entitled to stop our interpretive examination here.<sup>1528</sup> However, we note that recourse to the drafting history of the provision only serves to confirm this interpretation.

7.1456 As we have already mentioned, Article XVI of the *GATT 1947* contained two "parts". Part A was entitled "Subsidies in General". Part B was entitled "Additional Provisions on Export Subsidies". Article XVI:3 of the *GATT 1947*, in Part B, read:

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<sup>1527</sup> To the extent that the United States could be understood to have argued that the United States share of total world consumption is: (United States consumption + United States exports)/ total world consumption. (United States response to Panel Question 197 and Exhibit US-47.), we would note that calculation of the converse figure (Non-United States consumption + non-United States-exports)/total world consumption (presuming that other WTO Members would also apply the same methodology) results in a total world market share that exceeds 100 per cent. (See Brazil's 28 January comments on United States' response to Panel Question No. 236). Furthermore, the United States data and methodology double count exports as part of the "world market share" of the exporting country and part of the consumption of the importing country that contributes to total world consumption. (See United States' response to Panel Question No. 197 and footnote 24). There, the United States indicates that the figure for United States consumption includes imports. Exhibit US-120 contains USDA, Economic Research Service, *Fibres Yearbook*, Appendix Table 2, "Upland Cotton Supply and Use". For the years MY 1965-2003, it shows a consistently very low ratio of imports to United States production of upland cotton (for example, MY 2001, the ratio was 5:19,603 bales; the ratio was at its highest in 1998, at 427:13,426). Although the United States asserts that "United States cotton imports are often zero and, even when positive, have accounted for less than one per cent of consumption over the past decade", this United States-specific analysis would not be susceptible of universal application to all WTO Members, particularly in the case of a Member whose imports accounted for a larger proportion of domestic consumption. To the extent that the United States could be understood to have argued in these Panel proceedings that the United States share of total world consumption is: (United States consumption of *US cotton* + United States exports)/ total world consumption, as in , for example, United States' response to Panel Question No. 238(b), footnote 15, the above observations on the reference to "consumption" and the "consumption" data submitted to us would still hold. See also *supra*, footnote 1519.

<sup>1528</sup> *Supra*, footnote 636.

"3. Accordingly, contracting parties should seek to avoid the use of subsidies on the export of primary products. If, however, a contracting party grants directly or indirectly any form of subsidy which operates to increase the export of any primary product from its territory, such subsidy shall not be applied in a manner which results in that contracting party having *more than an equitable share of world export trade* in that product, account being taken of the shares of the contracting parties in such trade in the product during a previous representative period, and any special factors which may have affected or may be affecting such trade in the product." (emphasis added)

7.1457 As we have already observed, the *Tokyo Round Subsidies Code* contained four main substantive provisions on subsidies:<sup>1529</sup> Article 8 ("Subsidies – General Provisions"), Article 9 ("Export subsidies on products other than certain primary products"); Article 10 ("Export subsidies on certain primary products"); and Article 11 ("Subsidies other than export subsidies").

7.1458 Article 9.1 stipulated that: "[S]ignatories shall not grant export subsidies on products other than certain primary products". Article 10.1 of the *Tokyo Round Subsidies Code* read:

"1. In accordance with the provisions of Article XVI:3 of the General Agreement, signatories agree not to grant directly or indirectly any export subsidy on certain primary products in a manner which results in the signatory granting such subsidy having *more than an equitable share of world export trade* in such product, account being taken of the shares of the signatories in trade in the product concerned during a previous representative period, and any special factors which may have affected or may be affecting trade in such product." (emphasis added, footnotes omitted)

7.1459 This suggests that the drafters of the *Tokyo Round Subsidies Code* considered that the export subsidies in Article 10 of the *Tokyo Round Subsidies Code* were subject to Article XVI:3 of the *GATT 1994*. Read in context, the drafters indicated that those export subsidies on certain primary products were subject to certain disciplines, other export subsidies were subject to certain other disciplines and subsidies *other than export subsidies* were subject to still *other* disciplines and could form the main basis for a serious prejudice claim.<sup>1530</sup>

7.1460 The text of Article 6.3(d)<sup>1531</sup> of the current *SCM Agreement* is cited above, as are the export subsidy provisions of the current *Agreement on Agriculture* and the *SCM Agreement*.<sup>1532</sup>

7.1461 At first blush, there appear to be overarching similarities between Article XVI:3 and Article 6.3(d). For example, both call for a comparison of a Member's quantitative share in a certain world phenomenon with a corresponding share during a previous period. While the tests contained in Article 6.3(d) and Article XVI:3 may be similar, they are certainly not textually or conceptually identical. For example, Article 6.3(d) does not contain the terms "equitable share" and "special factors"; and it defines a "previous representative period" for comparison as three years. It also refers to "world market share" rather than "world export trade". It also refers to "a particular subsidized product or commodity" rather than "certain primary products".

7.1462 As we have already indicated<sup>1533</sup>, we believe that the text of Article XVI:3 refers only to export subsidies which are now also governed by the prohibition in Article 3.1(a) of the

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<sup>1529</sup> See *supra*, paras. 7.1007 *ff.* Also see *supra*, footnote 1492 for a discussion, in another context, of the GATT panel reports which occurred prior and subsequent to the entry into force of the *Tokyo Round Subsidies Code*.

<sup>1530</sup> *Supra*, paras. 7.999 *ff.* of Section VII:E.

<sup>1531</sup> *Supra*, para. 7.1417.

<sup>1532</sup> e.g. *supra*, paras. 7.654 *ff.*

<sup>1533</sup> *Supra*, paras. 7.999 *ff.* of Section VII:E.

*SCM Agreement* (except as provided in the *Agreement on Agriculture*). It does not address actionable subsidies governed by the provisions of Part III of the *SCM Agreement*. By extension, we do not believe that the language of Articles 5(c)/6.3(d) of the *SCM Agreement* suggests an intention by the Uruguay Round negotiators directly to *develop and refine* the requirements of Article XVI:3 of the *GATT 1994* within the actionable subsidy provisions of the *SCM Agreement*. At least, if there was such an intention, they have not clearly so indicated in the text of these two covered agreements.

7.1463 Rather, the Uruguay Round negotiators indicated in the text their intention to devise a new test pertaining to Members' "not-necessarily-export-contingent-subsidies" in respect of primary products and commodities, and which would take into account considerations germane to worldwide trade in such products and commodities, including trends in production and export that would be affected by Members' bestowal of subsidies.

7.1464 We therefore find that the phrase "world market share" of the subsidizing Member in Article 6.3(d) of the *SCM Agreement* refers to share of the world market supplied by the subsidizing Member of the product concerned.

7.1465 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*.<sup>1534</sup>

## 5. Claim under Article XVI:1 of the *GATT 1994*

### (a) Main arguments of the parties

7.1466 **Brazil** requests us to rule that the United States subsidies provided during MY 1999-2002 caused and continue to cause serious prejudice to the interests of Brazil by resulting in the United States having more than an equitable share of world exports of upland cotton in violation of Articles XVI:1 and XVI:3 of the *GATT 1994*.

7.1467 Brazil clarifies, in responding to a Panel question, that it does not seek relief under Article XVI in respect of "expired measures", by which Brazil understands the Panel to mean the legal instruments consisting of the FAIR Act of 1996 as well as the various emergency appropriation Acts in 1998-2001 providing, *inter alia*, for MLA payments.<sup>1535</sup>

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<sup>1534</sup> In accordance with the Panel's duty to make an objective assessment of the matter before it pursuant to Article 11 of the *DSU* concerning the interpretation of the term "world market share" in Article 6.3(d) of the *SCM Agreement*, we nevertheless observe that data pertaining to the share of United States exports as a proportion of world exports – i.e. corresponding to the legal interpretation proposed by Brazil in these proceedings – can be found in Exhibits BRA-206 and BRA-302 and in United States response' to Panel Question No. 160. See also our findings *supra*, para. 7.1283.

Data pertaining to the share of United States consumption as a proportion of world consumption – i.e. corresponding to the legal interpretation proposed by the United States in these proceedings – can be found in Exhibits US-47, US-70 and US-71. United States figures (MY 1995-1998 data from USDA/FAS, *Cotton, World Markets and Trade*; and otherwise from Production, Supply and Demand Estimates (www.fas.usda.gov/psd) and USDA, *World Agricultural Supply and Demand Estimates Report* (December (2003)) show the following for "US consumption and exports as a share of world consumption": MY 1995/96 – 21.3 per cent; MY 1996/97 – 20.4 per cent; MY 1997/98 – 21.6 per cent; MY 1998/9 – 17.4 per cent; MY 1999/2000 – 18.6 per cent; MY 2000/01 16.9 per cent; MY 2001/2 – 19.8 per cent; MY 2002/3 – 19.6 per cent. (2002/03 is considered an estimate).

We also recall our findings *supra*, relating to the United States share of world upland cotton production, para. 7.1282.

<sup>1535</sup> Brazil's response to Panel Question No. 250, para. 184.

7.1468 The **United States** contends that Brazil's joint claim under Articles XVI:1 and XVI:3 of the *GATT 1994* has no legal basis. According to the United States, Article XVI:3 pertains only to export subsidies and Brazil has failed to demonstrate a prima facie case of inconsistency with Article XVI:3.

(b) Main arguments of the third parties

7.1469 **Argentina**<sup>1536</sup>, **China**<sup>1537</sup>, **Chinese Taipei**<sup>1538</sup>, the **European Communities**<sup>1539</sup> and **New Zealand**<sup>1540</sup> are generally of the view that a finding of serious prejudice under Article 5(c) of the *SCM Agreement* would be determinative for a finding under Article XVI:1 of the *GATT 1994*.

(c) Evaluation by the Panel

7.1470 We understand that Brazil's claims under Article XVI:1 and XVI:3 of the *GATT 1994* envisage a joint application of these two provisions. That is, Brazil does not make independent claims under paragraphs 1 and 3 of Article XVI, but rather requests us to rule that the United States subsidies provided during MY 1999-2002 caused and continue to cause serious prejudice to the interests of Brazil by resulting in the United States having more than an equitable share of world exports of upland cotton in joint violation of Articles XVI:1 and XVI:3 of the *GATT 1994*.

7.1471 As we have already indicated<sup>1541</sup>, we do not believe that these provisions are susceptible to such joint application. Rather, each requires application in accordance with its own terms. We therefore examine the terms of these two distinct treaty provisions separately.

7.1472 Article XVI:1 of the *GATT 1994*, is found in Part A of that article, entitled "Subsidies in General". It states:

"If any [Member] grants or maintains any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory, it shall notify ... in writing of the extent and nature of the subsidization, of the estimated effect of the subsidization on the quantity of the affected product or products imported into or exported from its territory and of the circumstances making the subsidization necessary. In any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened by any such subsidization, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or parties concerned, ..., the possibility of limiting the subsidization."

7.1473 There is an explicit textual linkage between Article 6.3(d) and Article 5(c) of the *SCM Agreement*: the chapeau of Article 6.3 states that "[s]erious prejudice in the sense of paragraph (c) of Article 5 may arise where one of the following [including the elements in Article 6.3(d)] apply...".

7.1474 Following that cross-reference to Article 5(c), we see that footnote 13 to Article 5(c) explicitly refers to Article XVI:1 of the *GATT 1994*. It states: "The term "serious prejudice to the interests of another Member" is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice."

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<sup>1536</sup> Argentina's response to Panel third party Question No. 53.

<sup>1537</sup> China's response to Panel third party Question No. 53.

<sup>1538</sup> Chinese Taipei's response to Panel third party Question No. 53.

<sup>1539</sup> European Communities response to Panel third party Question No. 53.

<sup>1540</sup> New Zealand's response to Panel third party Question No. 53.

<sup>1541</sup> See Section VII:E.

7.1475 As the term "serious prejudice" in both provisions of the two agreements is used "in the same sense", our findings of "serious prejudice" under Articles 5(c)/6.3(c) of the *SCM Agreement* would also be conclusive for a finding of "serious prejudice" under Article XVI:1 of the *GATT 1994*. That is, if the terms "serious prejudice" are used "in the same sense" in the two provisions, a finding of "serious prejudice" under Article 5(c) must necessarily also constitute a finding of "serious prejudice" also for the purposes of Article XVI:1. In addition, the remedies available under Part III of the *SCM Agreement* are at least as effective as those that would be available under Article 19.1 of the *DSU* in respect of an infringement of Article XVI:1 of the *GATT 1994*.

7.1476 In light of our findings of inconsistency with Articles 5(c) and 6.3(c) of the *SCM Agreement*<sup>1542</sup>, and for these reasons, we see no need for an additional examination of "serious prejudice" for the purposes of Article XVI:1 of the *GATT 1994*.<sup>1543</sup>

## H. ACTIONABLE SUBSIDIES: CLAIMS OF "THREAT OF" SERIOUS PREJUDICE

### 1. Measures at issue

7.1477 This Section of our report deals with alleged actionable subsidies from MY 2003-MY 2007.<sup>1544</sup> These are the following measures, as described in Section VII:C of this report:

- (i) export credit guarantees under the GSM 102 programme<sup>1545</sup>;
- (ii) user marketing (Step 2) payments to exporters and domestic users<sup>1546</sup>;
- (iii) marketing loan programme payments;
- (iv) direct payments;

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<sup>1542</sup> *Supra*, para. 7.1416.

<sup>1543</sup> To the extent that Brazil's argument under Article XVI:1 also focuses upon the attainment of an "inequitable share of world export trade" within the meaning of Article XVI:3 of the *GATT 1994*, we have addressed this *supra*, in Section VII:E.

<sup>1544</sup> As regards the "implementation period" – during which Article 13 of the *Agreement on Agriculture* applies – the United States is of the view that the end of the 2003 *calendar* year is not relevant to this dispute because US commitments with respect to cotton are specified by *marketing* year. See United States' response to Panel Question No. 124. To the extent that there is any issue as to precisely when in "2003" the implementation period for purposes of Article 13 expires, we recall our findings in *supra*, Section VII:D relating to claims of threat of serious prejudice. In particular, we recall our statement in paragraph 7.595. Given those findings, we are of the view that the United States cannot, in any event, benefit from the conditional protection of Article 13 of the *Agreement on Agriculture* during MY 2003 or subsequently in relation to claims of threat of serious prejudice.

<sup>1545</sup> We recall that, in Section VII:E, we have found that export credit guarantees under the three export credit guarantee programmes before us constitute export subsidies in violation of Article 10.1 and 8 of the *Agreement on Agriculture* and prohibited export subsidies under Articles 3.1(a) and 3.2 of the *SCM Agreement*. We note that Brazil's references to GSM 102 in its claims of threat of serious prejudice are somewhat inconsistent. While it does not refer to GSM 102 as one of the five "mandatory" subsidies in question, it nevertheless refers to the GSM 102 programme in various places in its threat analysis. In any event, Brazil clarified, in response to Panel Question No. 139, that Brazil's serious prejudice claims relating to export credit guarantee programmes refer only to one of the three United States export credit guarantee programmes, GSM102. According to Brazil, this is because either no upland cotton allocations were made or only negligible amounts of cotton were exported under the GSM 103 and SCGP programs during the years in question.

<sup>1546</sup> We recall that, in Section VII:E, we have found that the aspect of the measure providing for payments to exporters constitutes an export subsidy in violation of the Articles 3.3 and 8 of the *Agreement on Agriculture* and a prohibited export subsidy under Articles 3.1(a) and 3.2 of the *SCM Agreement*; in Section VII:F, we have found that the aspect of the measure providing for payments to domestic users is an import substitution subsidy within the meaning of Articles 3.1(b) and 3.2 of the *SCM Agreement*.

- (v) counter-cyclical payments;
- (vi) crop insurance payments; and
- (vii) legislative and regulatory provisions providing for the payment of measures (i)-(vi) above.

## **2. Overview of Brazil's claims of threat of serious prejudice under the *SCM Agreement* and the *GATT 1994***

7.1478 Brazil alleges "threat of serious prejudice" under Articles 5(c), 6.3(c) and 6.3(d) of the *SCM Agreement*, and Articles XVI:1 and XVI:3 of the *GATT 1994*. Brazil claims that United States subsidies to be granted during MY 2003-MY 2007 threaten to cause serious prejudice to Brazil's interests as follows:

- (i) threat of significantly suppressing upland cotton prices in the United States, world and Brazilian markets in violation of Articles 5(c) and 6.3(c) of the *SCM Agreement*;
- (ii) threat of increasing the United States share of the upland cotton world market in violation of Articles 5(c) and 6.3(d) of the *SCM Agreement*; and
- (iii) threat of the United States continuing to have more than an equitable share of world export trade in violation of Articles XVI:1 and XVI:3 of the *GATT 1994*.

## **3. Claim of threat of serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement***

### **(a) Main arguments of the parties**

7.1479 **Brazil** submits that the appropriate test for "threat"<sup>1547</sup> of serious prejudice for the purposes of Articles 5(c) and 6.3(c)/(d) of the *SCM Agreement* is whether the payments are mandated by legal mechanisms and whether there are any effective limits on the volume of production, volume of exports or the budgetary expenditures related to upland cotton. Brazil also asserts an alternative test: the same elements necessary to demonstrate present serious prejudice focusing on the likely effects of the subsidies in suppressing world prices and increasing and maintaining a high level of world export market share.

7.1480 According to Brazil, the United States subsidies at issue threaten to cause serious prejudice within the meaning of Article 5(c) of the *SCM Agreement* because, under either test:

- five types of subsidies (user marketing (Step 2) payments; marketing loan programme payments; DP payments; CCP payments; and crop insurance payments) are "mandatory" payments to eligible recipients, with unlimited budgetary expenditures and on an unlimited amount of upland cotton production.
- existing "present" serious prejudice in MY 1999-2002 is proof that a "threat" exists in MY 2003-MY 2007 given the substantial similarity between the measures in question and the increase of subsidies under the FSRI Act of 2002;

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<sup>1547</sup> Brazil refers, in support, to past GATT Panel Reports in *EC – Sugar Exports (Australia)* and *EC – Sugar Exports (Brazil)* and the WTO Appellate Body Report in *US – FSC*.

- the nature of the United States subsidies and their likely trade effects are evidence of "threat";
- given continuing high costs of production, the United States producers' cost-revenue gap will remain significant and United States producers will remain dependent on all United States subsidies to maintain current levels of production throughout MY 2003-MY 2007;
- the significant production, export and price-suppressing effects of the mandated United States subsidies will exist between MY 2003-MY 2007 even as world prices fluctuate (as DP payments, crop insurance and export credit guarantees are not impacted by market price fluctuations);
- current and projected price levels indicate that marketing loan programme payments and CCP payments will be made during MY 2003-MY 2007;
- USDA's projected upland cotton acreage, United States Senators' statements and research by independent or other experts all support a finding of threat of serious prejudice between MY 2003-MY 2007;
- the increasing reliance of United States producers on export sales will enhance the price suppressing effects of the subsidies (particularly the user marketing (Step 2) payments and the export credit guarantees).

7.1481 The **United States** asserts that Brazil's test for "threat" of serious prejudice is incorrect as it would produce a threat determination wherever subsidies by a large exporter have no effective production or export limitations. According to the United States, the appropriate test for "threat" is whether there is a clearly foreseen and imminent likelihood of future serious prejudice in light of future market conditions, world prices and other factors.<sup>1548</sup>

7.1482 The United States argues that Brazil has not demonstrated a clearly foreseen and imminent likelihood of future serious prejudice, mainly because: no "present" serious prejudice exists and thus no threat can be presumed<sup>1549</sup>; and certain of the allegedly "mandatory" measures (marketing loan programme payments, user marketing (Step 2) payments and CCP payments) depend upon price conditions which may or may not be fulfilled in the future. Indeed, according to the United States, futures prices indicate that prices may be close to the average that existed in the era before Brazil alleged serious prejudice.

(b) Main arguments of the third parties

7.1483 **Argentina** agrees with Brazil that the threat of serious prejudice is clearly foreseeable and imminent because of the effects of the even larger subsidies provided under United States' legislation for the MY 2003-MY 2007 period. Argentina contends that the guaranteed flow of subsidies will lead to a higher level of United States' cotton production and exports, and result in price suppression and depression as well as an increasing and inequitable world market share for cotton, thus creating a source of permanent uncertainty that confirms the threat of serious prejudice generated by the subsidies. According to Argentina, future subsidies will continue to be necessary to bridge the gap

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<sup>1548</sup> The United States cites, in support, the "threat" of injury standard applicable in a countervailing duty investigation, articulated in Article 15.7 of the *SCM Agreement*.

<sup>1549</sup> As the Panel has found "present" serious prejudice within the meaning of Articles 6.3(c) and 5(c), this argument of the United States – that no "present" serious prejudice exists and thus no threat can be presumed – is no longer valid.

between market prices and the total production costs of the upland cotton producers of the United States, especially considering that the USDA forecasts an increase in total production costs.<sup>1550</sup>

7.1484 The **European Communities** asserts that subsidies without any "pre-established limitations" in terms of value and volume are not in and of themselves dispositive of the existence of threat of serious prejudice. It argues that other factors, including in particular factors analogous to those listed in Article 15.7 (ii)-(v) of the *SCM Agreement*, may also be relevant and should be examined as well. The European Communities considers that in light of Article 15.7 of the *SCM Agreement* a determination of threat of serious prejudice, like a determination of injury, must "be based on facts and not merely on allegation, conjecture or remote possibility". Also, the relevant "changes in circumstances" must be "clearly foreseen and imminent".<sup>1551</sup>

7.1485 **New Zealand** supports Brazil's arguments and asserts that Brazil has brought evidence to show that the United States subsidies threaten to cause serious prejudice to Brazil's interests in the future. It agrees with Brazil that the very same factors creating present serious prejudice also create a threat of serious prejudice in the future. It cites to the fact that United States' subsidies are mandated to continue until MY 2007, that they are effectively unlimited, and that they have already caused serious prejudice to Brazil's interests. New Zealand further asserts that the continued operation of the subsidies for a further four years cannot but be considered to threaten further serious prejudice to Brazil's interests.<sup>1552</sup>

(c) Evaluation by the Panel

7.1486 Article 5 of the *SCM Agreement* states:

"No Member should cause, through the use of any subsidy referred to in paragraphs 1 and 2 of Article 1, adverse effects to the interests of other Members, i.e.:

- (a) injury to the domestic industry of another Member<sup>11</sup>;
- (b) nullification or impairment of benefits accruing directly or indirectly to other Members under GATT 1994 in particular the benefits of concessions bound under Article II of GATT 1994<sup>12</sup>;
- (c) serious prejudice to the interests of another Member."<sup>13</sup>

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<sup>11</sup> The term "injury to the domestic industry" is used here in the same sense as it is used in Part V.

<sup>12</sup> The term "nullification or impairment" is used in this Agreement in the same sense as it is used in the relevant provisions of GATT 1994, and the existence of such nullification or impairment shall be established in accordance with the practice of application of these provisions.

<sup>13</sup> The term "serious prejudice to the interests of another Member" is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and includes threat of serious prejudice.

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<sup>1550</sup> Argentina's written submission to the resumed session of the first substantive meeting, paras. 44-49.

<sup>1551</sup> European Communities' written submission to the resumed session of the first substantive meeting, paras. 17-26.

<sup>1552</sup> New Zealand's written submission to the resumed session of the first substantive meeting, paras. 3.01- 3.06.

7.1487 Footnote 13 to Article 5(c) of the *SCM Agreement* makes it clear that: "The term "serious prejudice to the interests of another Member" is used in this Agreement in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and *includes threat of serious prejudice.*" (emphasis added)

7.1488 As we have already noted, Article XVI:1 of the *GATT 1994*, in Section A of that Article, is entitled "Subsidies in General". It states:

"If any [Member] grants or maintains any subsidy, including any form of income or price support, which operates directly or indirectly to increase exports of any product from, or to reduce imports of any product into, its territory, it shall notify ... in writing of the extent and nature of the subsidization, of the estimated effect of the subsidization on the quantity of the affected product or products imported into or exported from its territory and of the circumstances making the subsidization necessary. *In any case in which it is determined that serious prejudice to the interests of any other contracting party is caused or threatened* by any such subsidization, the contracting party granting the subsidy shall, upon request, discuss with the other contracting party or parties concerned, ..., the possibility of limiting the subsidization." (emphasis added)

7.1489 Article XVI:1 of the *GATT 1994* refers to the situation where "... serious prejudice to the interests of any other Member is caused *or* threatened by any such subsidization" (emphasis added).

7.1490 There is an explicit textual linkage between Article 5(c) of the *SCM Agreement* and the chapeau of Article 6.3 of the *SCM Agreement*. The chapeau of Article 6.3 states: "[s]erious prejudice in the sense of paragraph (c) of Article 5 may arise where one of the following apply...". Article 6.3(c) then sets out the condition that "the effect of the subsidy" is "significant price suppression" "in the same market".

7.1491 We consider it significant that the text of Article 5(c) of the *SCM Agreement* indicates that the term "serious prejudice to the interests of another Member" is used in the *SCM Agreement* "in the same sense as it is used in paragraph 1 of Article XVI of GATT 1994, and *includes* threat of serious prejudice" (emphasis added).<sup>1553</sup>

7.1492 We believe that this phrase gives rise to two initial issues:

- first, what guidance do we find in the indication that "serious prejudice" "includes threat of serious prejudice" in footnote 13 of the *SCM Agreement*?; and
- secondly, what guidance do we find in the phrase "... serious prejudice to the interests of any other Member is caused *or* threatened by any such subsidization" in Article XVI:1 of the *GATT 1994*?

7.1493 With respect to the first question, the cited legal provisions make it clear that, whatever the overall scope of the concept of serious prejudice may be, that scope includes the concept of "threat" of serious prejudice. The ordinary meaning of the verb "include" is: "comprise or reckon in as part of a whole."<sup>1554</sup> Thus, serious prejudice *includes* a threat of serious prejudice.<sup>1555</sup>

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<sup>1553</sup> By virtue of footnote 13 of the *SCM Agreement*.

<sup>1554</sup> *Concise Oxford English Dictionary* (Oxford: Clarendon Press, 1995).

<sup>1555</sup> The converse would not necessarily hold. That is, a finding of *threat* of serious prejudice would not necessarily include present serious prejudice.

7.1494 With respect to the second question, we consider the meaning of the phrase "... serious prejudice to the interests of any other Member is caused *or* threatened by any such subsidization" (emphasis added) in Article XVI:1 of the *GATT 1994*. The main question is whether to read the "or" inclusively, or exclusively. That is, are we to read this phrase in the sense of either *one* ("caused") *or the other* ("threatened"), *but not both* would be adequate to trigger the remedies in Article 7 of the *SCM Agreement*?<sup>1556</sup> Or should we read this phrase rather as "caused or threatened" in the sense of *either one or the other, or both in combination* ("caused or threatened [to be caused]") would be adequate?

7.1495 We believe that "threat" of serious prejudice refers to something distinct from serious prejudice. However, in terms of the rising continuum of seriously prejudicing another Member's interests, that ascends from a "threat" of serious prejudice" up to "serious prejudice", we see "serious prejudice" as necessarily *including* the concept of a "threat" and *exceeding* the presence of a "threat" for purposes of answering the relevant inquiry.<sup>1557</sup> This is confirmed by the text of footnote 13 of the *SCM Agreement*, which indicates that serious prejudice "includes" threat of serious prejudice.

7.1496 In this respect, we observe that present serious prejudice would more often be *preceded in time* by a prejudice that threatens to become serious, and serious prejudice would be the realization of a threat of serious prejudice.<sup>1558</sup>

7.1497 The text of the cited legal provisions leads us to conclude that either serious prejudice, or threat of serious prejudice, or both in combination, may trigger the remedies available in Article 7 of the *SCM Agreement*. The existence of either one, or the other, is both a necessary and sufficient condition, in and of itself, to achieve this.

7.1498 Turning to the particular factual situation before us, there are two main measures providing for payment of the United States subsidies in question:

- the FSRI Act of 2002 and implementing regulations (relating to MY 2002 – MY 2007)<sup>1559</sup>; and

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<sup>1556</sup> As, pursuant to footnote 13, "serious prejudice" in Article 5(c) is used in this same sense.

<sup>1557</sup> We do not mean to imply that the concept of serious prejudice to another Member's interests within the meaning of Article 5(c) of the *SCM Agreement* can be identified with the concept of "material injury" or "serious injury" to a Member's domestic industry as those terms are used in the trade remedy provisions of the *SCM Agreement*, the *Anti-dumping Agreement* or the *Agreement on Safeguards*. We nevertheless recall the view of the Appellate Body in addressing a similarly worded requirement in Article 2.1 of the *Agreement on Safeguards* in *US – Line Pipe*, paras. 170-171:

"The question at issue is whether the right [to apply a safeguard measure] exists in this particular case. And, as the right exists if there is a finding by the competent authorities of a 'threat of serious injury' or - something *beyond* - 'serious injury', then it seems to us that it is irrelevant, *in determining whether the right exists*, if there is 'serious injury' or only 'threat of serious injury' - so long as there is a determination that there is *at least* a 'threat'. In terms of the rising continuum of an injurious condition of a domestic industry that ascends from a 'threat of serious injury' up to 'serious injury', we see 'serious injury'- because it is something *beyond* a 'threat' - as necessarily *including* the concept of a 'threat' and *exceeding* the presence of a 'threat' for purposes of answering the relevant inquiry: is there a right to apply a safeguard measure?"

<sup>1558</sup> *Ibid.* In the only previous WTO Panel Report on "serious prejudice" (*Indonesia – Autos*) the "threat" claims were made in the alternative to the "present" serious prejudice claims. Having found present serious prejudice, the Panel declined to examine the alternative "threat" claims. See Panel Report, *Indonesia – Autos*, para. 14.257.

<sup>1559</sup> Certain transition rules apply, e.g. section 1106(d) entitled "special rule for 2002 crop year" relating to direct payments and counter-cyclical payments.

- legislation providing for crop insurance subsidies prior to and since MY 2002.

7.1499 Brazil's "present" "serious prejudice" claims pertain to measures in force and subsidies granted from MY 1999-MY 2002. Our finding of "present" serious prejudice thus pertain also to measures in force and subsidies paid in MY 2002, the first year of the FSRI Act of 2002.

7.1500 Brazil's "threat" claims pertain to subsidies granted (or yet to be granted) under measures in force from MY 2003-MY 2007. This is the remaining period of application of the FSRI Act of 2002. It is clear that the existing subsidy programmes are currently envisaged to remain in effect between MY 2003-MY 2007.

7.1501 Because the Panel's "present" serious prejudice findings include findings of inconsistency that 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. We recall that, pursuant to Article 7.8 of the *SCM Agreement*, the United States is under an obligation to "take appropriate steps to remove the adverse effects or ... withdraw the subsidy".<sup>1560</sup>

7.1502 Furthermore, we have found that certain of the measures challenged in the "threat" context are *prohibited* subsidies which must be withdrawn "without delay" pursuant to Article 4.7 of the *SCM Agreement* – i.e. user marketing (Step 2) payments to exporters and domestic users; and export credit guarantees in respect of certain products under the GSM 102, GSM 103 and SCGP programmes.<sup>1561</sup> Required withdrawal of these prohibited subsidies within the time frame we set below would, we believe, have real, practical implications for the scope of the measures subject to the threat analysis (i.e. the basket of measures that is the subject of the threat analysis that pertains to MY 2003-MY 2007 would include measures that the United States must, in any event, withdraw without delay).

7.1503 We consider that, upon required implementation by the United States of this Panel's prohibited subsidy findings and present serious prejudice findings, the basket of measures in question may be so significantly transformed or manifestly different from the measures that are currently in question that it is not necessary or appropriate to address Brazil's claims of threat of serious prejudice under Articles 5(c) and 6.3(c) of the *SCM Agreement*.<sup>1562</sup>

#### **4. Claim of threat of serious prejudice under Articles 5(c) and 6.3(d) of the *SCM Agreement***

7.1504 We recall our finding above<sup>1563</sup> that Brazil's evidence and argumentation in this dispute focused exclusively upon a legally erroneous interpretation of the phrase "world market share" in Article 6.3(d) of the *SCM Agreement*. As Brazil has also relied upon this same interpretation in its "threat" evidence and argumentation, we similarly find that Brazil has not established a prima facie case of violation of Article 6.3(d) (nor of Article 5(c)) here.

#### **5. Claims under Articles XVI:1 and XVI:3 of the *GATT 1994***

7.1505 We recall the Panel's finding above that, in light of the Panel's finding under Article 5(c) of the *SCM Agreement*, it is not necessary to make findings also under Article XVI:1 of the *GATT 1994*.<sup>1564</sup> We further recall our finding above that Article XVI:3 of the *GATT 1994* pertains only to export subsidies as those are currently defined in the *Agreement on Agriculture* and the

<sup>1560</sup> See Section VII:G and Section VIII.

<sup>1561</sup> See Sections VII:E, F and Section VIII.

<sup>1562</sup> See e.g. Panel Report, *US – FSC*.

<sup>1563</sup> *Supra*, Section VII:G.

<sup>1564</sup> *Supra*, Section VII:G.

*SCM Agreement*.<sup>1565</sup> On this basis, it is not necessary for us to address these claims of Brazil in order to resolve this dispute.

## I. CLAIMS OF *PER SE* INCONSISTENCY

### 1. Measures at issue

7.1506 This Section of our report deals with alleged actionable subsidies, including certain alleged subsidies that are not "exempt from actions" based on Articles 5 and 6 of the *SCM Agreement* and Article XVI of the *GATT 1994* within the meaning of Articles 13(b)(ii) and 13(c)(ii) of the *Agreement on Agriculture* as a result of our findings in Sections VII:D, E and F of our report. These are the following measures, as described in Section VII:C of this report:

- (i) Allegedly mandatory legislative provisions and implementing regulations providing for the payment of the following subsidies:
  - user marketing (Step 2) payments to domestic users and exporters;<sup>1566</sup>
  - marketing loan programme payments;<sup>1567</sup>
  - direct payments;<sup>1568</sup>
  - counter-cyclical payments;<sup>1569</sup> and
  - crop insurance payments.<sup>1570</sup>

### 2. Main arguments of the parties

7.1507 **Brazil** alleges that the legislative and regulatory provisions governing these five United States subsidies constitute "*per se*" violations of Articles 5(c) and 6.3(c) and (d) of the *SCM Agreement* and Articles XVI:1 and XVI:3 of the *GATT 1994* for the period MY 2002-MY 2007. According to Brazil, they are "mandatory in nature" and fall into two general categories: certain payments vary depending upon prevailing market conditions (i.e. marketing loan, counter-cyclical payments and require payment (with no budgetary or quantitative limitations), others (i.e. crop insurance payments and direct payments) do not; while user marketing (Step 2) payments are "somewhat of a hybrid". The five subsidies necessarily threaten to cause serious prejudice where market conditions require their joint payment. In addition, they cause threat of serious prejudice even when market conditions are such that only crop insurance and direct payments are made.

7.1508 The **United States** argues that even if the measures concerned do not permit the United States government discretion to grant the subsidies in certain market conditions, it is not clear that such

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<sup>1565</sup> *Supra*, Section VII:E.

<sup>1566</sup> Section 1207(a) of the FSRI Act of 2002, reproduced in Exhibit BRA-29 and 7 CFR 1427.103, 7 CFR 1427.104(a)(1) and (2), 7 CFR 1427.105(a) and 7 CFR 1427.108(d), reproduced in Exhibit BRA-37.

<sup>1567</sup> Sections 1201(a)-(b), 1202(a)(6), 1202(b)(6), 1204(b), 1205(a)(1), 1205(b), 1205(c)(1), 1608 of the FSRI Act of 2002, reproduced in Exhibit BRA-29 ; 7 USC 7286 (Section 166 of the FAIR Act as amended); and 7 CFR 1427.22, reproduced in Exhibit BRA-36.

<sup>1568</sup> Section 1103(a)-(d)(1) of the FSRI Act of 2002, reproduced in Exhibit BRA-29 and 7 CFR 1412.502, reproduced in Exhibit BRA-35.

<sup>1569</sup> Sections 1104(a)-(f)1 1608 of the FSRI Act of 2002, reproduced in Exhibit BRA-29 and 7 CFR 1412.503, reproduced in Exhibit BRA-35.

<sup>1570</sup> Section 508(a)(8), Section 508(b)(1), Section 508(b)(2)(A)(ii), 508(b)(3), 508(e) and 508(k) and 516 of "the ARP Act of 2000". The ARP Act of 2000 amended the *Federal Crop Insurance Act* which is reproduced in Exhibit BRA-30 as amended through Public Law 107-136, 24 January 2002. See Brazil's first written submission, footnotes 178 and 184.

market conditions will arise. The United States asserts that both it and Brazil agree that, given certain conditions such as price levels, these challenged measures would be "mandatory" in the sense that the United States could not arbitrarily decline to provide them. However, for purposes of a mandatory/discretionary analysis, no WTO-inconsistency is mandated by those measures because serious prejudice does not necessarily result, even where there is no discretion not to provide payment.<sup>1571</sup>

### 3. Main arguments of the third parties

7.1509 The **European Communities** claims that the Panel should reject Brazil's *per se* claim. First, it claims that Brazil's argument that a Member can challenge measures of another Member on a *per se* basis when those measures mandate a violation of its WTO obligations would have absurd and unacceptable results when applied to WTO provisions which, like Article 5(c) of the *SCM Agreement*, incorporate a "trade effects" test. It also claims that the "mandatory" standard invoked by Brazil would result in the creation of third category of prohibited adverse effects in addition to actual and threatened serious prejudice, which is nowhere mentioned in Article 5(c): the mere possibility of threat of serious prejudice in certain circumstances. Furthermore, in light of the European Communities' argument that threat of serious prejudice must be *imminent* and *foreseeable*, it further argues that under Brazil's interpretation, it would be sufficient to establish a *per se* violation if a complaining party demonstrated that the legislation at issue mandates action that threatens serious prejudice in certain circumstances, no matter how remote the likelihood that such circumstances will ever materialise.<sup>1572</sup>

### 4. Evaluation by the Panel

7.1510 The Panel recalls that it need not examine all legal claims before it. Rather, we need only address those claims that must be addressed in order to resolve the matter in issue in the dispute.<sup>1573</sup> This is the case provided that we address those claims on which a finding is necessary to enable the DSB to make sufficiently precise recommendations and rulings so as to allow for prompt compliance by a Member in order to ensure effective resolution of disputes to the benefit of all Members.<sup>1574</sup>

7.1511 In light of our findings above in Sections VII:E, F, G and H, we do not believe that it is necessary to address Brazil's *per se* claims relating to these measures under Articles 5(c) and 6.3(c) and (d) of the *SCM Agreement* and Articles XVI:1 and XVI:3 of the *GATT 1994*.

## VIII. CONCLUSIONS AND RECOMMENDATIONS

8.1 In light of the findings above, we conclude as follows:

- (a) Article 13 of the *Agreement on Agriculture* is not in the nature of an affirmative defence;
- (b) PFC payments, DP payments, and the legislative and regulatory provisions which establish and maintain the DP programme, do not satisfy the condition in paragraph (a) of Article 13 of the *Agreement on Agriculture*;

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<sup>1571</sup> United States' 28 January 2004 comments on Brazil's response to Panel Question No. 257 (a) (ii), para. 192.

<sup>1572</sup> European Communities' written submission to the resumed session of the first substantive meeting, paras. 27-36.

<sup>1573</sup> Appellate Body Report, *US – Wool Shirts and Blouses*, page 19. See also e.g. Appellate Body Report, *Canada – Autos*, paras. 112-117, where the Appellate Body refers to and endorses that panel's exercise of the "discretion" implicit in the principle of judicial economy.

<sup>1574</sup> Appellate Body Report, *Australia – Salmon*, para. 223.

- (c) United States domestic support measures considered in Section VII:D of this report grant support to a specific commodity in excess of that decided during the 1992 marketing year and, therefore, do not satisfy the conditions in paragraph (b) of Article 13 of the *Agreement on Agriculture* and, therefore, are not exempt from actions based on paragraph 1 of Article XVI of the *GATT 1994* or Articles 5 and 6 of the *SCM Agreement*;
- (d) concerning United States export credit guarantees under the GSM 102, GSM 103 and SCGP export credit guarantee programmes:
- (i) in respect of exports of upland cotton and other unscheduled agricultural products supported under the programmes<sup>1575</sup>, and in respect of one scheduled product (rice):
    - United States export credit guarantees under the GSM 102, GSM 103 and SCGP export credit guarantee programmes are export subsidies applied in a manner which results in circumvention of United States' export subsidy commitments, within the meaning of Article 10.1 of the *Agreement on Agriculture* and they are therefore inconsistent with Article 8 of the *Agreement on Agriculture*;
    - as they do not conform fully to the provisions of Part V of the *Agreement on Agriculture*, they do not satisfy the condition in paragraph (c) of Article 13 of the *Agreement on Agriculture* and, therefore, are not exempt from actions based on Article XVI of the *GATT 1994* or Articles 3, 5 and 6 of the *SCM Agreement*;
    - United States export credit guarantees under the GSM 102, GSM 103 and SCGP export credit guarantee programmes are provided by the United States government at premium rates which are inadequate to cover long-term operating costs and losses of the programmes within the meaning of item (j) of the Illustrative List of Export Subsidies in Annex I of the *SCM Agreement*, and therefore constitute *per se* export subsidies prohibited by Articles 3.1(a) and 3.2 of the *SCM Agreement*.
  - (ii) however, in respect of exports of unscheduled agricultural products not supported under the programmes<sup>1576</sup> and other scheduled agricultural products:
    - the United States has established that export credit guarantees under the GSM 102, GSM 103 and SCGP export credit guarantee programmes have not been applied in manner which either results in, or which threatens to lead to, circumvention of United States export subsidy commitments within the meaning of Article 10.1 and that they therefore are not inconsistent with Article 8 of the *Agreement on Agriculture*;

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<sup>1575</sup> As indicated *supra*, Section VII:E, paragraph 7.875, referring to Exhibit BRA-73, to the extent they are within our terms of reference and within the product scope of the *Agreement on Agriculture*.

<sup>1576</sup> i.e. unscheduled agricultural products, to the extent they are within our terms of reference and within the product scope of the *Agreement on Agriculture*, other than those indicated *supra*, Section VII:E, paragraph 7.875.

- in these circumstances, and as Brazil has also not made a prima facie case before this Panel that the programmes do not conform fully to the provisions of Part V of the *Agreement on Agriculture*, this Panel must treat them as if they are exempt from actions based on Article XVI of the *GATT 1994* and Article 3 of the *SCM Agreement* in this dispute.
- (e) concerning section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters of upland cotton:
- (i) section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters of upland cotton is an export subsidy, listed in Article 9.1(a) of the *Agreement on Agriculture*, provided in respect of upland cotton, an unscheduled product. It is, therefore, inconsistent with the United States' obligations under Articles 3.3 and 8 of the *Agreement on Agriculture*;
  - (ii) as it does not conform fully to the provisions of Part V of the *Agreement on Agriculture*, it does not satisfy the condition in paragraph (c) of Article 13 of the *Agreement on Agriculture* and, therefore, is not exempt from actions based on Article XVI of the *GATT 1994* or Articles 3, 5 and 6 of the *SCM Agreement*;
  - (iii) section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to exporters of upland cotton is an export subsidy prohibited by Articles 3.1(a) and 3.2 of the *SCM Agreement*.
- (f) concerning section 1207(a) of the FSRI Act of 2002 providing for user marketing (Step 2) payments to domestic users of upland cotton: it is an import substitution subsidy prohibited by Articles 3.1(b) and 3.2 of the *SCM Agreement*;
- (g) concerning serious prejudice to the interests of Brazil:
- (i) 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*;
  - (ii) however, Brazil has not established that:
    - the effect of PFC payments, DP payments and crop insurance 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*; or
    - the effect of the United States subsidy measures listed in paragraph 7.1107 of Section VII:G of this report is an increase in the United States' world market share within the meaning of

Article 6.3(d) of the *SCM Agreement* constituting serious prejudice within the meaning of Article 5(c) of the *SCM Agreement*.

- (h) concerning the ETI Act of 2000:
  - (i) Brazil has not made a prima facie case before this Panel that the ETI Act of 2000 and alleged export subsidies provided thereunder are inconsistent with Articles 10.1 and 8 of the *Agreement on Agriculture* in respect of upland cotton;
  - (ii) with respect to the condition in Article 13(c)(ii) of the *Agreement on Agriculture*, as Brazil has also not made a prima facie case before this Panel that they do not conform fully to the provisions of Part V of the *Agreement on Agriculture* in respect of upland cotton, this Panel must treat them as if they are exempt from actions based on Article XVI of the *GATT 1994* and Article 3 of the *SCM Agreement* in this dispute.

8.2 Under Article 3.8 of the *DSU*, in cases where there is an infringement of the obligations assumed under a covered agreement, the action is considered prima facie to constitute a case of nullification or impairment. We conclude that, to the extent that the United States has acted inconsistently with the covered agreements, it has nullified or impaired benefits accruing to Brazil under these agreements.

8.3 In light of these conclusions:

- (a) we recommend pursuant to Article 19.1 of the *DSU* that the United States bring its measures listed in paragraphs 8.1(d)(i) and 8.1(e) above into conformity with the *Agreement on Agriculture*;
- (b) as required by Article 4.7 of the *SCM Agreement*, we recommend that the United States withdraw the prohibited subsidies in paragraphs 8.1(d)(i) and 8.1(e) above without delay. The time-period we specify must be consistent with the requirement that the subsidy be withdrawn "without delay". In any event, this is at the latest within six months of the date of adoption of the Panel report by the Dispute Settlement Body or 1 July 2005 (whichever is earlier);
- (c) pursuant to Article 4.7 of the *SCM Agreement*, we recommend that the United States withdraw the prohibited subsidy in paragraph 8.1(f) above without delay and, in any event, at the latest within six months of the date of adoption of the Panel report by the Dispute Settlement Body or 1 July 2005 (whichever is earlier); and
- (d) we recall that, in respect of the subsidies subject to our conclusion in paragraph 8.1(g)(i) above, pursuant to Article 7.8 of the *SCM Agreement*:

"7.8 Where a panel report or an Appellate Body report is adopted in which it is determined that any subsidy has resulted in adverse effects to the interests of another Member within the meaning of Article 5, the Member granting or maintaining such subsidy shall take appropriate steps to remove the adverse effects or shall withdraw the subsidy."

Accordingly, 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".

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